The Non-Uniformity of Uniform Laws

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I. INTRODUCTION

The laws of the myriad nations and subsidiary states stand at a critical crossroad. Technological developments in transportation and communication and the opening up of free trade have dramatically increased national and international trade to a point at which regulation by small countries and states seem anachronistic. Even the smallest firms and transactions now have links across the globe. Applying the laws of all jurisdictions that firms and transactions touch could place significant burdens on modern trade. Coordinating regulation by multiple jurisdictions therefore is one of the main problems facing modern commerce.

This complex problem has no easy solution. One approach is to permit transacting parties to contract in advance for the law of a single jurisdiction.¹ States, however, have important regulatory interests to protect. Choice-of-law contracts therefore may not be enforced in some places that might adjudicate claims arising out of the transaction. The alternative of federal regulation that imposes a single law across several jurisdictions also

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is not completely satisfactory. The appropriate regulation may be unclear and different types of regulation may suit different transactions. Accordingly there is significant value to preserving a variety of regulatory approaches and enabling jurisdictions to compete to supply the applicable law. In short, the alternatives present uneasy choices between uniformity and chaos.

These competing values might be reconciled if jurisdictions could coordinate to make their laws uniform as to matters for which the benefits of uniformity outweigh the benefits of preserving jurisdictional choice. Instead of sweeping away variety or preserving costly chaos, this system of “efficient uniformity” would seek the best of both worlds: choice and coordination. The trick, of course, is finding this happy middle.

One approach to achieving efficient uniformity is to create lawmaking organizations that are tasked with promulgating proposed statutes for uniform adoption by states. The organizations would be structured to represent the interests of their member states and would develop a reputation for quality and impartiality. The organizations’ reputation, political legitimacy, and lawmaking expertise would guide the states toward efficient uniformity.

There are, indeed, several influential lawmaking organizations that have the objective of increasing uniformity. One of the largest and most influential is the National Conference of Commissioners for Uniform State Laws (NCCUSL). Another is the prestigious American Law Institute (ALI), which was founded in 1923 “to promote the clarification and simplification of the law,” stemming in part from “numerous variations within different jurisdictions.” 2 The ALI has not only crafted restatements of numerous areas of the law, but has also participated in the creation of the influential Uniform Commercial Code. The International Institute for the Unification of Private Law (UNIDROIT) is an organization of 63 member states established in 1926 to “study needs and methods for modernising, harmonising and coordinating private and in particular commercial law as between States and groups of States.” 3 UNIDROIT’s most important product is the Convention relating to a Uniform Law on the International Sale of Goods (CISG). 4

Uniform lawmaking organizations are becoming increasingly important with the expansion of international trade. Accordingly, it is useful to understand how these organizations operate and to provide mechanisms for evaluating their lawmaking contributions. This Article takes a significant step toward this understanding and provision by examining NCCUSL, one of the leading uniform lawmaking bodies. We look at NCCUSL through the lens of a single project, the Revised Uniform Limited Liability Company Act promulgated in 2006 (ULLCA 2). We chose this approach because two recent NCCUSL projects within a ten-year period and significant state legislative activity regarding a popular new business entity provide a unique opportunity to examine both the NCCUSL process and its interaction with existing state legislation.

The question we address is whether NCCUSL has the potential for producing


efficient uniformity. Surprisingly, we find evidence that NCCUSL’s processes actually may be undermining uniformity rather than furthering it. Moreover, our analysis indicates that the problem lies at the heart of the very political mechanisms that NCCUSL uses to promote uniformity. In other words, this study suggests that uniform lawmaking may be a self-limiting process. This analysis is potentially important for understanding the constraints on uniform lawmaking and has implications both for other NCCUSL projects and for uniform lawmakers around the world.

This Article proceeds as follows. Part II provides general background by discussing NCCUSL in the general context of uniform lawmaking, and our prior work on NCCUSL and state law uniformity. Part III discusses data from our prior work and new data on the effect of the original Uniform Limited Liability Company Act (ULLCA 1) on state LLC adoptions. ULLCA 1’s sparse enactment record is a red flag indicating that NCCUSL may be subverting the process of state uniformity in this area, consistent with implications of our prior work. Part IV models the uniform lawmaking process, showing that its perverse effect on uniformity results from inherent aspects of this process. This suggests that the problems we find with NCCUSL are likely to infect other NCCUSL projects and other uniform lawmaking organizations. Part V illustrates and supports this model by showing how ULLCA 2 repeats many of the same problems as ULLCA 1.

II. BACKGROUND AND INTRODUCTION

NCCUSL is one of the best known and most important uniform lawmaking bodies. Founded in 1892, NCCUSL is a quasi-political organization of state commissions, generally provided for by state statute. Three hundred lawyers, judges, and law professors serve as uniform law commissioners for specified terms without compensation. NCCUSL says its function is “to study and review the law of the states to determine which areas of law should be uniform. The commissioners promote the principle of uniformity by drafting and proposing specific statutes in areas of the law where uniformity between the states is desirable.”

NCCUSL was created out of a concern for the continued vitality of state law against the onslaught of “federal common law” under the authority of Swift v. Tyson, and interstate competition’s erosion of state lawmakers’ power. Even after the Supreme Court overruled Swift in Erie R. Co. v. Tompkins, the federal threat was greater than ever because of the New Deal. The federal threat to state regulatory autonomy has continued to grow, particularly given potential moves toward another federal New Deal in the wake of the current financial meltdown.

6. Id.
7. Id.
NCCUSL has proposed more than 200 laws on a wide variety of subjects from child custody to partnerships.\(^\text{11}\) NCCUSL worked with the ALI to produce the Uniform Commercial Code, which NCCUSL regards as its “signature product.”\(^\text{12}\) NCCUSL’s scope, long history, and reputation make it by far the most influential uniform lawmaking organization in the United States, and perhaps the single most important influence on the content of state legislation.

In a 1996 article we surveyed NCCUSL’s proposals and their adoption by the states.\(^\text{13}\) We found that states tended to reject NCCUSL proposals in areas for which uniformity was inefficient, such as in long-term or large contracts in which the parties can easily mitigate the costs of state law diversity by contracting for the application of a particular state’s law. On the other hand, states tended to widely adopt NCCUSL proposals where uniformity was efficient—that is, where the parties’ conduct or transactions may be subject to the laws of several different states, making it difficult to determine at the time of the conduct, or even at the time of litigation, which state law will apply, and where the affected parties cannot easily settle these issues by contract.\(^\text{14}\) Examples are torts and short-term commercial contracts like those covered by the Uniform Commercial Code where the transaction costs of negotiating customized terms, or of contractually choosing a particular law, may outweigh the benefits.

A question posed by the above data concerns NCCUSL’s contribution to the uniformity the states evidently are achieving. We hypothesized in our 1996 article that NCCUSL encouraged state adoption of their proposals, among other ways, by lobbying and providing a coordination mechanism. Supporting this hypothesis, we found that states that have relatively small legislative resources tend to adopt more NCCUSL proposals, perhaps because they rely on NCCUSL to provide drafting resources. Moreover, fewer states adopt NCCUSL proposals that NCCUSL does not push for uniform adoption (which NCCUSL designates as “model” acts) than proposals that NCCUSL urges for uniform adoption. NCCUSL therefore seemed to be helping move the states toward efficient uniformity.

These data still leave open important questions concerning NCCUSL’s impact on uniformity. Even if states tend to adopt NCCUSL statutes in situations in which uniformity is efficient, states can still vary individual provisions of these statutes. Does NCCUSL create more uniformity than what states could achieve without NCCUSL’s help? In order to get a better idea of the costs and benefits of NCCUSL, we must move from the “macro” level of NCCUSL’s effect on the adoption of entire laws to the “micro” level of NCCUSL’s effect in promoting particular provisions of laws.

We address this question by examining the evolution of limited liability company (LLC) statutes. LLCs provide a particularly good context to study the evolution of uniformity. LLCs are a relatively new form of business that combines limited liability of all the members with a partnership-type structure. Wyoming adopted the first LLC statute in 1975.\(^\text{15}\) Only one other state adopted an LLC statute between 1975 and 1988, when the

\(\text{11. See About NCCUSL, supra note 5.}\)
\(\text{12. Id.}\)
\(\text{14. Id.}\)
\(\text{15. See William J. Camey, Limited Liability Companies: Origins and Antecedents, 66 U. COLO. L. REV.}\)
Internal Revenue Service opened the floodgate by issuing a ruling confirming the LLC’s tax status.\textsuperscript{16} In the next six years, 46 states adopted LLC statutes.\textsuperscript{17} LLC statutes went through a round of revisions after 1996, when the IRS promulgated a rule eliminating restrictions on the forms of LLCs that would qualify for partnership tax treatment.\textsuperscript{18} This rapid ferment in LLC law over a short period makes state adoption of LLC statutes a useful laboratory for studying how uniformity evolves.\textsuperscript{19}

LLCs are worth studying for the additional reason that the statutes of all 50 states and the District of Columbia let LLCs do business in the state under the law of their state of formation.\textsuperscript{20} This allows LLC members to decide what level of uniformity they want in the LLC statute they choose. States can respond by spontaneously evolving toward an efficient level of uniformity based on party demand.

In prior writing we have used the LLC laboratory to test the spontaneous evolution of uniformity against the effect of NCCUSL uniform law proposals. In one paper we showed that the states spontaneous moved toward uniformity as to those provisions of LLC law that we hypothesized should be uniform from an efficiency standpoint, but not with respect to provisions that we hypothesized should not be uniform.\textsuperscript{21} In another paper we found evidence consistent with the hypothesis that this process of spontaneous evolution was assisted by a non-NCCUSL model law, the Prototype Limited Liability Company Act (PLLCA), proposed by a committee of the American Bar Association.\textsuperscript{22} That article also showed that NCCUSL’s first Uniform Limited Liability Company Act (ULLCA 1), promulgated in 1996, failed to follow the obviously uniformity-maximizing strategy of building on the LLC provisions that the states had most commonly adopted.\textsuperscript{23} ULLCA 1 instead included idiosyncratic provisions more consistent with the influence on the NCCUSL process of lawyers and other powerful interest groups.\textsuperscript{24} This paper indicated that NCCUSL seemed to be working counter to rather than in coordination with the state process of spontaneous uniformity.\textsuperscript{25}

The present Article picks up where the prior work left off by updating the history of uniform LLC statutes since ULLCA 1. As discussed in Part III, we show that, consistent

\footnotesize{855, 857 (1995) (briefly recounting this history).
19. The rapid evolution is indicated by the growth in the number of LLCs. Tax data show an increase from 221,000 to 1,630,161 LLCs between 1996 and 2006. There are now more LLCs than any other type of unincorporated firm, about half the total. Data on formations of different types of firms gathered from various sources is presented in Larry E. Ribstein & Robert Keatinge, Ribstein & Keatinge on Limited Liability Companies (2d ed. 2004). For the most recent number for LLCs, see Tim Wheeler & Nina Shumofsky, Internal Revenue Serv., Partnership Returns, 2006, at 216 (2008), available at http://www.irs.gov/pub/irs-soi/08fallbulpr.pdf. For additional data on LLC formations, see generally Larry E. Ribstein & Bruce H. Kobayashi, Choice of Form and Network Externalities, 43 WM. & MARY L. REV. 79 (2001).
20. See generally Ribstein & Keatinge, supra note 19, app. 13-1 (tabulating statutes).
23. Id. at 983.
24. Id.
25. Id. at 954.
with the hypothesis in our prior article, ULLCA 1’s practice of rejecting the state uniformity that had emerged spontaneously prior to the uniform law has worked against state uniformity. We also discuss NCCUSL’s attempt to recover from the failure of ULLCA 1 by promulgating a second LLC act in 2006, the Revised Uniform Limited Liability Company Act (ULLCA 2). Again, as with ULLCA 1, NCCUSL failed to pursue a uniformity-maximizing strategy of building on the uniformity that states had managed to develop without, or despite, NCCUSL’s efforts to date. Thus we have a mystery: why would NCCUSL subvert the very uniformity goal it is supposed to be furthering? Parts III and IV show that the answer lies in the very NCCUSL institutions that are designed to maximize uniformity.

III. ULLCA’S EFFECT ON UNIFORMITY

Our prior analyses of LLC statutes examined the pattern of state-by-state adoptions of various provisions contained in enacted LLC statutes. Table 1 lists the 72 provisions studied (the section numbers refer to categories in the original database, which are retained to ensure consistency throughout the tables). For each provision, the table lists whether the provision primarily affects third parties (3P), affects the members (M), or is primarily tax related (TX). The Table also lists the leading form, the form adopted by ULLCA 1, and the number of adoptions of each in 1994 and 2007. This covers the period beginning before ULLCA 1 and ending around the adoption of ULLCA 2.

### TABLE 1

#### A COMPARISON OF ULLCA 1 AND THE LEADING FORM

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>TYPE</th>
<th>LEADING FORM</th>
<th>N 94/07</th>
<th>ULLCA 1 FORM</th>
<th>N 94/07</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. ULLCA 1 DOES NOT ADOPT LEADING FORM</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>§3. Minimum Number of Owners*</td>
<td>TX</td>
<td>2 or more (1994–1997) 1 or more (1997–2007)</td>
<td>21/0 3/36</td>
<td>No separate provision, 1 required to form</td>
<td>9/14</td>
</tr>
<tr>
<td>§4. Contents of Articles</td>
<td>3P</td>
<td>Name, registered or principal office, registered agent, whether managed by manager or members, names, addresses, original members, period of duration, and purpose</td>
<td>6/11</td>
<td>Same as leading form, but no purpose, and add whether members are liable for debts and whether LLC is for a term</td>
<td>0/5</td>
</tr>
<tr>
<td>§8. Firm Name Includes</td>
<td>3P</td>
<td>Short list (must include LLC or LC)</td>
<td>24/24</td>
<td>Longer list, must add “Ltd.” or “Co.”</td>
<td>10/15</td>
</tr>
<tr>
<td>§13. Duty to Amend Erroneous Statement</td>
<td>3P</td>
<td>No</td>
<td>26/29</td>
<td>Yes</td>
<td>20/22</td>
</tr>
<tr>
<td>§18. Profit Sharing</td>
<td>M</td>
<td>Pro-rata by contribution</td>
<td>26/27</td>
<td>Per-capita</td>
<td>12/15</td>
</tr>
<tr>
<td>§20. Oral Agreement to</td>
<td>M</td>
<td>Writing and record</td>
<td>36/33</td>
<td>None</td>
<td>4/9</td>
</tr>
<tr>
<td>Contribute</td>
<td>Distribution Form</td>
<td>Restrictions on non-cash distributions</td>
<td>§21. Distribution Form</td>
<td>3P</td>
<td>Restrictions on non-cash distributions</td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>-------------------</td>
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<td>-----------------------------------------</td>
</tr>
<tr>
<td>§27. Effect of Assignment on Membership Status**</td>
<td>M</td>
<td>Assignor not a member after assignee becomes member (before 1997) Assignor not a member after assignment of entire interest (after 1997)</td>
<td>§27. Effect of Assignment on Membership Status**</td>
<td>M</td>
<td>Assignor not a member after assignee becomes member (before 1997) Assignor not a member after assignment of entire interest (after 1997)</td>
</tr>
<tr>
<td>§32. Inheritance – Divorce</td>
<td>M</td>
<td>Legal representation may exercise all of member’s rights</td>
<td>§32. Inheritance – Divorce</td>
<td>M</td>
<td>Legal representation may exercise all of member’s rights</td>
</tr>
<tr>
<td>§37. Member Agency Power</td>
<td>3P</td>
<td>Partnership type authority</td>
<td>§37. Member Agency Power</td>
<td>3P</td>
<td>Partnership type authority</td>
</tr>
<tr>
<td>§38. Manager Agency Power</td>
<td>3P</td>
<td>Same as would be for members if member-managed</td>
<td>§38. Manager Agency Power</td>
<td>3P</td>
<td>Same as would be for members if member-managed</td>
</tr>
<tr>
<td>§39. Member Agency Power in Centrally Managed Firms</td>
<td>3P</td>
<td>Members have no agency power if firm is managed by managers</td>
<td>§39. Member Agency Power in Centrally Managed Firms</td>
<td>3P</td>
<td>Members have no agency power if firm is managed by managers</td>
</tr>
<tr>
<td>§40. Duty to Keep Records</td>
<td>M</td>
<td>Must maintain certain records</td>
<td>19/22</td>
<td>Inspection right but no duty to keep records</td>
<td>3/5</td>
</tr>
<tr>
<td>---</td>
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<td>---</td>
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<td>---</td>
</tr>
<tr>
<td>§41. Member’s Right to Inspect Records</td>
<td>M</td>
<td>Member entitled to access, no proper purpose limitation (1994–2005) Members entitled to access to specified records upon demand for a proper purpose (2006–2007)</td>
<td>27/21</td>
<td>Proper purpose requirement only for former members and assignees. Also provides for general duty to disclose without demand for information required for proper exercise of member’s rights and duties, and other information on reasonable demand</td>
<td>0/5</td>
</tr>
<tr>
<td>§41.5. Manager Duty of Care**</td>
<td>M</td>
<td>At least gross negligence, bad faith or recklessness standard (1994–1999) Manager liable only for gross negligence, bad faith, recklessness, or equivalent conduct (1999–2007)</td>
<td>20/16</td>
<td>Manager liable only for gross negligence, bad faith, recklessness, or equivalent conduct</td>
<td>13/20</td>
</tr>
<tr>
<td>§41.75. Consent to Conflict of Interest Transactions</td>
<td>M</td>
<td>No provision</td>
<td>19/17</td>
<td>Operating agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable and specify the number or percentage of members or disinterested managers that may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty</td>
<td>0/7</td>
</tr>
<tr>
<td>§42. Waiver of Fiduciary Duties*</td>
<td>M</td>
<td>No provision (1994–1999) Full power to contract in operating agreement (2000–2007)</td>
<td>16/10</td>
<td>May not eliminate the loyalty duty or good faith obligation or unreasonably reduce duty of care, but may identify</td>
<td>0/9</td>
</tr>
</tbody>
</table>
activities that do not violate the duty of loyalty, if not manifestly unreasonable, and specify the vote necessary to approve act or transaction that otherwise would violate the duty of loyalty.

§43. Member Duties

| M | No provision | 18/15 | Unless otherwise agreed and subject to other law, member may transact business with LLC and has the same rights and obligations as non-member. Members have no duties as such in manager-managed firm. Member who exercises some management power has duties even in manager-managed firm, and manager has no liability to extent authority delegated to members. |

§45. Indemnification*


§47. Member Dissociation Right*

| M | May withdraw on notice specified in statute or in operating agreement (1994–1997) Member has no default power to exit (1998–2007) | 20/6 0/17 | Power but not nec. right to w/d at any time, but agreement specifies notice and may prohibit dissociation |

§51. Agreement to Continue**

| M | Unanimous consent within 90 days (1994–1997) No dissolution for member dissociation (1999–2007) | 30/15 0/25 | No dissolution for member dissociation |

§53. Dissolution Filing Required

| 3P | Filing required when event of dissolution occurs | 18/16 | LLC may terminate existence after dissolution and winding up by filing articles of termination |

§53.5. Winding Up**

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<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>TYPE</th>
<th>LEADING FORM</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>II. ULLCA 1 ADOPTS LEADING FORM</td>
<td></td>
<td></td>
<td>94/07</td>
</tr>
<tr>
<td>§1. Who May Form</td>
<td>3P</td>
<td>1 or more, not necessarily a member</td>
<td>30/48</td>
</tr>
<tr>
<td>§2. How Formed</td>
<td>3P</td>
<td>Formed on filing or with sec. of state or deliv. for filing</td>
<td>34/38</td>
</tr>
<tr>
<td>§5. Execution of Articles</td>
<td>3P</td>
<td>No acknowledgement of verification</td>
<td>36/48</td>
</tr>
</tbody>
</table>

* - Leading form changes.
** - Leading form changes to ULLCA 1 form.
| §6. Consequences of False Execution | 3P | No penalty provided for | 27/31 |
| §6.5 Purpose Limitations | 3P | Generally permits lawful business or purpose | 27/31 |
| §7. Powers | 3P | Corporate-type list | 30/32 |
| §9. Firm Name Excludes | 3P | Distinguishable on records from other LLC, LP, or corp. | 11/19 |
| §10. Reservation of Name | 3P | Yes | 43/49 |
| §11. Maintenance of Agent | 3P | Must maintain, can change with filing; prov. for agent registration | 46/51 |
| §12. Service of Process | 3P | Service on reg. agent, mbr or mgr., plus prov. for svc. on secty. of state | 29/31 |
| §14. Consequences of Noncompliance with Formalities | 3P | No such provision | 29/35 |
| §15. Operating Agreement in Writing | M | No writing required | 21/26 |
| §16. Operating Agreement Adoption | M | Power in members to adopt, repeal, or amend | 31/21 |
| §19. Capital Contribution Form | 3P | Any form | 43/40 |
| §20.5. Compromise | 3P | Does not affect right of intervening creditor | 33/35 |
| §22. Wrongful Distribution Liability | 3P | Member or manager who voted for or assented to dist. and knowing recept. liable | 13/18 |
| §25. Member Interest Definition | M | Is personal property, defined as financial rights and is assignable | 31/33 |
| §26. Transfer of Financial Interest Assignee | M | No liability until assignee become a member | 22/25 |
| §28. Transfer of Financial Interest Assignor | 3P | Assignor remains liable even if assignee becomes member | 41/46 |
| §29. Transfer of Management Rights | TX | On consent of all members unless otherwise provided in agreement | 22/29 |
| §31. Rights of Member Creditors | 3P | Partnership-type charging order provision | 37/28 |
| §33. Default Management | TX | Managed by members unless otherwise provided for | 34/44 |
| §34. Method of Varying Default Management | M | Prov. varying default mgmt. must be included in articles or certificate | 23/19 |
| §44. Derivative Suits Authorized | M | RULPA-type prov. | 18/26 |
| §46. Suits Against Firm | M | May be brought in firm name | 33/34 |
| §48. Member Dissociation Events | M | Limited partnership-type provisions defining events of dissociation | 23/31 |
| §49. Rights of Wrongful Dissociating Member | M | Liable for damages | 21/27 |
| §52. Contracting Around Agreement to Continue | TX | Unanimous consent within 90 days | 37/# |
In order to measure the degree of uniformity, we use the Herfindahl–Hirschman Index of Concentration (HHI). The HHI is used by antitrust authorities as the primary measure of concentration in antitrust markets. The HHI equals the sum of the squared shares of each form, multiplied by 10,000. Where a single law is adopted everywhere, the squared market share of the law is obviously 1, and the HHI would be 10,000. Squaring market shares and multiplying by 10,000 allows the index to record the distribution of market shares among statutory provisions and small differences in the market concentrations of multiple statutory provisions. The intuition behind using this measure is that, since the goal of state coordination is to reduce the chaos in having multiple state laws, a few widely adopted provisions is preferable to having a single widely adopted provision plus many different provisions each adopted in a couple of jurisdictions. Our work shows that states spontaneously can achieve significant but not complete uniformity. NCCUSL theoretically could add value by resolving some of this remaining disagreement. Using the HHI can measure NCCUSL’s success by showing its effect in increasing the overall level of concentration.

As we noted in our earlier articles, states managed to achieve considerable

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26. For a discussion of the HHI and its use as a measure of concentration in antitrust, see IV PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 930a, at 148–49 (2d ed. 2000).
27. Id. at 149.
28. Id. at 150.
uniformity prior to the 1996 promulgation of ULLCA 1. The most-adopted form (the “leading form”) had an average share of 58.4% of the states. Applying the HHI, we can also determine that the distribution of different types of provisions reflected an overall concentration of 4648. This shows there was substantial remaining non-uniformity—the difference between 10,000 and 4648.

The next step in the analysis is to determine whether the remaining non-uniformity was efficient or inefficient. In order to determine when uniformity is efficient, we obviously need a theory of efficient uniformity. As discussed in our earlier articles, provisions affecting third parties present the strongest case for efficient uniformity, while uniformity may be inefficient for provisions that primarily affect the relationship between the members of the LLC. In the former case, the parties need standardized provisions because smaller transaction amounts make it uneconomical for them to engage in customized drafting or investigate legislative alternatives. By contrast, provisions affecting LLC members involve parties engaged in frequent and repeated interactions for which the net benefits from variation and innovation are likely to be high, and the net benefits of uniform rules are likely to be relatively low.

Applying this theory, the data from 1994 show that pre-ULLCA non-uniformity was mainly for provisions where uniformity would be inefficient. Specifically, the adoption rate of the leading form and the HHI index for provisions affecting third parties are significantly higher than the leading form adoption rate and HHI index for provisions affecting members. Leading forms of provisions affecting third parties were adopted in 29.7 states, compared to 23.5 states for provisions affecting members. Leading forms of provisions affecting third parties were adopted in 29.7 states, compared to 23.5 states for provisions affecting the members. The HHI indices averaged 5303 for third party provisions and 3880 for member provisions.

We next need to determine ULLCA 1’s effect on uniformity. This requires augmenting our prior data with state-by-state adoption data from 1994–2007, spanning the post-ULLCA/pre-ULLCA 2 period. Figure 1 shows that the average adoptions of the leading type of provision rose slightly from just under 27 states in 1994 to just under 30 states by 2007. ULLCA 1 provisions were adopted in just under 18 states in 1994 and just under 24 states in 2007. The graph also depicts the effect on ULLCA 1 adoptions of NCCUSL’s choosing to adopt the leading form of state provision. ULLCA 1 adopted the leading form in 36 of the 72 provisions examined. The number of adoptions of ULLCA 1 provisions increased from 30 states in 1994 to just over 35 in 2007, when ULLCA 1 adopted the leading form, and from approximately 5.6 states in 1994 to 12.6 states in 2007, when ULLCA 1 did not adopt the existing leading form, all statistically significant.

29. See supra Table 1 (showing 29 provisions with a leading form adopted by 30 or more states, and six provisions with a leading form adopted by more than 40 states).
30. This 5.2 state difference is statistically significant (p-value = .0031).
31. This difference is statistically significant (p-value = .0027).
We also analyzed the share of the leading form of provision over time. This analysis takes account of the increase in statutes from 46 to 48 in 1995 and from 48 to 51 by the beginning of 1997. Indeed, much of the increase in adoptions shown in Figure 1, with the exception of the ULLCA 1 forms that did not adopt the leading form, takes place before 1997 with this increase in the number of statutes. Figure 2, which depicts the leading form’s share from 1994 to 2007, shows little increase in this share after ULLCA 1’s promulgation. The leading form’s average share fell slightly (from 58.4% to 57.5%, not statistically significant), while the average share of ULLCA 1 provisions significantly increased. What is happening during this period is that while the share of adoptions of ULLCA 1 provisions increased from 38.6% to 46.7% overall, the increase was significantly less when ULLCA 1 adopted the leading form (65.2% to 68.7%) than when it did not do so (12.1% to 24.6%).

32. The overall increase in ULLCA 1 provisions and the increase in ULLCA 1 provisions that did not adopt the leading form are statistically significant, with p-values equaling .0000. The increase in ULLCA 1 provisions that adopted the leading form is not significant at the .05 level, with a p-value equal to .0632.
This data shows that although state adoptions and adoption shares of ULLCA 1 forms increased after ULLCA 1’s promulgation, this increase in adoptions does not imply that ULLCA 1 increased uniformity. The problem is that much of the increase in adoption of ULLCA 1 provisions resulted from increased state adoptions of ULLCA 1 provisions that were non-leading forms. Since the average share of the leading form fell slightly after ULLCA 1, the data suggests that ULLCA 1 may have decreased uniformity by having little effect on the adoption of leading forms while increasing the adoption of non-leading forms.

Time series data on the concentration of statutory provisions further support this hypothesis. Figure 3 illustrates the post-ULLCA 1 HHI data. For ULLCA 1 provisions that adopted the leading form, the average HHI index increased 341 points, from 5311 in 1994 to 5652 in 2007.\(^\text{33}\) Thus, there is little evidence that ULLCA adoption of the leading form increased uniformity, as measured by the HHI, over what the states achieved spontaneously prior to 1994. Moreover, to the extent that states adopted ULLCA 1 provisions, adoption reduced uniformity. Although the HHI for all provisions fell only slightly\(^\text{34}\) the average HHI for provisions where ULLCA 1 did not adopt the leading form dropped significantly, from 3985 to 3389.\(^\text{35}\)

\[\text{33. However, this increase is not statistically significant (p-value = .1020).}\]
\[\text{34. The HHI score fell 128 points from 4648 to 4520, which was not statistically significant (p-value = .45).}\]
\[\text{35. p-value = .021.}\]
FIGURE 3

ULLCA AND UNIFORMITY

We are therefore confronted with the seemingly odd result that the states’ adoption of a uniform law reduced uniformity. Even odder, this apparent anomaly resulted from NCCUSL’s deliberate strategic decision. NCCUSL promulgated ULLCA 1 after the states had achieved significant uniformity. Although adopting the existing leading form would seem to be the fastest path to uniformity, we show that NCCUSL rejected this approach in half of the provisions studied.\(^{36}\) Given this decision, it is not surprising that ULLCA 1’s adoption of non-leading forms reduced uniformity. Table 1 shows that ULLCA 1 became the leading form in only 7 out of the 36 provisions for which ULLCA 1 did not adopt the leading form. Overall uniformity decreased for provisions as to which ULLCA 1 deviated from the existing leading form.

While non-uniformity followed logically from NCCUSL’s failure to follow the obvious uniformity-maximizing strategy, we now have to explain why NCCUSL followed that strategy. One possible reason is that NCCUSL concluded that decreasing uniformity might increase efficiency, which would lead to more uniformity in the long run. However, there is no reason to expect that NCCUSL would be able to make an independent determination of efficiency, since it is not organized as a general-purpose law reform body. Indeed, as we have discussed previously, NCCUSL’s structure actually cuts against efficient lawmaking since it is subject to interest group pressure, lacks specific expertise in the areas in which it drafts laws, and may sacrifice efficiency to

\(^{36}\) See Ribstein & Kobayashi, supra note 22.
produce uniformity.\textsuperscript{37} In fact, as discussed in the next Part, NCCUSL’s seemingly perverse strategy results from the very aspects of NCCUSL’s structure designed to achieve uniformity.

IV. THE UNIFORM LAWMAKING PROCESS

This Part explains why NCCUSL chooses to depart from the obvious uniformity-maximizing strategy of adopting state leading forms. Specifically, we focus on the role of reformers and other interest groups at the drafting committee level, and the drafting committee’s need to compromise with the general NCCUSL legislative body. We show that NCCUSL’s perverse strategy ironically inhibits the very process that is designed to produce uniformity.\textsuperscript{38} Part A discusses the institutional background of NCCUSL. Part B builds on this background to present a model of the uniform lawmaking process.

\textit{A. NCCUSL’s Procedures}

NCCUSL is organized as a private legislature with representatives from every state.\textsuperscript{39} This large membership helps incorporate all states’ views into the process, and thereby gives NCCUSL the necessary political legitimacy and credibility to promote passage of its proposals. However, such a large group cannot effectively draft laws. Thus NCCUSL must delegate responsibility for each law to a drafting committee. The logistics of drafting dictate that the committee should have the basic power to formulate proposals, leaving the general legislative body with the power to accept or reject proposals and to generally indicate its preferences. As elaborated by the model in Part B, this bifurcation of power affects the substance of NCCUSL proposals in a way that compromises NCCUSL’s uniformity goal.

Drafting committees consist of NCCUSL commissioners, including experts in the relevant area, representatives from various interest groups, and a law professor who serves as reporter.\textsuperscript{40} The drafting committee is constituted to combine general drafting skill and specific expertise. As with the general legislative body, these characteristics are intended to maximize NCCUSL’s influence on state legislatures considering its proposals.\textsuperscript{41}

Work on the committees is time-consuming because drafters have several multi-day meetings at geographically dispersed locations. Since drafters are not compensated, one might expect that the committees will include people who seek to gain from NCCUSL’s

\textsuperscript{37} See id.

\textsuperscript{38} Our institutional analysis of NCCUSL supports some conclusions in Schwartz and Scott’s earlier analysis of private lawmaking. See Alan Schwartz & Robert E. Scott, \textit{The Political Economy of Private Legislatures}, 143 U. Pa. L. Rev. 595 (1995). However, while Schwartz and Scott discuss the effects of private lawmaking procedures on the substance of the proposals, we focus on these procedures’ effects on the uniform lawmakers’ specific goal of producing uniform laws.

\textsuperscript{39} For reviews of NCCUSL procedures, see Armstrong, supra note 8; John H. Langbein, \textit{Why Did Trust Law Become Statute Law in the United States?}, 58 Ala. L. Rev. 1069 (2007); Uniform State Laws, supra note 13.


\textsuperscript{41} See Langbein, supra note 39, at 1080 (noting that “[t]he Commission’s reputation for good drafting tends to predispose state bar associations and state legislators toward acts that the Commission promulgates”).
ability to achieve enactment of their preferred state laws. Other members likely participate in the lengthy NCCUSL process not necessarily because they are devoted to NCCUSL’s goal of uniformity, but because they have an interest in reforming the specific law involved in the project and have strong views about what the law should be. These include academics and academically inclined lawyers who have written on the relevant law and would gain reputation from the enactment of their ideas. The reporter may also have strong substantive views and may bring those views into the proposal through close involvement in the drafting process. These participants may favor proposals that are less likely to be widely adopted than laws that would spread among states without NCCUSL.

Although drafting committees have significant power, the broader body of NCCUSL commissioners must ultimately approve their recommendations. These commissioners play an ongoing role through multiple readings of drafts at successive annual meetings, rather than merely approving the final product. In contrast to some of the drafting committee members, NCCUSL commissioners are involved in NCCUSL as an institution. Therefore, commissioners will likely be better attuned to NCCUSL’s goals than drafting committees.

NCCUSL commissioners’ approval of proposals would seem to serve as a conservative check on any reform or interest group excess at the drafting committee level that might deviate from NCCUSL’s uniformity objectives. However, in practice the NCCUSL process does not necessarily work that way. The problem is that the interaction between the drafting committee and the general legislative body produces additional compromises. For the reasons modeled in Part IV.B, this process can make the drafting committee’s proposals even more idiosyncratic than when the proposals emerge from the committee. The drafting committee may try to resolve disagreements within both the committee and the broader legislative body through convoluted rules that delegate substantial discretion to the courts.  

B. A Model of the Uniform Lawmaking Process

This Part presents a model of the uniform law drafting process that shows how the process described in Part A can fail to achieve the institution’s uniformity goal. Figure 4 illustrates the preferences of the NCCUSL drafting committee and commissioners that are considering the revision of a uniform law. In terms of the ULLCA drafting process, Figure 4 thereby represents the position facing the ULLCA 2 drafting committee. The horizontal axis measures preferences regarding the substantive content of a provision. Holding the number of adoptions constant, the drafting committee and the commissioners both favor provisions that lie further to the right of the origin. The vertical axis measures the expected number of adoptions of a provision, which proxies for the degree of uniformity.

42. Our analysis is similar to that of Schwartz & Scott, supra note 38, who discussed how a private legislative process can produce vague general rules. However, we are less concerned with the substance of the rules than with how the process interferes with uniformity by producing rules designed more for various NCCUSL constituencies than for broad acceptance by state legislatures.
43. Although we seek to model the specific process of revising ULLCA 1, there is no apparent reason to assume that the process would be fundamentally different for an initial uniform law in an area.
The above paragraph deals with the drafters’ substantive preferences. Holding substantive factors constant, both the drafting committee and the commissioners also want more adoptions. However, drafters and commissioners may have different tradeoffs as between substance and uniformity. This means their preference curves, reflecting these tradeoffs, have different slopes. In other words, each group may trade a different number of units of one value (substance or uniformity) for the other. Because we hypothesize that NCCUSL commissioners primarily prefer uniformity, and therefore more adoptions, their preference curves are relatively flat. The NCCUSL commissioners’ preferences are depicted by the solid indifference curves in Figure 4. By contrast, we hypothesize that drafting committee members are less aligned with NCCUSL’s uniformity goals and therefore can be expected to place more importance on the substance of the provisions than on achieving uniformity. Their preference curves therefore will have a steeper slope than those of the commissioners. In other words, the drafters may want to trade a lot of uniformity potential for scoring points on law reform. The drafting committee’s preferences are depicted by the dashed indifference curves in Figure 4.

Figure 4 illustrates the case where the existing uniform law (point U1 in Figure 4) fails to adopt the leading form (point LF in Figure 4). MP represents the area that both drafters and commissioners mutually prefer to U1. The drafting committee might prefer alternative X in Figure 4 to both U1 and LF. However, the NCCUSL commissioners may reject this because they expect few legislatures to adopt it. Because the relevant parties do not both prefer this provision vis-à-vis the status quo U1, X is also drawn outside MP.
If X and LF are the only viable alternatives to U1, it would seem to follow from the fact that both options lie outside MP that NCCUSL will retain the existing, sparsely adopted U1. However, there is another possibility: the NCCUSL commissioners and drafting committee might agree on a compromise provision C that is both substantively acceptable to the drafting committee and has enough likelihood of adoption to satisfy the commissioners. C is drawn within MP—again, the set that both groups are willing to accept. As noted above, the commissioners may work out their concerns over the substance of provisions by drafting a provision that is vague or convoluted and therefore gives state courts substantial discretion in determining the rule applied in specific cases.
Figure 5 illustrates the case where U1 is not only adopted by fewer states than the leading form (point LF) but also is less preferred by both the drafters and the commissioners. Because the leading form is within MP, NCCUSL likely will adopt LF in the absence of other viable alternatives. However, even when both groups support LF, the drafting process can result in the adoption of an alternative provision that is likely to result in fewer adoptions. For example, provision D in Figure 5 lies in MP because it is acceptable to both drafters and commissioners. Figure 5 indicates that the commissioners prefer LF to D. However, the drafting committee may use its strong position as first mover in the drafting process to give NCCUSL commissioners a choice of accepting D or keeping the inferior provision U1. Even if the NCCUSL commissioners provide a stronger check on the preferences of the drafting committee, NCCUSL still might not adopt D because the drafting committee will insist on C as a compromise.
FIGURE 6A
THE NCCUSL DRAFTING PROCESS: ULLCA 1 = LEADING FORM

Uniformity (Number of Adoptions)

Substance of Provision

FIGURE 6B
THE NCCUSL DRAFTING PROCESS: ULLCA 1 = LEADING FORM

Uniformity (Number of Adoptions)

Substance of Provision
Figures 6A and 6B analyze the revision process when U1 adopted the existing leading form or became the leading form after promulgation of ULLCA 1. Figure 6A depicts the case where the U1 provision is not only leading but the only provision that states have recognized. In this situation it is unlikely that there is an alternative or compromise provision that both the drafting committee and the NCCUSL commissioners would prefer. Even if the drafting process produces alternative suggestions, unless some states have adopted them, these suggestions are unlikely to attract enough support to move NCCUSL away from the leading form. In the situation depicted in Figure 6B, U1 is a leading form but the states have recognized several alternatives that could serve as focal points for NCCUSL deliberations. These viable alternatives make compromise more likely. But note that in either case there is always a possibility that NCCUSL will promulgate an alternative that has fewer adoptions than the leading form.

V. AN ILLUSTRATION OF THE UNIFORM LAWMAKING PROCESS: ULLCA 2

Part IV demonstrates theoretically how uniform lawmaking can produce a proposal that, by adopting idiosyncratic provisions and failing to capitalize on the state process of spontaneous uniformity, can actually decrease uniformity as compared to a world in which there is no uniform law proposal. This Part analyzes NCCUSL’s second LLC proposal, ULLCA 2, with a view to illustrating this model in action. ULLCA 2 supports the model’s prediction concerning NCCUSL’s incentive to adopt non-leading forms. Indeed, ULLCA 2 is even less consistent with NCCUSL’s objectives than in ULLCA 1 because LLCs had an additional decade to develop stable leading forms. We see that even while the LLC form is taking shape in state legislatures, NCCUSL is actively attempting to distort this shape. NCCUSL’s repeat performance supports our theory that the problem is one of institutional failure of the NCCUSL process.

The ULLCA 2 Drafting Committee consisted both of formal members who were NCCUSL commissioners and various “advisors” from the American Bar Association (ABA). The NCCUSL commissioners included five law professors (including the two co-reporters). The ABA participated through a main advisor (Robert Keatinge), eight ABA Business Law Section advisors, including one designated as a representative of the California bar, three representatives of the ABA Real Property, Probate and Trust Law Section, and one representative of the ABA Tax Section. The reporters noted that, although the ABA advisors outnumbered commissioners, the commissioners and the advisors usually voted as a group, and even on close votes the ABA advisor vote was noted. The reporters also emphasized the “scholarly perspective,” including a law school dean, dean emeritus, and professor on the drafting committee, and three professors as ABA advisors.

The drafting took three years and spanned ten drafting committee meetings, five of

45. Id.
46. Id.
47. Id.
48. Id. at 517–18.
which were two and a half day in-person meetings in Atlanta, Chicago, and Phoenix.\textsuperscript{49} This lengthy and geographically dispersed process gave a significant advantage to the views of those willing and able to devote substantial time to participation in drafting. ULLCA 2 was presented to four successive NCCUSL annual meetings attended by the broader body of NCCUSL commissioners. This process afforded ample opportunity for compromise between the differing objectives of the drafting committee and the NCCUSL legislature, with the results predicted by the model discussed in Part III.

As was the case with the promulgation of ULLCA 1 in 1996, ULLCA 2 eschews the simple formula for uniformity by largely adopting non-leading forms. Table 2 shows the provisions altered by ULLCA 2 and the number of states adopting ULLCA 1 and 2 forms.\textsuperscript{50} The states adopting ULLCA 2 forms decreased relative to the pre-existing ULLCA 1 forms from an average of 13.0 to 8.68.\textsuperscript{51} Of the 19 provisions ULLCA 2 alters, the number of adoptions of the leading form increases in 5 cases and decreases in 14. Thirteen out of nineteen ULLCA 2 revisions altered non-leading forms. ULLCA 2 therefore replaced a ULLCA 1 provision that was the leading form in six cases, while moving to the leading form in only three cases. In general, the ULLCA 2 pattern follows the ULLCA 1 pattern of generally rejecting leading forms in favor of non-leading forms, resulting in a decrease in uniformity. Not surprisingly, three years after promulgation, only two states, Idaho and Iowa, have adopted ULLCA 2.\textsuperscript{52}

\textsuperscript{49} Kleinberger & Bishop, supra note 44, at 518.

\textsuperscript{50} Note that many of the codes for the ULLCA 2 provisions use the closest available code from the existing tables for consistency. Because some of the ULLCA 2 provisions differ from existing statutes, new codes will have to be assigned to these provisions. Thus, the table in some respects actually makes ULLCA 2 appear to be more consistent with current law than it is.

\textsuperscript{51} This difference is not statistically significant (p-value = .132).

\textsuperscript{52} Uniform Law Commissioners, A Few Facts About the Uniform Limited Liability Company Act (2006), \texttt{http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-ullca06.asp} (last visited Nov. 1, 2009).
This Part’s remaining task is to analyze ULLCA 2 with a view to describing and explaining how it came to diverge from uniformity goals. We begin with the provisions that have attracted the most attention. These provisions are not only the most idiosyncratic, and therefore the most needing of a non-uniformity-producing explanation, but also have a useful written record of commentary by reporters, drafting committee members, and advisors that explains the drafters’ objectives.

We also include some policy analysis of the proposals. This analysis is intended less as a substantive critique than for its bearing on uniformity. The point is to clarify NCCUSL’s choices, and thereby determine whether and how they fit the model of the NCCUSL process discussed in Part IV.A. Where NCCUSL drafters reject an existing leading form, they might be pursuing a long-term uniformity strategy by projecting the likely future path of state legislation. This future path is determined partly by the fact that the parties to LLCs can easily choose among different state laws, and will be reluctant to choose laws that impose unnecessary costs. Consistent with this notion, one of us has presented evidence that LLC provisions have evolved toward efficiency and away from rules such as those imposing unnecessary restrictions.

know that local firms can choose to form in Delaware, which has largely eliminated restrictions on contracting in LLCs.\textsuperscript{55} Thus, even if local interest groups such as lawyers favor these provisions, state legislators have an incentive to consider the overall effect of inefficient laws on filing fees and business activity in the state. Given state legislators’ incentives to adopt efficient laws, drafters’ efficiency objectives can be reconciled with a long-run objective to achieve uniformity, even if the drafters reject an existing leading form.

Despite this theoretical possibility of long-run uniformity through adoption of non-leading forms, our policy analysis of specific provisions indicates that the most likely explanation of these provisions is the political one indicated above. In other words, the proposal likely results from a compromise between reform-minded drafting committee members and uniformity-minded NCCUSL legislators resulting in idiosyncratic provisions that the states are unlikely to adopt widely. With respect to each provision or set of provisions discussed in the following Parts, we first describe and present the background of the proposal, then analyze the proposal, and finally show how the proposal fits the uniform lawmaking model described in Part III.

\textit{A. Management Provisions}

ULLCA 2’s treatment of managers’ and members’ default powers illustrates the adoption of a minority compromise position illustrated in Figures 4 and 5. The states had developed a clear majority rule that an LLC must disclose in its certificate whether it is electing management by members or by managers, and that only managers have default power to bind a firm that identifies itself as manager-managed. ULLCA 1 was generally consistent with this rule. ULLCA 2, however, adopts a small minority position by deleting default rules regarding the managers’ and members’ power to bind the firm and defaulting to common law agency rules.

There was evidence of reform-minded committee members trumping uniformity. One of the ABA advisors (as noted above, these advisors participated actively in the drafting committee decisions) wrote an article critical of NCCUSL’s initial decision to stay with the original approach on allocating agency power,\textsuperscript{56} and co-authored an article supporting the revision.\textsuperscript{57} The initial article reports that the commissioners were reluctant to accept such a significant change because they were concerned about state acceptance.\textsuperscript{58} The NCCUSL commissioners accepted a compromise that abandoned the statutory agency rules and idiosyncratically did not replace them with some alternative positional power.

\begin{footnotesize}
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\textsuperscript{55} See Bruce H. Kobayashi & Larry E. Ribstein, Jurisdictional Competition for LLCs (U. Ill. Law & Econ. Research Paper No. LE09-017, 2009), available at http://ssrn.com/abstract=1431989 (presenting evidence that larger LLCs tend to form in Delaware when they do not form in their home states).


\textsuperscript{57} See generally Thomas E. Rutledge & Steven G. Frost, RULLCA Section 301—The Fortunate Consequences (and Continuing Questions) of Distinguishing Apparent Agency and Decisional Authority, 64 Bus. Law. 37, 57–58 (2008) (arguing that RULLCA section 301(a) “properly reflects what in the development of LLCs should have always been the rule for apparent agency authority”).

\textsuperscript{58} See Rutledge, supra note 56, at 757.
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An efficiency rationale is doubtful. The reporters suggest that the leading LLC rule that ULLCA 2 rejected is a “trap for the unwary” because third parties may not be aware of whether an LLC is member-managed or manager-managed. The “trap” is unclear, however, because apparent authority rules protect third parties’ expectations even under the leading form. The problem is actually one for insiders of the firm rather than for third parties when the firm unintentionally grants power to a person designated as a manager. However, it is not clear how ULLCA 2 makes the insiders better off, since it creates significant uncertainty by throwing out the existing rule and the attendant case law. The ULLCA 2 comments suggest that existing agency law fills the gap. However, the Restatement (Third) of Agency does not provide for agency power in LLCs. Even worse, it is not even clear whether members have default agency power under ULLCA 2.

ULLCA 2’s agency provision is best explained by Part III’s model of the uniform lawmaking process. As drawn in Figure 6, NCCUSL did not adopt U1 although it was the leading form. Rather than adopting LF, the drafters ended up with a compromise, C, that eliminates the LLC default rule and goes to agency law. The ULLCA 2 drafters had several potential alternatives. For example, they might have chosen Delaware law, one of the alternatives Rutledge discusses, which gives each member and manager default authority to bind the LLC subject to variation in the operating agreement. This avoids the problem of the members unintentionally endowing someone with agency power simply by making her a manager. The Delaware approach might be deemed to be point D on Figure 6A. However, such a rule might have made the potential “trap” for third parties that the reporters were concerned about even worse by forcing third parties to consult the agreement to determine members’ power. Consistent with the model, the ULLCA 2 drafters chose to neither retain nor delete positional authority, but rather to leave it to courts to create such authority on a case-by-case basis under the general law of agency. The delegation of power to the courts creates a space around alternative C that brings it close enough to existing law to be acceptable to the commissioners.

B. Duty of Care

ULLCA 2 replaces the gross negligence standard of care under ULLCA 1 with a rule providing that,

subject to the business judgment rule, the duty of care of a member of a member-managed limited liability company in the conduct and winding up of the company’s activities is to act with the care that a person in a like position

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60. See Kleinberger & Bishop, supra note 44, at 531. Even if third parties know the form of management, they may not be able to easily determine who the members or managers are. See RIBSTEIN & KEATINGE, supra note 19, § 8:5.
61. See RULLCA § 301(b) cmt.
62. See Ribstein, supra note 53, at 59.
63. See 6 DEL. CODE ANN. § 18-402 (providing that “unless otherwise provided in a limited liability company agreement, each member and manager has the authority to bind the limited liability company”). The section is discussed in RIBSTEIN & KEATINGE, supra note 19, § 8:5.
64. ULLCA § 409(c).
would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the best interests of the company.  

Referring to Table 1, Category 41.5, this represents a move from a clear leading form to a minority position. 

Policy problems with the new standard make it unlikely the states will broadly adopt it, even in the long run. First, it introduces confusion and uncertainty. It is unclear whether the change in the rule means that the standard of care has been tightened, as the section seems to say, or left the same because of the application of the business judgment rule, which incorporates the gross negligence standard that ULLCA 2 has supposedly eliminated. Second, the reliance on the business judgment rule brings in a corporate concept that is an inappropriate default rule for partnership-type firms.

Applying the model in Part III, the ULLCA 2 approach seems to be a move from a uniform law provision that was also a leading form. Figure 6A suggests that such a move will be rare because there will be little room for the drafting committee and the commissioners to agree on a proposal that is within the mutually preferred space. However, the drafting committee had a strong preference that it was apparently unwilling to relinquish. The committee rejected ULLCA 1’s gross negligence standard as “too low” in “a post-Enron era.” The tumultuous drafting history that the reporters describe seems to reflect a disagreement between the drafting committee and the commissioners, as indicated by the fact that a commissioner moved from the floor to return to the gross negligence standard during the final NCCUSL consideration of the draft. However, the committee “reached a compromise—maintaining an ordinary negligence standard but expressly superimposing the business judgment rule.”

Thus, the final convoluted proposal represents NCCUSL’s typical compromise strategy of throwing the decision to the court’s discretion. Specifically, the provision lets a court choose to impose the stricter ordinary negligence standard preferred by the reformers on the drafting committee, or to effectively return to the lighter former standard by applying the business judgment rule.

65. RULLCA § 409(c).
66. See Report of the RULLCA Task Force of the Partnerships and Unincorporated Business Organizations Committee of the Section of Business Law (June 29, 2007) [hereinafter Task Force] (manuscript on file with author) (stating that the “language as written appears circular, in that the prefatory language appears to restate what most believe to be the business judgment rule”).
67. See id. (“[T]he introduction of the business judgment rule as a default rule goes beyond what many believe to be the current state of the law with regard to unincorporated entities in many jurisdictions. In general, there is a sense that the imposition of a business judgment rule standard is not an appropriate default rule for a contractual entity.”).
68. See Kleinberger & Bishop, supra note 44, at 526–27.
69. See id. at 526 n.69.
70. Id.
71. Id.
C. Waiver of Fiduciary Duties

ULLCA 2, like the equivalent provision in ULLCA 1, includes intricate restrictions on what the LLC operating agreement can effectively provide. ULLCA 2’s intricacy is a minority position—indeed, an even smaller minority than the complex ULLCA 1 provision, which had at least been adopted by a few states. The following examples indicate the provision’s sometimes vague and confusing restrictions on contracting:

1. The agreement may not “eliminate” the duty of loyalty, but may eliminate each specific aspect of the duty of loyalty identified in the statute. The statute also constrains the parties’ ability to modify fiduciary duties and remedies.

2. The parties may avoid the limitations on duty of loyalty waivers discussed above through an agreement that (1) “expressly relieves a member of a responsibility that the member would otherwise have under [the act]”; (2) “imposes the responsibility on one or more other members”; and (3) “eliminate[s] or limit[s] any fiduciary duty that would have pertained to the responsibility.” It is not clear what it means for the parties to “expressly relieve[]” a member of a responsibility and impose the responsibility on others, particularly since the Act permits oral operating agreements.

3. The parties may not eliminate the duty of care, but may alter the duty, as long as they do not “authorize intentional misconduct or knowing violation of law.” It is not clear where the border is between altering and eliminating the duty—for example, whether the parties can permit reckless conduct, which involves an element of intent or known risk that qualitatively differs from negligent behavior.

4. The parties may not limit money damages for “intentional infliction of harm” and “intentional violation of criminal law.” These phrases are unclear. For example, what kind of harm, and when is a violation of criminal law not intentional?

5. An elimination or modification of fiduciary duties that is within one of the permissible categories is effective only “if not manifestly unreasonable.” In applying this term, the courts must consider “only circumstances existing” when “the challenged term became part of the operating agreement;” whether the term has an “unreasonable” “objective,” or “is an unreasonable means to achieve the provision’s objective,” all “in light of the purposes and activities of the limited liability company,” and in either case

72. ULLCA § 110.
73. ULLCA § 103.
74. ULLCA § 110(c)(4).
75. § 110(d)(1).
76. See § 110(d)(2) (requiring the parties to identify specific acts or activities that do not violate the duty of loyalty); § 110(e) (specifying how the parties may authorize an act that would otherwise violate the duty of loyalty).
77. The parties “may eliminate or limit a member or manager’s liability to the limited liability company and members for money damages, except for: (1) breach of the duty of loyalty; (2) a financial benefit received by the member or manager to which the member or manager is not entitled.” § 110(g). This language suggests that the parties may not eliminate or limit liability for breaches in categories 1 or 2.
78. ULLCA § 110(f).
79. § 110(c)(4).
80. § 110(d)(3).
81. § 110(g)(4)–(5).
82. § 110(d).
whether the unreasonableness is “readily apparent.” 83 These requirements are unclear both in isolation and in how they relate to the parties’ contractual obligation of good faith and fair dealing 84 and the general contract doctrine of unconscionability. 85

(6) Even if the parties successfully manage to alter or eliminate a duty of care or duty of loyalty or damages for breach, the parties may not eliminate “any other fiduciary duty,” 86 though they may alter such a duty. 87

(7) The agreement may not “unreasonably restrict the right of a member to maintain an action under [Article] 9,” which relates to members’ direct and derivative actions. 88 It is not clear how “unreasonably” relates to the “manifestly unreasonable” standard discussed above, or if this provision restricts arbitration and choice of forum clauses. Rather than facing the tricky compromise task of dealing with this issue in black letter, the drafters addressed it in a comment by noting that “[a]rbitration and forum selection provisions are commonplace in business agreements, and this paragraph’s restrictions do not reflect any special hostility to or skepticism of such provisions.” 89

In general, returning to Part III’s model, these provisions are best explained by Figure 4. NCCUSL rejected both the leading form and ULLCA 1 in favor of a compromise (C), lying between ULLCA 1 and the drafting committee’s even more radical preference, X. Some drafting committee members had an interest in law reform and sought to restrict waiver. This is evident from the drafters’ comments deploring the “ultra-contractarian” approach to fiduciary duties and evidencing a concern for the dangers of potential abuse. 90 Also, one of the reporters wrote a short article during the drafting process which reviews a few LLC and partnership cases that involved the application of contractual restrictions on fiduciary duties to issues the parties evidently had not anticipated. 91 The commissioners, however, were concerned about whether the states would accept restrictions on contracting. The result is a compromise that alternates between permission and proscription. In general, the compromise effectively leaves enforcement almost completely to judges’ discretion by giving them a long menu of options, each of which is largely undefined and open-ended.

D. Financial Rights: Distributions in Kind

ULLCA 1 adopted a simple default rule that members had “no right to receive, and [could] not be required to accept, a distribution in kind” unless agreed otherwise. 92 In other words, the firm has to distribute, and members accept, cash, unless the members

83. § 110(h).
84. § 409(d).
85. This doctrine would enter through RULLCA § 107 (providing for application of “the principles of law and equity”).
86. RULLCA § 110(c)(4).
87. § 110(d)(4).
88. §§ 110(c)(9), 901, 902.
89. § 110(c)(9) cmt.
90. § 110(d) cmt. (citing CARTER G. BISHOP & DANIEL G. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW para. 14.05[4][a][ii]).
92. ULLCA § 405.
have agreed to an alternative arrangement. This approach avoids tricky valuation problems, though it may require a costly and untimely asset sale if the firm wants to make a distribution, which can cause hardship and encourage litigation. The leading state form compels members to accept distributions in kind as long as they are proportionate to their total shares in distributions. This involves a possible cost of fixing a value on the distribution in kind in order to determine whether it violates proportionality.

ULLCA 2 takes an idiosyncratic position by providing that “a limited liability company may distribute an asset in kind if each part of the asset is fungible with each other part and each person receives a percentage of the asset equal in value to the person’s share of distributions.” States are unlikely to widely adopt this provision because it is virtually unusable. It applies only to assets that can be divided among the members in proportion to each member’s share, and in a way that each member receives an identical share (because of the requirement that each part is fungible with every other part). It is difficult to imagine what could meet these conditions other than cash or commodities easily convertible into cash.

The model helps explain why NCCUSL rejected both existing, clear approaches to distributions in kind and adopted an idiosyncratic alternative. As in Figure 5, U1 was a minority position. Moreover, reform-minded drafters might be inclined to reject this provision because it was too “contractarian” in imposing the burdens associated with cash distributions unless the members had the foresight to draft for distributions in kind. The drafting committee may have preferred more broadly permitting distributions in kind to avoid the need for contracts, while the commissioners might have wanted something closer to the leading form to maximize the potential for uniformity. The drafting committee could block adoption of the leading form, but could not avoid compromise. As a result, the groups compromised by permitting distributions in kind even if the parties have not planned for it in advance, but only in a small category of cases. The provision is unlikely to attract many adoptions because it accomplishes little more than either of the two prevailing rules other than inviting litigation.

E. Acceptance and Rejection of Innovative Provisions

In two areas, NCCUSL considered whether ULLCA 2 should address new developments, and thereby hope to lead the states toward uniformity where there was no leading state form. Although the two situations appear comparable in many respects, ULLCA 2 addresses only one of them. NCCUSL’s contrasting positions on these issues illustrate the political forces discussed in this paper.

ULLCA 2 provides for “shelf” registration, which enables parties to temporarily set up a firm without any members. The comments to this section note that this seemingly arcane provision was one of the most debated. Nevertheless, NCCUSL was not afraid to innovate. In determining what approach to take, NCCUSL had to balance the need to provide certainty as to whether a viable firm has been formed against the inherent

93. Supra Table 1 herein, § 21.
94. RULLCA § 404(c).
95. See supra text accompanying note 90.
96. See RULLCA § 201(e).
97. § 201 cmt.
anomaly of a firm that has no members. NCCUSL’s strategy was, as usual, to compromise.

Shelf registration involves the initial filing of a certificate of organization stating that the firm is being formed with no members. The certificate then lapses after 90 days unless the firm files a notice that the LLC has at least one member and when that member joined, in which case the LLC is “deemed formed as of the date of initial membership stated in the notice.”

This dual filing procedure poses but does not answer the critical question of the effect of the first filing. In particular, does the filing protect an initial purported member from individual liability on account of business activity between the first and second filing, or in the event there is no second filing? The drafters evidently had difficulty reaching a compromise that both the committee and the commissioners would accept. The official comment to the shelf provision notes that “[n]o topic received more attention or generated more debate in the drafting process for this Act . . . .”

In contrast to its boldness on shelf registration, NCCUSL refused to adopt a “series LLC” provision. Here, action by NCCUSL might have had a significant effect in leading states toward uniformity in a still-developing area in which there are several disparate statutes. Even if NCCUSL did not want to adopt a specific provision, it could have clarified that adopting states should enforce the series law of the state in which a foreign LLC is organized. Instead, NCCUSL not only explicitly declined to adopt a provision, but took a position in the comments against enforcing organization state law.

NCCUSL’s rationale for its failure to act was concern about several unresolved questions involving tax, bankruptcy, securities, choice of law, and other matters. The note added that:

> after serious discussion [by the Drafting Committee], no one was willing to urge adoption of the proposal, even for the limited purposes of further discussion. Given the availability of well-established alternate structures (e.g., multiple single member LLCs, an LLC “holding company” with LLC subsidiaries), it made no sense for the Act to endorse the complexities and risks of a series approach.

It is not clear why these problems should keep NCCUSL from even considering a device that had already been enacted in several states, when questions regarding the “shelf” provision, and the fact that no state had enacted such a provision, did not prevent NCCUSL from proposing a provision on that issue.

The different treatments of shelf registration and series LLCs can be explained by the model in Part III, and particularly Figure 6A. In both cases, U1 was the same as the leading state form, with the variation that in these cases the leading form is no provision at all on these matters. This predicts that NCCUSL will not act in either case. Why, then,

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98. § 201(b)(3).
99. § 201(e)(1)-(2).
100. See Task Force, supra note 66.
101. RULLCA § 201 cmt.
102. See RIBSTEIN & KEATINGE, supra note 19, § 4:17 (discussing state “series LLC” provisions).
103. See RULLCA § 801(a) cmt.
104. RULLCA, Prefatory Note.
did NCCUSL act on shelf registration? A possible answer focuses on the perspective of the transactional lawyers on the drafting committee. The shelf provision gives lawyers a way to minimize the risk of malpractice liability, or at least embarrassing mistakes, relating to rendering opinions regarding forming LLCs. Specifically, the provision enables lawyers to opine that the LLC has cleared a specific formation hurdle through the initial filing, even if they cannot opine that the LLC validly exists. NCCUSL was therefore willing to cater to this important interest group even if this meant complications for everybody else dealing with LLCs. However, as predicted by the unavailability of compromise alternatives, the process was a difficult one.

The drafting committee did not provide for series LLCs or the effect of a shelf registration because the drafting committee members’ demand for such clarification likely was not enough to overcome resistance by the more conservative commissioners and the lack of clear compromise alternatives. In particular, dealing with the series LLC would have required the committee to take positions on several complex issues. At the same time, drafting committee members may have been concerned about the risk of professional liability or embarrassment for lawyers who are called on to create this new type of entity. By contrast, the effect of acting on shelf registration was to reduce the risk of liability or embarrassment.

Issues like series LLCs and shelf registration indicate a problem with NCCUSL’s uniformity goal. NCCUSL can promote uniformity by helping states recognize efficient alternatives, even where there is no leading form. Indeed, NCCUSL’s coordinating power and the drafting committee’s expertise are arguably especially helpful in this situation. However, NCCUSL must reconcile its uniformity goal with the disparate goals of the interest groups that participate in the NCCUSL process and the need for compromise between the drafting committee and commissioners.

VI. CONCLUDING REMARKS

The history and substance of ULLCA 1 and 2 raise serious questions about NCCUSL as a provider of “uniform” law proposals. We show that NCCUSL does not follow a strategy of providing laws that are likely to be uniformly adopted by the states, and that this is supported by the adoption history of ULLCA 1. NCCUSL does not follow the most logical uniformity strategy of utilizing the state process of spontaneous uniformity. Instead, NCCUSL’s provisions emerge from a process of compromising the reform and interest group objectives of the drafting committee with the more conservative adoption-maximizing strategy of the NCCUSL legislative body. These compromises often result in idiosyncratic provisions. In other words, the NCCUSL process results in the ironic contradiction that the procedures designed to produce uniform law proposals actually end up undermining uniformity.

We do not argue that NCCUSL must, to achieve its uniformity goal, use state leading forms. Particularly where the states are closely divided, and even in some situations where a type of provision clearly dominates, NCCUSL may best achieve uniformity by making a considered policy judgment as to which type of provision is

105. See Kleinberger & Bishop, supra note 44, at 529 n.84.
106. See RIBSTEIN & KEATINGE, supra note 19, § 4:17 (discussing some of these issues).
preferable from a policy standpoint. Assuming that state competition reaches efficient results, this policy-oriented approach would anticipate the direction of state law. Even under some assumptions of state law inefficiency—for example, that states tend to reflexively copy other states without making their own policy judgments—NCCUSL might lead states in a different direction from the one they would have followed in the absence of NCCUSL. However, our substantive critique of ULLCA 2’s provision indicates at least some question as to whether NCCUSL is following this alternative strategy.

It is important to emphasize our hypothesis that NCCUSL’s failings are inherent in any uniform lawmaking process. The basic problem is that the uniformity goal invites a process that, ironically, subverts the uniformity that the process is intended to achieve. The uniform lawmaker must both assemble a large legislature to provide political legitimacy and delegate drafting to an expert committee. This process necessitates compromises that undermine uniformity. Thus, our project has implications for all U.S. and international uniform lawmakers. However, our work does not preclude the possibility that there are critical structural differences among lawmakers that lead to different results.

Our criticism of the uniform lawmaking process invites consideration of the alternative of “model” lawmaking. In our previous study of an example of such lawmaking—the Prototype Limited Liability Company Act—we found that it assisted the process of spontaneous uniformity. Carney later reached a similar conclusion with regard to the effect of the Model Business Corporation Act in helping to produce significant uniformity in corporate law. The present Article’s analysis helps explain why model laws are better able than NCCUSL’s uniform lawmaking process to achieve uniformity. Since model lawmakers do not actively seek uniform adoption, they can dispense with a legislative-type body equivalent to the NCCUSL commissioners and do all the work in the drafting committee, perhaps informally seeking inputs from other experts. While this process does not check idiosyncratic provisions that states are unlikely to adopt, it also does not require compromise between the drafting committee and the commissioners that can produce idiosyncratic provisions. The end result may be laws that become uniform because they win the state competition rather than because they are promoted by a uniform lawmaking body.

A possible test of the differences between the uniform and model lawmaking processes may be available. A task force associated with the American Bar Association Business Law Section is undertaking a revision of the Prototype Act. In contrast to NCCUSL’s mission of producing a single, static uniform law, the Task Force says that its “mission is to update the Prototype Act and thereafter continually revise the Act so as to reflect the rapidly developing and ever changing law of LLCs.” Instead of a formal interchange between drafting committee and NCCUSL legislature, the task force has established a “listserv to distribute the Act, portions of the Act and suggested changes to

107. For a discussion of this “herding” hypothesis, see Kobayashi & Ribstein, supra note 21, at 478–79.
108. For other examples, see supra text accompanying notes 2–4.
109. See generally Uniform Laws, supra note 22, at 980–89 (comparing ULLCA to PLLCA with respect to spontaneous uniformity).
111. See Task Force, supra note 66.
Finally, we have focused on only one type of NCCUSL project concerning business associations, and specifically LLC statutes. It may be that the structural pathologies of uniform lawmaking are not present or are not severe in some kinds of uniform lawmaking. In particular, we have focused on an area in which the parties’ ability to contract for the applicable law promotes efficient spontaneous uniformity. In areas where this is not the case, there may be no alternative to NCCUSL for coordinating the states. In these situations, any “defects” in the NCCUSL process would be in comparison with an unattainable ideal.