"A Guide to Wisconsin Business Entities: What Bankruptcy Practitioners Should Know."
Lou Jones Breakfast Club (January 15, 2019)

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I. Formation & Legal Characteristics of Wisconsin Business Organizations

Entity Type	**Statutory Provisions**
General Partnership (Including Limited Liability Partnership)	Chapter 178
Limited Partnership	Chapter 179
Business Corporations • Statutory Close Corporation • Service Corporation	Chapter 180 • Subchapter XVIII • Subchapter XIX
Nonstock Corporation	Chapter 181
Limited Liability Company	Chapter 183
Benefit Corporation	Chapter 204

A. Sole Proprietorships

1. Legally, a sole proprietorship has no identity separate from the proprietor. Accordingly, a sole proprietorship generally affords the proprietor no protection against imposition of liability, whether in tort or contract. Consistent with this notion of identity as between the proprietor and his or her proprietorship, a sole proprietor generally makes contracts on behalf of the proprietorship in his or her own name or using a trade name.

2. The proprietor's potential liability for the actions of his or her employees, if the action is in tort, will depend on whether the employee's actions were undertaken in the course of the proprietor's business.

   - This often involves a determination of whether the employee-tortfeasor, when the tort is committed, was engaged in the performance of his or her employment duties or was instead operating outside the scope of such duties.

   - When employees of a sole proprietorship purport to bind the proprietor to a contract, general principles of state agency law will generally determine the degree of the proprietor's personal liability under such contract.

   - Thus, if the employee had either express, implied or apparent authority to act on the proprietor's behalf in the area of the contract subject matter, the proprietor will be bound even if he or she had no knowledge of the action.

3. The sole proprietor must thus be cautious with respect to grants of agency to others (employees as well as independent contractors) to bind the proprietorship contractually.

   - Even when the proprietor has been cautious in granting express authority, however, the proprietor may still be found liable on contracts entered into on his or her behalf by one possessing either implied or apparent authority.

4. Accordingly, a sole proprietorship is a risky vehicle when the business is a sales business.

   - Provision for arbitration of such disputes between purchasers and suppliers may help mitigate this liability exposure, but the simplest way to mitigate the degree of exposure for a proprietor in these situations would be to form a single member LLC or to incorporate.

   - Liability risk can also be controlled by limiting grants of agency in scope and duration; however, controlling the proprietorship's agency relationships can be difficult.

5. In sum, a sole proprietorship is generally not a favored organizational form due to the exposure of the proprietor to personal liability risks associated with the business, particularly in businesses where employees, contractors or other agents are required or in businesses where there is endemic tort liability risk. These liability risks will often offset the advantage of relative organizational and operational simplicity associated with this organizational form.

6. A sole proprietorship cannot file for bankruptcy without its sole proprietor—it is ineligible to be a debtor under Title 11 and a sole proprietorship must be filed as the individual proprietor's personal bankruptcy. *See, e.g., Gillam v. Speier (In re KRSM Props., LLC*), 318 B.R. 712, 717 (9th Cir. B.A.P. 2004). *See also In re Christenberry*, 336 B.R. 353, 356–37 (Bankr. E.D. Tenn. 2005) (collecting cases); 11 U.S.C. §§ 101(41) & 101(9)[1].

[1] These cases reach this conclusion without discussing the impact of 11 U.S.C. § 101(9)(A)(iv), which defines a corporation to include an "unincorporated company or association." However, the only cases we are aware of that have addressed this issue have also held sole proprietorships do not constitute an "unincorporated company or

7. Accordingly, all of the rules applicable to an individual's bankruptcy apply to the sole proprietorship.

- ➢ The property attributed to the sole proprietorship is considered property of the individual debtor's estate, *see, e.g., U.S. v. Van Allen*, 524 F.3d 814, 821–22 (7th Cir. 2008) (rejecting criminal defendant's argument that property in sole proprietorship is not "property" under 11 U.S.C. § 541(a)).

- ➢ The debts of the sole proprietorship can be discharged as the individual's business debts.

- ➢ The automatic stay will serve as a bar against any acts to take judicial action, collect debts from, or obtain the property of either the individual or sole proprietorship, *see, e.g., In re Harris*, 64 Fed. Appx. 540, 541–42 (7th Cir. 2003) (uncitable authority) (Seventh Circuit did not disturb district court's order approving bankruptcy judgment finding creditor in violation of automatic stay for pursuing judgment entered against individual debtor and one of his sole proprietorships).

- ➢ A sole proprietorship can obtain a Chapter 7 discharge and can also seek relief under Chapter 13 (again, because a sole proprietorship's bankruptcy is nothing more than the sole proprietor's individual bankruptcy filing). *See* 11 U.S.C. §§ 109(e) & 727(a)(1).

- ➢ Although a discharge can be obtained in a Chapter 7 proceeding, all of the sole proprietorship's property is subject to liquidation in Chapter 7 unless all of that property falls within available exemptions.

- ➢ All of a sole proprietorship's assets should be disclosed in the debtor's schedules, even if the debtor believes they are worthless or are not actually property of the debtor's estate. *See Van Allen*, 534 F.3d at 821–22. *See also Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 208 (1988) (noting that there is value in control of a sole proprietorship, even if the "going concern" value of such an entity may be minimal).

B. Partnerships

1. A general partnership affords little insulation from liability to its partners. Indeed, in this regard, a partnership potentially presents a greater degree of liability risk to the entity participant than even a sole proprietorship, although steps may be taken, through indemnification provisions in the partnership agreement, to mitigate this danger.

2. In general, partners are personally liable for all obligations of the partnership. Liability on contracts, debts and other obligations is joint and several (Wis. Stat. § 178.0306). *See, e.g.*, *Benjamin Plumbing, Inc. v. Barnes*, 162 Wis.2d 837, 470 N.W.2d 888 (1991), affirming, 156 Wis. 2d 276, 456 N.W.2d 62 (Ct. App. 1990) (decided pre-RUPA).

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association" because "the sole proprietorship has no powers beyond that of an individual." *See, e.g. In re T.W. Kroeger Trucking Co.*, 105 B.R. 512, 515 (Bankr. E.D. Mo. 1989). There does not appear to be any Seventh Circuit authority addressing this issue and the common consensus otherwise appears to remain that sole proprietorships cannot independently file bankruptcy under Title 11 because they are not "persons" under § 109.

- A partner's joint and several liability for torts includes everything chargeable to the partnership under:

  - Wis. Stat. § 178.0305(1), which provides that any loss or injury to a third party caused by the wrongful act or omission of any partner acting in the ordinary course of the business of the partnership, or with the authority of the co-partners, is chargeable to the partnership. *See Grotelueschen v. American Family Mut. Life Ins. Co.,* 171 Wis. 2d 437, 492 N.W.2d 131 (1992) (decided pre-RUPA); and

  - Wis. Stat. § 178.0305(2), which provides that the partnership is chargeable with any loss caused by the following breaches of trust: (1) one partner acting within the scope of his or her apparent authority who receives money or property from a third party and misapplies it; and (2) any partner who misapplies money or property received by the partnership from a third party in the course of the partnership's business while such money or property is in the custody of the partnership.

3. Every partner is an agent of the partnership for purposes of the partnership's business and the act of every partner, including the execution of contracts in the partnership's name, for apparently carrying on the partnership's business in the usual way binds the partnership unless the partner, in fact, had no such authority and the person with whom the partner was dealing actually knew of the fact that the partner had no such authority. Wis. Stat. § 178.0301(1).

   - Accordingly, a partnership employee who commits a tort or who, with actual or apparent authority, enters into a contract with a third party on the partnership's behalf, can bind the partnership and, hence, the other partners.

   - Thus, even if the partnership agreement restricts a partner's authority, liability may be imposed on a partner for the actions of a co-partner in furtherance of the partnership's business if there is either *implied* or *apparent* authority to bind the partnership.

4. However, an act of a partner that is not apparently for the carrying on of the ordinary course of the partnership's business does not bind the partnership unless authorized by the other partners. Wis. Stat. § 178.0301(2). Thus, a partnership is bound by the partner's actual authority, even if the partner had no apparent authority.

5. When misrepresentations are made in a partnership context (such as a misrepresentation of an individual that he or she is a partner in a partnership), the existence or lack of knowledge on the part of the actual partners can be crucial in determining whether joint or several liability will be imposed.

   - In this regard, Wis. Stat. § 178.0103(5) effectively imputes to a partnership notice or knowledge of any partner of matters pertaining to regular partnership business except in cases of fraud on the partnership committed with the knowledge or consent of such partner.

6. Partners who enter into existing partnerships, and partners in dissolved partnerships, are subject to certain special rules concerning the imposition of liability.

7. An individual who enters a partnership after that partner has been operating for some time will generally become liable for the existing obligations of the partnership jointly and severally as if he or she had been a partner when such obligations were incurred. This liability, however, may only be satisfied out of the entering partner's partnership interest. In this respect, an entering partner is treated similarly to a shareholder in a corporation or a limited partner in a partnership. *See* Wis. Stat. § 178.0306(2).

8. Taken as a whole, the general partnership is generally a poor choice of organizational form when limited liability is a significant consideration. A partner is at all times at significant risk of personal liability, even in situations in which he or she has taken no action individually.

   - When other business reasons compel the choice of a partnership as the business entity, means that can be employed to reduce the risk of loss should be considered:

     - Obtaining insurance to cover applicable risks;

     - Exercising caution in granting agency authority;

     - Monitoring representations to third parties by co-partners;

     - Publicizing to third parties who regularly do business with the partnership any limits on a partner's authority; and

     - Providing for indemnification for certain acts giving rise to liability between co-partners in the partnership agreement.

9. Notwithstanding the above-referenced protections, a partner, like a sole proprietor, can never be fully immunized against the risk of personal liability, and in a partnership, greater potential exists for the liability to arise because of the actions of others. Indeed, the greater the number of co-partners and the greater the scope of the partnership's business dealings with third parties, the greater this risk of personal liability becomes.

10. In bankruptcy, general partnerships are subject to the following limitations:

   - Partnerships cannot receive Chapter 7 discharges. *See* 11 U.S.C. § 727(a)(1).

   - Partnerships cannot file for bankruptcy under Chapter 13. *See* 11 U.S.C. § 109(e).

   - The automatic stay does not automatically apply to the partnership's partners when only the partnership files for bankruptcy.[2] *See, e.g.*, *Patton v. Beardon*, 8 F.3d 343,

[2] For each of the entities (e.g., partnership, corporation, and limited liability company), the general rule that the automatic stay will not extend to non-debtor owners, executives, directors, members, etc. is always subject to the doctrine of extraordinary circumstances, which allows a court to "extend" the automatic stay to non-debtors. Such extensions are usually only granted "when the debtor and the non-bankrupt party are closely related or the stay contributes to the debtor's reorganization." *See Patton*, 8 F.3d at 348–49. Examples of extending the automatic stay

348–49 (6th Cir. 1993) (explaining that absent extraordinary circumstances, automatic stay will not apply to general partners when only partnership files for bankruptcy).[3]

- As a general matter, the physical property owned by the partnership will only be property of the estate if the partnership has filed for bankruptcy—such property will not be property of the bankruptcy estate if one of the partners have filed for bankruptcy (only that individuals' equitable interest in the underling property will pass to the trustee as estate property). *See, e.g., In re Wallen*, 43 B.R. 408, 409 (Bankr. D. Idaho 1984). In the context of partnerships, however, the physical property owned by the partnership may not all be property of the estate if all of the partners do not join in the bankruptcy filing. *See id.* But of course, the scope and extent of any debtor's interest in partnership property will be controlled by the underlying state law. *See, e.g., Matter of Newman*, 875 F.2d 668, 670–71 (8th Cir. 1989).

- Required Documentation

  - A general partnership can be formed without any formal documents. In fact, a general partnership can even be formed by accident.

  - The association of two or more persons to carry on, as co-owners, a business for profit forms a partnership, whether or not the persons intend to form a partnership. Wis. Stat. § 178.0202(1).

- Suggested Documents

  - Partnership Agreement. Defines rights of partners in relation to other partners and the partnership

  - Consent Minutes of Partners. Memorializes major actions to which the partners agree

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when the debtor and non-debtor are closely related include situations where the individual debtor is the sole owner of the non-debtor entity or the corporate veil is pierced with respect to a individual debtor who is the sole owner of a non-debtor entity. *See, e.g., Ng v. Adler*, 518 B.R. 228, 246–50 (E.D. N.Y. 2014) (after piercing corporate veil with respect to individual sole owner of multiple corporations, bankruptcy court ruled sua sponte that automatic stay applied retroactively to debtor's corporations that state court entered judgment against while bankruptcy was pending, rendering state court judgments void *ab initio*). Courts also often refuse to "extend" the stay under 11 U.S.C. § 362(a), instead providing the same relief by injunction under 11 U.S.C. § 105(a). *See generally Matter of Rickel Home Centers, Inc.*, 199 B.R. 498 (Bankr. D. Del. 1996) (concluding automatic stay under § 362(a) did not apply to non-debtor executives of debtor-entity, but nonetheless granting requested stay by injunction under § 105(a)).

[3] Also note that entities may not be entitled to any relief under 11 U.S.C. § 362(k), since that provision only applies to "individuals". *See In re Material Corp.*, 206 B.R. 933, 937–38 (Bankr. N.D. Ill. 1996) (concluding debtor-entity lacked standing to seek relief under § 362(k) for alleged violation of automatic stay) (also collecting cases, including contrary authority).

C. **Limited Liability Partnerships**

1. An LLP is essentially a general partnership with the one fundamental difference being that the liability of the general partner or partners of an LLP is less extensive than the liability of a partner in a general partnership.

2. Generally, a general partner of an LLP is not personally liable for all partnership obligations, but rather only for those obligations arising from his or her own activities (i.e., negligence, misconduct, malpractice, etc.) and those of any person acting under the partner's actual supervision and control in the specific activity in which the activities occurred. Wis. Stat. § 178.0306(3) and (3m).

    - ➢ In this way, the LLP provides liability protection not usually available to partners in a general partnership, where, in addition to the assets of the partnership itself, all of the assets of each partner generally are at risk for all debts and obligations of the partnership. Wis. Stat. § 178.0306(a).

3. In many cases, from the standpoint of limited liability, there may be little reason for a partnership not to elect LLP status in that the partners' liability exposure can be reduced substantially without creating additional structure or formality. Wisconsin's partnership statute, Wis. Stat. Chapter 178, allows a general partnership to register as a "registered limited liability partnership" by filing a Limited Liability Partnership Registration Statement with the WDFI. Wis. Stat. § 178.9891 to 178.0913.

- ❖ Required Documentation

    - ➢ Form 602 – LLP Registration Statement

    - ➢ Form 13 – LLP Statement of Change (online filing)

D. **Limited Partnerships**

1. The liability concepts applicable to general partners in a limited partnership under Wis. Stat. § 179 are substantially similar to those applicable to partners in a general partnership under Wis. Stat. § 178.

2. Just as a general partner of a limited partnership has all of the rights and powers of a partner in a general partnership, a general partner in a limited partnership also has all of the liabilities of a partner in a general partnership. Wis. Stat. § 179.33(2).

- ➢ Accordingly, a general partner of a limited partnership is personally liable for the limited partnership's debts and obligations, both as to third parties and as to the partnership and other partners. Wis. Stat. § 179.33(2)(a) and (b).

3. A general partner's liability obligations to the partnership and the other partners may be modified in the limited partnership agreement.

- ➢ However, there is no express provision in Chapter 179 for a general partner's liability obligations with respect to third parties to be so modified. Wis. Stat. § 179.33(2)(a) and (b).

4. A general partner has the right to have partnership assets applied to the partnership's debts before application of the partner's assets. In this regard, the position of a general partner in a Wisconsin limited partnership is analogous to that of a guarantor of a corporate loan. *Wild, Inc. v. Citizens Mortgage Inv. Trust*, 95 Wis. 2d 430, 290 N.W.2d 567 (Ct. App. 1980); *Reddington v. Franey*, 124 Wis. 590, 102 N.W 1065 (1905). *See also Sundseth v. Roadmaster Body Corp.,* 74 Wis. 2d 61, 245 N.W.2d 919 (1976).

5. However, personal liability of a limited partner is restricted in most situations to the limited partner's investment in the partnership in a manner similar to a shareholder's limited liability in a corporation. In this regard, Wis. Stat. § 179.23 governs the liability of limited partners to third parties, as follows:

- Wis. Stat. § 179.23(1) provides that, except as provided in § 179.23(2), a limited partner is not personally liable for the limited partnership's obligations unless: (i) the limited partner is also a general partner; or (ii) in addition to the exercise of his or her rights and power as a limited partner, he or she "participates in the control of the business."

- When such participation in the control of the business is not substantially similar to the control that a general partner would exercise, however, the limited partner will only be liable to persons who reasonably believe, based upon the limited partner's conduct, that the limited partner is a general partner. Wis. Stat. § 179.23(1).

6. An exception to the general rule that a limited partner will not incur personal liability to third parties beyond his or her limited partnership interest exists for a limited partner who knowingly permits his or her name to be used in the name of the limited partnership, except under certain enumerated circumstances. Wis. Stat. § 179.02(4).

- Required Documentation
  - Form 302 – Certificate of Domestic LP
    - Submission must have original manual signature (i.e., cannot be e-filed or faxed)
    - Must submit two copies with original signatures

- Suggested Documentation
  - LP Agreement
    - Defines rights of partners in relation to other partners and the partnership
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E. Business Corporations

1. A corporation, in contrast to a sole proprietorship or a general partnership, whether for-profit or not-for-profit, Subchapter C or Subchapter S, will generally limit the liability of its shareholders to the extent of their respective investments. *See* Wis. Stat. § 180.0622.

2. Because a corporation is a legal entity distinct and separate from its shareholders, the rights and obligations of a corporation are normally deemed to be separate from those of the shareholders. *Milwaukee Toy Co. v. Indus. Comm'n of Wisconsin,* 203 Wis. 493, 234 N.W. 748 (1931).

- *See* Wis. Stat. § 180.0622(2) ("Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation, except that a shareholder may become personally liable by his or her acts or conduct other than as a shareholder.").

- *See also* Wis. Stat. § 180.0622(1) ("A purchaser from a corporation of the corporation's shares is not liable to the corporation or its creditors with respect to the shares except to pay the consideration for which the shares were authorized to be issued or the consideration specified in the subscription agreement entered into before incorporation.").

3. Under certain circumstances, such as when a corporate entity fails to conduct business in the corporate form, shareholders can be found liable for corporate debts; when this occurs, courts are said to "pierce the corporate veil" (i.e., treat the shareholders as they would be treated if the corporation did not exist).

   - To the extent that the "veil is pierced," the shareholders will lose the corporate advantage of limited liability. *See, e.g.*, *Andrae Elec. Co. v. Grossman*, 4 Wis. 2d 243, 89 N.W.2d 820 (1958). *See also* Mark R. Hinkston, *Piercing the Corporate Veil*, 79 <u>Wisconsin Lawyer</u> 22 (Feb. 2006).

4. The tests for whether the corporate veil will be pierced are generally vague. Often, corporate veil piercing will generally be considered in cases where the corporation is found to be essentially the "alter ego" or "instrumentality" of its owners, when the corporation has been undercapitalized, or when observance of the corporate form would promote injustice or sanction fraud. *See, e.g.*, *Sprecher v. Weston's Bar, Inc.,* 78 Wis.2d 26, 253 N.W.2d 493 (1977); *Milwaukee Toy Co*., 203 Wis. at 495. *See also*, Susan V. Kelley, *Personal Liability for Corporate Debt*, 67 <u>Wisconsin Lawyer</u> 12 (Oct., 1994).

5. Another common formulation of this concept is that a corporate entity will be disregarded and the veil of limited liability pierced, when the following two requirements are met:

   - There must be such unity of interest and ownership that the separate personalities of the corporation and its shareholder or shareholders no longer exist; and

   - Circumstances must be such that adherence to the fiction of separate corporate existence would sanction fraud or promote injustice.

     - *See, e.g.*, *Consumer's Co-op of Walworth County v. Olson*, 142 Wis.2d 465, 419 N.W.2d 211 (1988). *See also Nat'l Soffit & Escutscheons v. Superior Sys.,* 98 F.3d 262 (7th Cir. 1996); *Van Dorn Co. v. Future Chem. and Oil Corp.,* 753 F.2d 565 (7th Cir. 1985).

6. In determining whether a corporation is so controlled by another, i.e., whether such "unity of interest and ownership" exists, to justify disregarding the separate identities, pertinent cases tend to focus on four factors:

   - <u>Commingling of Funds or Assets</u>: A commingling of the corporation's assets and the shareholder's personal assets occurs when the shareholders have dealt with the assets of the corporation as if those assets were their own (e.g., using corporate funds to pay private debts, using corporate assets for private purposes). *See, e.g.*, *Wolf Co. v.*

Kutch, 147 Wis. 209, 132 N.W. 981 (1911); *Sea-Land Servs., Inc. v. Pepper Source,* 941 F.2d 519 (7th Cir. 1991).

- Failure to Maintain Corporate Records or to Comply with Corporate Formalities: The corporate veil will also be pierced where basic corporate formalities are not followed (e.g., failure to issue stock, maintain corporate records, elect directors and/or officers, hold regular meetings of the shareholders and/or directors). *Consumer's Co-op*, 142 Wis. 2d at 485.

  - Note that a "statutory close corporation" created under Wis. Stat. §§ 180.1801-180.1837, among other things, permits less formal management of an electing corporation's affairs. *See* Wis. Stat. § 180.1835 ("The failure of a statutory close corporation to observe usual corporate formalities or requirements relating to the exercise of its corporate powers or the management of its business and affairs is not grounds for imposing personal liability on the shareholders for obligations of the corporation.").

- Undercapitalization: An important factor in deciding whether the corporate veil should be pierced is whether the corporation was organized with sufficient resources/capital, liability insurance, etc., to meet the obligations that reasonably could be expected to arise in its business.

  - The inquiry here is to ascertain whether the shareholders could reasonably have anticipated that the corporation would be unable to pay its debts it would be likely to incur.

- Domination and Control: Courts will often pierce the corporate veil of a corporation when a shareholder who owns most of the stock so completely dominates the corporation's policy and business practices that the corporation can be said to have no separate existence of its own. *Consumer's Co-op,* 142 Wis. 2d at 484.

  - This can occur in situations where, for instance, a parent corporation directly determines business policy of a subsidiary rather than allowing such policy to be determined by such subsidiary's board of directors.

  - In such situations, it is advisable for the subsidiary's business policies to be determined by its own board of directors, even though such directors are elected by the parent corporation and even though there are common officers and directors as between the parent and subsidiary.

7. Courts may also ignore the corporate entity when it is used to evade a statutory or contractual obligation.

   - In such cases, the inquiry is not whether the shareholders are personally liable for the debts of the corporation but rather one of statutory or contract interpretation—i.e., was a statute or contract applicable only to a corporation intended to also apply to the corporation's shareholders. *See, e.g.*, *United States v. Milwaukee Refrigerated Transit Co.,* 142 F. 247 (E.D. Wis. 1905) (statute prohibiting railroads to give rebates to shippers held to apply to rebates given to a corporation that was not itself a shipper,

but that was formed by a shipper's officers and principal shareholders for the purpose of obtaining what were in substance, though not in form, rebates to a shipper).

8. In bankruptcy, piercing the corporate veil is typically accomplished through an adversary proceeding. *See, e.g., Steinberg v. Buczynski*, 40 F.3d 890, 891 (7th Cir. 1994); *see also In re Vermont Toy Works, Inc.*, 135 B.R. 762, (Bankr. D. VT 1991) (without citing Fed. R. Bankr. P. 7001, stating veil piercing action must be brought as adversary proceeding). State law will control whether the corporate veil should be pierced. *See generally Wellness Int'l Network, Ltd. v. Sharif,* 727 F.3d 751, 767–777 (7th Cir. 2013) (analyzing veil piercing claim as state-law counterclaim) (citing *In re Vebeliunas*, 332 F.3d 85, 90 (2d Cir. 2003) *overturned on other grounds by Wellness Intern. Network, Ltd. v. Sharif,* 135 S. Ct. 1932, 1952–54 (2015)). An adversary proceeding to pierce the corporate veil can be brought by a creditor or the trustee. *See, e.g.*, *Freeland v. Enodis Corp.*, 540 F.3d 721, 738 (7th Cir. 2008) (noting district court's ruling that trustee had standing to bring veil piercing claim under 11 U.S.C. § 541(a)); *see also Wellness*, 727 F.3d at 754–55 (case involving veil piercing claim brought by judgment creditors).

   - Parties should be wary seeking final judgments from bankruptcy courts on veil piercing claims without expressly consenting to the bankruptcy court's jurisdiction to enter such an order: whether bankruptcy courts have authority to enter final judgments on corporate veil piercing claims absent consent of the parties appears to be an issue left open by the United States Supreme Court. *See Wellness Intern. Network, Ltd,* 135 S. Ct. at 1952–54 (2015) (Roberts, J., dissenting) (noting that majority should have concluded veil piercing claim in the present case was a core claim instead of relying on resolution of consent issue).

9. While a corporation's shareholders, directors and officers are generally afforded limited liability, the corporation itself can be found liable under general tort law principles for torts committed by its employees, officers and agents acting on the corporation's behalf (i.e., while engaged in the conduct of the corporation's business).

10. Capital stock in a corporation is "security" under Article 8 of the Wisconsin Uniform Commercial Code (*see* Wis. Stat. §408.103) and subject to the remedial processes of the Wisconsin UCC.

   - Accordingly, a shareholder's stock in a corporation may be attached and foreclosed upon by a creditor of such shareholder (as opposed to a creditor of the corporation itself) and such creditor may obtain such shareholder's stock and all of the rights and benefits pertaining thereto (including any voting rights) in satisfaction of a debt of the shareholder. *See In re Murphy*, 51 Wis. 519, 8 N.W. 419 (1881).

   - This is a material difference between a corporation, on the one hand, and a limited liability company, a general partnership or a limited liability partnership on the other.

     - The sole remedy of a creditor of a partner or LLC member with respect to the partnership or LLC interest of such partner or member is to obtain a charging order.

   - This aspect of a corporation illustrates that, while corporations are generally thought of as limited liability entities as to shareholders, such limited liability is generally

limited to that of the shareholder when the corporation is sued—the same limited liability does not apply to the corporation when the shareholder is sued.

11. A "Statutory Close Corporation" is an election that can be made, via the Articles of Incorporation, to incorporate special terms and conditions of Subchapter XVIII of Chapter 180, which purport to provide certain operational flexibility and restrictions on ownership if the entity has 50 or fewer shareholders. In the area of limited liability, a statutory close corporation is treated fundamentally the same as a business corporation.

12. A "Service Corporation" is a construct of Subchapter XIX of Chapter 180 of the Wisconsin Statutes. They are specifically permitted to "own, operate, and maintain an establishment and otherwise serve the convenience of its shareholders in carrying on the particular profession, calling, or trade for which the licensure, certification, or registration of its organizers is required." *See* Wis. Stat. § 180.1903(1). Service corporations are generally subject to the other provisions of Chapter 180. However, there is a critical difference in the area of limited liability: The service corporation form does ***not*** limit the personal liability of a shareholder, director, officer or employee for "his or her own omissions, negligence, wrongful acts, misconduct and malpractice and for the omissions, negligence, wrongful acts, misconduct and malpractice of any person acting under his or her actual supervision and control in the specific activity in which the omissions, negligence, wrongful acts, misconduct and malpractice occurred." *See* Wis. Stat. § 180.1915(2).

13. In bankruptcy, corporations face these general limitations:

- Corporations cannot receive Chapter 7 discharges. *See* 11 U.S.C. § 727(a)(1).

- Corporations cannot file for bankruptcy under Chapter 13. *See* 11 U.S.C. § 109(e).

- The automatic stay does not automatically apply to the corporation's shareholders, directors, or executives, when only the corporation files for bankruptcy. *See, e.g., Levesque v. Kelly*, 164 B.R. 29, 30 (S.D. N.Y. 1994) (holding automatic stay did not apply to individual defendant when only corporate defendants filed for bankruptcy). *See also Rimco Acquisition Co. v. Johnson*, 68 F. Supp. 2d 793, 797 (E.D. Mich. 1999) (automatic stay will not automatically bar judicial proceeding against subsidiary when only parent has filed bankruptcy). This principle is subject to the doctrine of extraordinary circumstances discussed above.

- The physical property underlying the value of the corporation's shares will only be property of the estate if the corporation has filed for bankruptcy—such property will not be property of the bankruptcy estate if one of the directors, executives, shareholders, etc. have filed for bankruptcy (only that individuals' equitable interest in the underling property will pass to the trustee as estate property). *See, e.g., Fowler v. Shadel*, 400 F.3d 1016, 1018–1019 (7th Cir. 2005).

❖ Required Documentation

- Form 2 – Articles of Incorporation (online filing)
- Consent Minutes of Incorporator
    - Appointing initial directors
- Initial Consent Minutes of Directors

    - Appointing initial officers
    - Approving Articles of Incorporation, Bylaws, Stock Certificates, Subscriptions, and other matters
  - Bylaws
    - Internal rules that govern operations of the corporation

- Suggested Documentation

  - Shareholder Agreement
    - Defines rights of shareholders in relation to other shareholders
  - Stock Certificate and Transfer Sheet
  - Subscription
  - Shareholder List
  - Form SS-4 – Application for Employer Identification Number (EIN) (online form)
  - Authorization to Apply for & Receive EIN
  - Annual Report (online form)

F. Nonstock Corporations

1. In the area of limited liability, a nonstock corporation is treated fundamentally the same as a business corporation. Accordingly, the limited liability discussion set forth above regarding business corporations applies equally to nonstock corporations. Similarly, Title 11 does not delineate between business and nonstock corporations. Thus, the principles stated above apply equally to nonstock corporations.

- Required Documentation

  - Form 102 – Articles of Incorporation (online filing)
    - Must include certain provisions to receive tax exempt status from IRS

  - Consent Minutes of Incorporator
    - Appointing directors

  - Consent Minutes of Directors
    - Appointing initial officers
    - Approving Articles of Incorporation, Bylaws, application to IRS for tax exemption, and other matters

  - Bylaws
    - Internal rules that govern operations of the corporation
  - Annual Report (online form)
- Suggested Documentation

  - List of Members (if any)

G. Limited Liability Companies

1. The essence of the LLC is that it provides limited liability to all of its members.

2. The debts, obligations and liabilities of an LLC, whether arising in tort, contract or otherwise, are solely those of the LLC and LLC members generally bear no personal liability for the debts, obligations and liabilities of the LLC solely by virtue of their capacity as members. Wis. Stat. § 183.0304(1).

3. Similarly, a manager of an LLC is generally not personally liable for the LLC's debts, obligations or liabilities. Id.

4. However, an LLC member or manager may become personally liable by reason of his or her own acts or conduct other than as a member or manager. Wis. Stat. § 183.0304(1).

   - For example, a member or manager may be liable to the LLC, its members or others for torts, breaches of fiduciary obligation (i.e., duties of care, loyalty) or misconduct committed by such member or manager and if he or she acts beyond his or her actual authority.

5. Unlike a limited partner in a limited partnership, an LLC member may materially participate in management without losing limited liability protection.

6. As discussed above, corporate owners that do not respect the corporate form may be subject to the "piercing the corporate veil" theory of liability.

   - Wis. Stat. § 183.0304(2) expressly contemplates the application of common law "corporate veil piercing" concepts in the context of LLCs, providing as follows:

7. A growing number of other states have indicated a willingness to apply corporate veil-piercing to LLC members by analogy.

8. Wis. Stat. § 183.0705(1) provides that a judgment creditor may request a court to charge a member's LLC interest with payment of the unsatisfied amount of the judgment. A judgment creditor with such a charging order has only the rights of an assignee of the member's LLC interest. Wis. Stat. § 183.0705(2).

   - This section does not deprive an LLC member of the benefit of any exemption laws applicable to the LLC interest. Wis. Stat. § 183.0705.

9. If the LLC is merely used as a pretext to shield the owner from his or her own creditors, such use will likely fail. *See, e.g.*, *Litchfield Asset Management v. Howell*, 70 Conn. App. 133, 799 A.2d 298, *cert. denied*, 261 Conn. 911, 806 A.2d 49 (2002) (taxpayer individual established two LLCs and contributed assets to them in order to hide those assets from creditors; the court disregarded the existence of the LLCs so the plaintiff state taxing authority could attach company assets as if they were assets of the taxpayer individual, which was noted by the court as a "reverse pierce of the corporate veil").

10. In bankruptcy, limited liability companies are treated much the same as corporations.

   - Limited liability companies cannot receive Chapter 7 discharges. *See* 11 U.S.C. § 727(a)(1).

   - Limited liability companies cannot seek relief under Chapter 13 of Title 11. *See* 11 U.S.C. § 109(e).

- The automatic stay does not automatically apply to the limited liability company's members when only the limited liability company files for bankruptcy. *See, e.g.*, *In re Uni-Marts, LLC,* 404 B.R. 767, 781 (Bankr. D. Del. 2009).

- The automatic stay does not automatically apply to a non-debtor limited liability company even if all of its owners have filed for bankruptcy individually. *See, e.g., In re Lengacher*, 485 B.R. 380, 383–84 (Bankr. N.D. Ind. 2012).

- The physical property underlying the value of the members' interest in the limited liability company will only be property of the estate if the limited liability company has filed for bankruptcy—such property will not be property of the bankruptcy estate if one of the members has filed for bankruptcy (only that members' equitable interest in the underling property will pass to the trustee as estate property). *See, e.g., In re Coenen*, 487 B.R. 539, 540–42 (Bankr. W.D. Wis. 2012).

❖ Required Documentation

- Form 502 – Articles of Organization (online filing)

- Consent Minutes of Organizer

- Initial Consent Minutes of Members

❖ Suggested Documentation

- Operating Agreement

- Manager List

- Member List

- Form SS-4 – Application for EIN

- Authorization to Apply for & Receive EIN

H. Benefit Corporations

1. Benefit corporations are a creation of new Chapter 204 of the Wisconsin Statutes. In short, benefit corporations are business corporations created under Chapter 180 that have elected, via a provision in its Articles of Incorporation, to have the provisions of Chapter 204 apply. By this election, a benefit corporation shall have a purpose of creating "general public benefit" – as well as any specific public benefits it might enumerate in its Articles of Incorporation. In the area of limited liability, a benefit corporation is treated fundamentally the same as a business corporation. Accordingly, the limited liability discussion set forth above regarding business corporations applies equally to benefit corporations.

I. Bankruptcy Remote Entities

1. Bankruptcy remote entities, also called bankruptcy remote vehicles, are separate entities created by borrowers and lenders to avoid the complications of a potential bankruptcy. *See Paloian v. LaSalle Bank, N.A.*, 619 F.3d 688, 695 (7th Cir. 2010) (collecting law review articles discussing this topic); *see also Paloian v. La Salle Bank Nat'l Ass'n (In re Doctors Hospital of Hyde Park, Inc.*, 507 B.R. 558, 694–722 (Bankr. N.D. Ill. 2013) (providing in-depth analysis of bankruptcy remote entities).

   - The basic premise behind a bankruptcy remote entity is that the underlying debtor will create a separate entity, the separate bankruptcy remote entity will buy certain assets from the underlying debtor, and then the lender will rely on those assets. *See Paloian*, 619 F.3d at 695.

   - If done correctly, this will shield the assets held by the bankruptcy remote entity from avoidance and preference actions in a bankruptcy filed by the underlying debtor. *See id.* at 695–96.

   - To shelter a debtor and lender from a bankruptcy's avoidance and preference mechanisms, the bankruptcy remote entity must actually be separate—it must buy specific assets, manage those interests in its own interests, and observe corporate formalities, *Paloian*, 619 F.3d at 695–696 ("debtors and creditors can't evade bankruptcy law through clever choice of words,") (citing *United Airlines, Inc. v. HSBC Bank USA, N.A.*, 416 F.3d 609, 616–618 (7th Cir. 2005) (holding that labels on documents will not control and concluding that a "lease" was really a secured loan,)) and should also (i) keep "separate accounts, books, records, resolutions, and agreements to file its own separate tax returns;" (ii) pay its own liabilities and expenses out of its own assets and cannot comingle its funds with the affiliate debtor; (iii) evenly allocate any overhead costs shared with other entities, and (iv) maintain its own letterhead, telephone number, and make it clear communications are with a separate entity, *see In re Doctors Hospital of Hyde Park, Inc.*, 507 B.R. at 714–722.

   - *Paloian* appears to be the only Seventh Circuit case to address bankruptcy remote entities. As such, it appears these entities will be viable in the Seventh Circuit, although they will be subjected to a fact-intensive inquiry to determine whether or not the assets held by that entity are excepted from the debtor's bankruptcy. *See Paloian,* 619 F.3d at 695-696*; see also Paloian v. La Salle Bank Nat'l Ass'n (In re Doctors Hospital of Hyde Park, Inc.*, 507 B.R. 558, 714–722 (Bankr. N.D. Ill. 2013) (on remand from the Seventh Circuit, concluding the entity at question was a proper bankruptcy remote entity, including factual analysis to reach that conclusion)).

J. Summary

1. When limited liability for entity participants is a priority, which is often the case, the sole proprietorship and general partnership are generally ***not*** favored organizational forms because the proprietor and general partners, respectively, are exposed to personal liability for the obligations (both tort and contract) of the enterprise.

   - Further, in a general partnership, the partners are exposed to personal liability for the actions of the other partners.

2. By contrast, a corporation, by virtue of its status as a legal entity separate and distinct from its shareholders, generally limits the liability of the shareholders to the extent of their respective investments in the entity.

   - However, the corporate "veil" may be "pierced" and the shareholders liable for corporate obligations under certain limited circumstances (e.g., if corporate formalities are not adhered to, funds or assets as between the corporation and its shareholder(s) are commingled such that the entity is operated as the "alter ego" of the shareholder(s); if the entity is undercapitalized in relation to its activities, etc.).

3. An LLC also provides limited liability to entity participants in a manner similar to a corporation, subject to the same "veil piercing" concepts.

4. If the features of a partnership are otherwise preferred but limited liability is also important, an LLP restricts the liability of the partners by causing the partners to be liable only for their own activities and omissions and those persons under their supervision, thus providing liability protection to the partners from the LLP's debts and obligations (both in contract and tort) and the acts and omissions of other partners.

5. The limited partnership, while subjecting general partners to liability for debts and obligations of the limited partnership in accordance with the rules applicable to general partnerships, insulates limited partners from debts and obligations of the limited partnership so long as limited partners are not materially involved in the control of the business of the partnership or otherwise have voting rights other than in connection with fundamental changes in the partnership.

6. Each of the organizational forms has different characteristics from the standpoint of rights of a judgment creditor of an entity participant to attach such participant's ownership interest in the entity in order to satisfy an obligation of the entity participant to the judgment creditor.

   - In an LLC, general partnership, LLP, and limited partnership, a judgment creditor's right to satisfy such obligation with the member or partner interests is limited to obtaining a charging order, which effectively limits the creditor to a share of distributions, if any, attributable to the debtor-member or debtor-partner's interest, without conferring on the judgment creditor any voting or management rights with respect to the interest.

   - By contrast, a shareholder's stock in a corporation may be attached and foreclosed upon by a creditor of such shareholder and such creditor may obtain such shareholder's stock (including voting rights) to satisfy an obligation of the shareholder to the judgment creditor.

     - Accordingly, the charging order limitation applicable to LLCs, partnerships, LLPs, and limited partnerships constitutes a potentially valuable asset protection tool for participants in those entities; by contrast, a corporation, while generally thought of as a limited liability entity as to shareholders, provides little limited liability protection to the corporation as to such shareholder obligations.

II. Governance & Fiduciary Duty Considerations Among the Various Entity Forms

A. Sole Proprietorship

1. Governance

- Inasmuch as a sole proprietorship is, by definition, owned and operated by a single, sole proprietor, all management and governance rights, duties and functions are vested solely in the proprietor. All decisions pertaining to the business are made by the proprietor and only the proprietor may bind the proprietorship.

2. Fiduciary Duties

- Because a sole proprietor is the only participant, and hence the only governing force, in a sole proprietorship and there are no other venturers involved, fiduciary obligations as between entity participants do not generally come into play in the context of the sole proprietorship.

- The operation of a sole proprietorship is predominantly within the owner's discretion, and no special formalities (such as shareholder meetings or organizational documents) are required in operating or managing a sole proprietorship.

B. General Partnership.

1. Governance

- In contrast to shareholders in a corporation, who have no right to participate in the corporation's business, the following principles describe the governance of a general partnership unless otherwise provided in the partnership agreement:

  - Every partner has an equal right to participate in the management of the partnership business. *See* Wis. Stat. § 178.0401(8). ("[a]ll partners have equal rights in the management and conduct of the partnership's business.").

    - The right of a partner to participate in the management of the partnership's business is one reason that partners have unlimited liability with respect to the partnership.

    - By contrast, the fact that a shareholder has no right to participate in the management of a corporation's business is one reason that shareholders of corporations have limited liability. This is also so for limited partners in a limited partnership and an LLLP.

  - Any difference arising as to ordinary matters connected to partnership business may be decided by a majority of the partners, with each partner having one vote regardless of the relative amount of his or her capital contributions. *See* Wis. Stat. § 178.0401(11).

  - The following extraordinary matters require approval by all of the partners:

    - An act outside the ordinary course of business of a partnership;

- An amendment to the partnership agreement; or
- A merger, interest exchange, conversion, or domestication by the partnership

See Wis. Stat. § 178.0401(11).

- As stated above, the above default rules can be modified by the partners in a partnership agreement.

➢ Authority to Bind Partnership

- In contrast to a corporate shareholder, who has no authority to bind the corporation, every partner of a partnership is an agent of the partnership for purposes of its business absent an agreement between them to the contrary. Wis. Stat. § 178.06(1) ("[e]ach partner is an agent of the partnership for purposes of its business. An act of a partner, including the signing of an instrument in the partnership name…").

- Accordingly, unless otherwise agreed by the partners in the partnership agreement, each partner has an equal right to participate in the management of the affairs of the partnership.

- A partner has apparent authority for carrying on in the usual way the business of the partnership unless the partner so acting in fact has no actual authority to act for the partnership in a particular matter and the person with whom he or she is dealing "has knowledge" that the partner has no such authority. Wis. Stat. § 178.0301(1). ("An act of a partner, including the signing of an instrument in the partnership name, for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership, unless the partner did not have authority to act for the partnership in the particular matter and the person with which the partner was dealing knew or had notice that the partner lacked authority").

    - "Knowledge," for this purpose, is defined broadly, to include both actual knowledge and "knowledge of such other facts as in the circumstances shows bad faith." Wis. Stat. § 178.0103.

    - However, an act of a partner that is not for the carrying on of the business of the partnership in the usual way does not bind the partnership unless the act is actually authorized by the other partners. Wis. Stat. § 178.0301(2).

- Here again, it should be noted that the partners can modify these default statutory partner agency rules in a partnership agreement.

- Even if a general partner's actual authority is restricted by the terms of the partnership agreement, he or she has apparent authority to bind the partnership in either (A) the ordinary course of the partnership's actual business; or (B) business of

the kind carried on by the partnership, unless the third party actually knew or had received a notification that the partner lacked authority. Wis. Stat. § 178.0308.

- Wis. Stat. § 178, which is based on the Revised Uniform Partnership Act (RUPA), provides for the filing of a "Statement of Partnership Authority" as a means of limiting the authority of a partner.

  - A grant of authority set forth in such a Statement is normally conclusive in favor of third persons, even if they had no actual knowledge of the Statement, unless they have actual knowledge that the partner has no such authority.

  - However, a limitation on a partner's authority that is contained in such a Statement (other than a limitation on the partner's authority to transfer real property) will not be effective unless the third party knows of the limitation or the Statement has been delivered to him.

  - A limitation on a partner's authority to transfer real property will be effective if properly filed, even if the third party does not know of the Statement and it has not been delivered to him. Wis. Stat. § 178.0303(6).

2. Fiduciary Duties

- Under Wisconsin's partnership statute, Wis. Stat. § 178, each partner of a general partnership stands in a fiduciary relationship to the other partners. Wis. Stat. § 178.0409 requires every partner to account to the partnership for any benefit, and "hold as trustee" for it, any profits derived by such partner without the consent of the other partners from any transaction connected with the conduct of the partnership or from any use by such partner of partnership property. *See, e.g.*, *Caveney v. Caveney,* 234 Wis. 637, 291 N.W. 818 (1940).

- The scope of this statutory duty has been largely left to the courts to determine on a case-by-case basis. However, judicial pronouncements concerning the fiduciary relationship in this context have not always been consistent.

- Wis. Stat. § 178 provides for the following duties of a partner to the partnership and the other partners:

  - To account to the partnership and hold as trustee for it any property, profit or benefit derived by the partner in the conduct or winding up of the partnership business or derived from use by the partner of partnership property, including appropriation of a partnership opportunity;

  - To refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and

  - To refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

- Wis. Stat. § 178 also requires that a partner's rights and duties be discharged in a manner consistent with the obligation of good faith and fair dealing implied in contractual relationships, although a partner is not considered to violate such duty merely because the conduct furthers the partner's own interests.

C. Limited Liability Partnership

- The above discussion regarding governance in general partnerships applies equally to LLPs.

- Fiduciary obligations pertaining to the general partner or partners in an LLP are fundamentally similar to those of partners in general partnerships.

D. Limited Partnership

1. Governance

- Except as otherwise provided in Wis. Stat. § 179 or in the limited partnership agreement, a general partner of a limited partnership has all of the rights and powers of, and is subject to the same restrictions as, a general partner in a general partnership. Wis. Stat. § 179.33(1).

- One of the most important rights of a general partner in a limited partnership is the right to manage the business and affairs of the limited partnership.

- Generally, limited partners have little or no right or authority to be involved in the management or decision-making processes of the limited partnership or to bind the limited partnership contractually.

    - This is so because the limited liability of a limited partner is premised on the limited partner's not participating in the control of the limited partnership's business.

    - A limited partner is not per se prohibited from participating in the management or control of the business, but doing so has implications for one of the primary features of a limited partnership, i.e., limited liability for the limited partner, by making the limited partner liable to persons who transact business of the limited partnership reasonably believing, based on the limited partner's conduct, that the limited partner is a general partner. Wis. Stat. §179.23(1).

- The limited partnership agreement may grant to all or certain identified general partners the right to vote on a per-person or any other basis, separately or with all or any class of the limited partners on any matter. Wis. Stat. §179.35.

    - o Subject to the foregoing, the limited partnership agreement may grant to all or a specified group of limited partners the right to vote, on a per-person or other basis, upon any matter. Wis. Stat. § 179.22.

- A limited partner may be deemed to be "participating in the control of the business" of the limited partnership (which, as stated above, could adversely affect the limited partner's immunity from liability under Wis. Stat. § 179.23(1)) if he or she engages

in certain acts and/or is allowed to vote on all matters or on enough matters to justify a finding that the limited partner's participation reaches such "participation" threshold.

- Wis. Stat. § 179.23(2) provides some clarity as to where the line is with respect to how much limited partner participation is permitted before limited liability will be affected by providing that a limited partner will not be deemed to participate in the control of the business, for purposes of the liability provision of §179.23(1), solely on account of:

  - engaging in the following actions:

    - being a contractor for or an agent or employee of the limited partnership or of a general partner, a director officer of shareholder of a corporate general partner, or the manager or member of an LLC general partner (Wis. Stat. § 179.23(2)(a));

    - consulting with or advising a general partner with respect to the limited partnership's business (Wis. Stat. § 179.23(2)(b));

    - acting as a surety for the limited partnership or guaranteeing or assuming an obligation of the limited partnership (Wis. Stat. § 179.23(2)(c));

  - voting on one or more of the following matters:

    - dissolution of winding up of the partnership's business;

    - sale, exchange, lease, mortgaging or transfer of substantially all of the assets of the limited partnership;

    - the incurrence of debt by the limited partnership other than in the ordinary course of business;

    - a change in the nature of the business;

    - the removal of a general partner or the admission of an additional general partner;

    - the removal of a limited partner or the admission of an additional limited partner;

    - a conflict of interest transaction between a general partner and the limited partnership;

    - an amendment to the limited partnership agreement or the certificate of limited partnership;

    - other matters related to the business of the limited partnership agreement that the agreement states may be subject to approval or disapproval of limited partners.

See, Wis. Stat. § 179.23(2)(e).

- Accordingly, a limited partner may have a right to vote on limited issues involving certain fundamental changes in the limited partnership as described above without being deemed to be "participating in the control of the business" of the partnership and thereby being subjected to liability as a general partner under Wis. Stat. § 179.23(1).

- Additionally, it should be noted that certain fundamental changes require the approval of all general and limited partners unless the limited partnership agreement provides otherwise:

  - admission of an additional general partner (Wis. Stat. § 179.31);

  - admission of an additional limited partner (Wis. Stat. §§ 179.21(1m)(a) and 179.64(1)(b)); and

  - compromise an obligation to make a contribution to the limited partnership (Wis. Stat. § 179.42(2)).

- Although, as stated above, organizers of a limited partnership have latitude to structure the rights, powers and obligations of general partners in any manner they desire that is consistent with Chapter 178, and to structure the voting/participation rights of limited partners so as to fully insulate the limited partners from liability as described above under Chapter 179, there is no express provision in Chapter 179 for modifying the liability exposure provisions of limited partners thereunder if they meet the "participation in the control of the business" threshold set forth in Wis. Stat. § 179.23(1).

- In most respects, the fiduciary principles applicable to partners in general partnerships also apply to general partners in limited partnerships.

- Although Wisconsin's limited partnership statute, Wis. Stat. § 179, does not expressly provide for a fiduciary duty for general partners, Wis. Stat. § 179.33(1) provides that a general partner of a limited partnership generally has the rights and powers and is subject to the same restrictions as a partner of a partnership without limited partners, thus extending the partner fiduciary concepts of Chapter 178 to limited partnerships under Chapter 179. *See, e.g.*, *Century Capital Group v. Barthels*, 196 Wis. 2d 806, 539 N.W.2d 691 (Ct. App. 1995) (incorporating the fiduciary obligation provision applicable to partners in a general partnership under Wis. Stat. § 178.18(1) into the limited partnership context by virtue of Wis. Stat. § 179.33(1)) (decided pre-RUPA). *See also Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.,* 817 A.2d 160 (Del. 2002) (describing fiduciary duty of general partners under Delaware Revised Uniform Limited Partnership Act).

2. Fiduciary Duties

- There is no express provision in Chapter 179 imposing any fiduciary obligation on limited partners in a limited partnership.

- The obligations of the general partner, however, would be the same as under a general partnership.

E. Business Corporations

1. Governance

- A business corporation provides the feature of centralized governance in which the management and control of the corporation's affairs are centralized in a board of directors and in officers acting under the board's authority.

- Although the shareholders elect the board, they cannot directly control its activities.

  - Shareholders, as such, generally have no power either to participate in management or to determine questions within the scope of the corporation's business, such matters being solely the province of the board.

  - Correspondingly, shareholders, as such, generally have no authority to act on the corporation's behalf.

  - Except to the extent that a corporation chooses to elect status as a statutory close corporation, these dynamics between the shareholders, the board of directors, and the officers generally are not susceptible to substantial modification by agreement.

(a) Directors

- The management and control of a corporation's affairs are centralized in a board of directors and in officers acting under the board's authority.

- All corporate powers are exercised by or under the authority of the board of directors and the business and affairs of the corporation are managed under the overall direction and oversight of the board of directors, not the corporation's shareholders. *See* Wis. Stat. § 180.0801(2).

- The board of directors determines direction and policy for the corporation, but generally does not execute its directives—this generally being the province of the officers of the corporation.

  - Directors generally perform their direction and oversight function collectively through the board of directors rather than by acting individually.

  - Directors generally act only at a duly convened meeting at which a quorum is present (except when acting by consent without a meeting as provided in , Wis. Stat. § 180.0821). Wis. Stat. § 180.0820.

  - Assuming a quorum is present when a vote is taken, the affirmative vote of a majority of those directors present (not simply a majority of directors) is generally required for valid board of directors action (subject to the requirement

that a greater-than-majority vote of the board is required for certain actions). Wis. Stat. § 180.0824.

(b) **Shareholders**

- Although shareholders elect the board of directors, shareholders generally cannot directly control the activities of the board.

- Shareholders generally have the following powers:

  - to elect directors (Wis. Stat. § 180.0803(3));

  - to remove directors with or without cause unless the articles of incorporation or bylaws provide that directors may be removed only for cause (Wis. Stat. § 180.0808(1));

  - ratify certain kinds of management transactions;

  - adopt and amend articles of incorporation and bylaws (Wis. Stat. §§ 180.1003 and 180.1020);

  - to approve certain fundamental changes in the corporation, such as merger, sale of substantially all assets and dissolution (*see, e.g.*, Wis. Stat. §§ 180.1102, 180.1103, 180.1202 and 180.1402).

- Shareholders, as such, generally have no power to either individually participate in management or to determine questions within the scope of the corporation's business. These are matters for the board of directors.

- Correspondingly, shareholders, as such, have no authority to act on the corporation's behalf. *See, e.g.*, *Kappers v. Cast Stone Const. Co.,* 184 Wis. 627, 200 N.W. 376 (1924) (corporate powers are vested in shareholders collectively as a body and not as individuals; shareholders have no power to act for the corporation except at a legally held meeting).

- Absent provisions in the articles of incorporation of the corporation or in voting agreements providing for different shareholder voting rights, each share held by a shareholder is entitled to one vote on each matter voted on at shareholders' meeting and only shares are entitled to vote. Wis. Stat. § 180.0721. This should be compared to partners in a partnership, where each partner has an equal vote regardless of the amount of capital contributed by the respective partners unless otherwise provided in a partnership agreement.

(c) **Officers**

- The corporation is required to have such officers as may be described in the corporation's bylaws or appointed by the board of directors by resolution not inconsistent with its bylaws. Wis. Stat. § 180.0840(1).

- Officers have the authority and are responsible to perform the duties prescribed in the bylaws as well as such duties as are prescribed by the board of directors. Wis. Stat. § 180.0841.

- Generally, the powers of key officers include the authority to bind the corporation to contracts, the shareholders and directors generally not having the authority to bind the corporation contractually.

(d) **Statutory Close Corporations**

- A statutory close corporation, which is authorized and governed by Wis. Stat. §§180.1801, et. seq., allows for a corporation eligible for and electing such status to achieve simplified governance.

- A statutory close corporation may operate without a board of directors if the articles of incorporation contain a statement to that effect. In such case, all corporate powers are exercised by the shareholders and all powers and duties conferred on the board of directors are exercised by the shareholders. Wis. Stat. § 180.1821(1).

- The shareholders of a statutory close corporation may enter into an agreement relating to any phase of the corporation's affairs (e.g., election of officers, payment of salaries, distribution of dividends, election not to have a board of directors). Wis. Stat. § 180.1823.

- A statutory close corporation need not adopt bylaws if provisions required by law to be contained in the bylaws are contained in the articles of incorporation or in an agreement described above. Wis. Stat. § 180.1825.

- The failure of a statutory close corporation to observe usual corporate formalities or requirements relating to the exercise of its corporate powers or the management of its affairs is not grounds for imposing personal liability on the shareholders for obligations of the corporation. Wis. Stat. § 180.1835.

2. Fiduciary Duties

(a) **Directors and Officers**

❖ **<u>Duty of Care</u>**

- Directors and officers are considered to occupy a fiduciary relationship to the corporation and must exercise the care of ordinarily prudent and diligent persons in like positions under similar circumstances.

- In many jurisdictions this duty is codified (*see, e.g.*, Revised Model Business Corporation Act (2002), § 8.30(a)).

- Although no express provision codifying this duty is set forth in the Wisconsin Business Corporation Law, Wis. Stat. § 180, Wisconsin courts have generally acknowledged the existence of this duty. *See, e.g.*, *Boyd v. Mut. Fire Ass'n of Eau Claire,* 116 Wis. 155, 90 N.W. 1086 (1902) (officers and directors of a corporation occupy a fiduciary relation, demanding care, vigilance and good faith).

- A director or officer of a corporation cannot escape his or her fiduciary duties as such by claiming to be a mere "figurehead" — if an individual holds such position, he or she is charged with a responsibility to vigilantly fulfill the requirements of such position. *Burroughs v. Fields*, 546 F.2d 215 (7th Cir. 1976).

- Some courts have adopted the rule that, where an act or omission by a director does not involve fraud, illegality or a conflict of interest, a director who acts in good faith is not personally liable for mere errors of judgment, short of clear and gross negligence (the "Business Judgment Rule"). *See, e.g.*, *In re Caremark International, Inc. Derivative Litigation,* 698 A.2d 959 (Del. Ch. 1996); *Shlensky v. Wrigley*, 237 N.E.2d 776 (Ill. App. 1968).

  - Underlying the Business Judgment Rule is an acknowledgment that the standard of reasonable prudence and diligence is difficult to apply in situations involving business risks which directors are often called upon to make.

  - Courts have generally recognized that since potential profit often corresponds to potential risk, shareholders to a certain extent assume the risk of bad business judgment and if liability were imposed too readily on an after-the-fact basis to evaluate business judgments, it might deter many persons from serving as directors. *See Joy v. North*, 692 F.2d 880 (2d Cir. 1982).

- Most courts conclude that a director cannot invoke the Business Judgment Rule if he or she has not been "reasonably diligent," as where he or she should have known that he or she did not have sufficient facts to make a judgment, yet failed to make reasonable efforts to inform himself or herself. *See*, *e.g., Francis v. United Bank*, 432 A.2d 814 (N.J. 1981).

- Under Wisconsin law, directors and officers are not required to make first hand investigations of every detail of corporate business, at least in the absence of suspicious circumstances.

  - As long as the director or officer acts in good faith, he or she is entitled to rely on statements and reports made to him or her by corporate officers, employees, legal counsel, accountants or other persons and on reports of any committee of the board of which the director is not a member, as to matters within their authority that appear to merit confidence. Wis. Stat. § 180.026.

Duty of Loyalty

- Directors and officers also have a duty of loyalty in all dealings with the corporation, i.e., to promote the interests of the corporation without regard for personal gain. *See, e.g.*, *Jorgenson v. Water Works, Inc.,* 246 Wis. 2d 614, 630 N.W.2d 230 (Ct. App. 2001); *Jacobson v. Am. Tool Cos., Inc.,* 222 Wis. 2d 384, 588 N.W.2d 67 (Ct. App. 1998); *Modern Materials, Inc. v. Advanced Tooling Specialists*, 206 Wis. 2d 435, 557 N.W.2d 835 (Ct. App. 1996). This duty of loyalty commonly arises in the context of conflicts of interest and corporate opportunities.

- **Conflicts of Interest**

  - Conflict of interest issues arise whenever a corporation contracts directly with one or more of its officers or directors or a company in which the officer or director is financially interested.

  - Wisconsin (as is the case with most states) has a statute, Wis. Stat. § 180.0831, which permits an "interested" director to be counted in determining the presence of a quorum and provides that interested director transactions are not automatically voidable by the corporation simply because the interested director's vote was necessary for approval if any of the following requirements are met:

    - the material facts of the transaction and the director's interest are disclosed or known to the board of directors and the board has approved the transaction by a majority vote of disinterested directors;

    - the material facts of the transaction and the director's interest are disclosed or known to the shareholders entitled to vote and they approved or ratified the transaction by a majority of shares held by disinterested shareholders; or

    - the transaction was fair to the corporation.

      - *See, e.g.*, *Frey v. Geuder, Paeschke & Frey, Inc.,* 4 Wis. 2d 257, 90 N.W.2d 765 (1958); *Cookies Food Products v. Lakes Warehouse Distributing, Inc.,* 430 N.W.2d 447 (Iowa 1988).

  - Accordingly, if a director will benefit from a transaction into which the corporation is about to enter, the director must disclose this information to the Board of Directors. Wis. Stat. § 180.0831.

  - Disinterested directors (or the shareholders) must then approve the transaction.

  - If there is no disclosure, or no approval by disinterested directors (or shareholders), the transaction can be set aside or the corporation can recover damages unless the transaction is fair to the corporation.

- **Corporate Opportunity**

  - The fiduciary duty of loyalty also prohibits a director from taking for himself or herself any advantage or business opportunity that properly belongs to the corporation.

  - As to any such opportunity, a director must first offer it to the corporation. *See, e.g.*, *Racine v. Weisflog*, 165 Wis. 2d 184, 477 N.W.2d 326 (Ct. App. 1991); *Gauger v. Hintz*, 262 Wis. 333, 55 N.W.2d 426 (1952); *CSFM Corp. v. Elbert & McGee Co.,* 870 F.Supp. 819 (N.D. Ill. 1994).

  - There is no clear-cut definition of what constitutes a corporate opportunity.

- Rather, it depends on whether, under the circumstances, it would be unfair for the director to exploit the opportunity.

➢ The following factors are most frequently relied upon by courts in holding that an opportunity is "corporate" and hence may not legitimately be taken advantage of by the directors personally:

- Corporate Interest of Expectancy Test: If the corporation has a present interest or tangible "expectancy" in the opportunity in the sense that it has a specific need for it, has resolved to acquire it, or had actively considered its acquisition, it may not be taken advantage of by the director. The mere fact that the property or opportunity would be "useful" to the corporation is ordinarily not in itself enough to render it a corporate opportunity. *See, e.g.*, *Weisflog*, 165 Wis. 2d 184; *Burg v. Horn*, 380 F.2d 897 (2d Cir. 1967).

- Line of Business Test: If the opportunity was discovered by the director in his or her capacity as a director (i.e., offered to the director intended for the corporation) and/or the corporation is involved in the activity intimately or closely associated with existing or prospective activities of the corporation, it is a corporate opportunity. *See Weisflog*, 165 Wis. 2d 184. The mere fact that an opportunity relates to the corporation's "line of business" does not necessarily mean that the director must deal with it on behalf of the corporation—particularly where it also falls within the director's personal business interests that are outside the capacity of director of the corporation *See Burg*, 380 F.2d 897.

- Fairness Test: Determines the existence of a corporate opportunity by applying ethical standards of what is fair and equitable under the circumstances. *See Weisflog*, 165 Wis. 2d 184.

- Other Factors. There are also several other factors courts use in ascertaining the existence of a corporate opportunity.

➢ Courts have held that a director must promptly disclose all known material facts to disinterested directors (or if there are no such directors, to the disinterested shareholders).

➢ After full disclosure, the director may then take advantage of the business opportunity if it is rejected by the corporation or if the director proves that the corporation unreasonably failed to reject it and it would be otherwise fair for the director to personally take the opportunity. *See, e.g., Klinicki v. Lundgren,* 298 Or. 662, 695 P.2d 906 (Or. 1985).

➢ It should be noted that Wis. Stat. § 180.0828(1), provides that, although a director generally has immunity from liability for failure to fulfill any duty resulting solely from his or her status as a director, such immunity does not exist if such failure consists of any of the following:

- Willful failure to deal fairly with the corporation or its shareholder in connection with a matter in which the director has a material conflict of interest;

- A violation of criminal law, unless the director had a reasonable cause to believe that his or her conduct was lawful or no reasonable cause to believe that his or her conduct was unlawful;

- A transaction from which the director derived an improper personal profit; or

- Willful misconduct

(b) **Controlling Shareholder Obligations to Minority Shareholders**

➢ Where a controlling shareholder serves as a director or officer, he or she generally owes fiduciary obligations to the corporation in those capacities.

➢ A controlling shareholder of a corporation, even if he or she does not serve as an officer or director, may owe fiduciary obligations to minority shareholders in exercising his or her control as such.

- A controlling shareholder of a Wisconsin corporation owes a fiduciary duty to minority shareholders to act in good faith and inherent fairness toward them. *Notz v. Everett Smith Group, Ltd.,* 312 Wis. 2d 636, 754 N.W.2d 235 (Ct.App. 2008). *See also Jorgenson v. Water Works, Inc.,* 218 Wis. 2d 761, 582 N.W.2d 98 (Ct. App. 1998); *Garvey v. Fox Valley Const. Co.,* 246 Wis. 64, 16 N.W.2d 432 (1944).

➢ Although a controlling shareholder may validly contract with the corporation, he or she cannot exploit the corporation at the expense of the minority.

- Thus, if a contract is unfair (i.e., where the price terms are not those that would be set in an arm's length bargain), the controlling shareholder has breached a fiduciary obligation to the minority.

➢ A controlling shareholder who enters into a transaction with the corporation generally fulfills the duty of fair dealing to the corporation with respect to the transaction if:

- A transaction is fair to the corporation when entered into; and

- The transaction is authorized in advance or ratified by disinterested shareholders, following disclosure concerning the conflict of interest and the transaction, and does not constitute a waste of corporate assets at the time of the shareholder action.

➢ A controlling shareholder is subject to the corporate opportunity doctrine. Generally, a controlling shareholder cannot take advantage of a corporate opportunity unless:

- the taking of the opportunity is fair to the corporation; or

- the taking of the opportunity is authorized in advance or ratified by disinterested shareholders, following disclosure of the conflict of interest and the corporate

opportunity, provided the taking of the opportunity is not equivalent of a waste of corporate assets.

- A controlling shareholder also owes a duty of fairness in causing fundamental changes (such as mergers and amendments to the articles of incorporation) that may promote the controlling shareholder's own interest at the expense of the minority.

- While many of the governing provisions of corporate law may be modified by agreement (some modifications may be made in the articles of incorporation or bylaws, others in a shareholder agreement or through use of voting trusts), the fiduciary obligations of shareholders, directors and officers in a corporation are less susceptible to modification than in, for instance, the partnership or limited liability company contexts.

F. Nonstock Corporations

1. Governance

- In the area of governance, a nonstock corporation is similar to, but not identical to, a business corporation.

- The governance is centralized through directors and officers.

- A nonstock corporation may have members, but it is not required

  - Members are similar to shareholders. However, they do not own any interest in the nonstock corporation. Their only power is the power to elect directors.

  - If a nonstock corporation does not have members, the board of directors is self-perpetuating (i.e., the current directors elect their successors).

2. Fiduciary Duties

- In the area of fiduciary duties, a nonstock corporation is treated fundamentally the same as a business corporation. Accordingly, the discussion set forth above, pertaining to fiduciary obligations of directors and officers of a business corporation applies equally to nonstock corporations.

G. Limited Liability Companies

1. Governance

(a) Management

- Unless the articles of organization of an LLC vest management of the LLC's business and affairs in one or more managers, the statutory default rule in Wisconsin is that management of a Wisconsin LLC is vested in its members, subject to any provision in an operating agreement between the members restricting or enlarging management rights and duties of any member or group of members. Wis. Stat. § 183.0401(1).

- If management duties are so vested in one or more managers, management of the business and affairs of the LLC is vested in the designated manager or managers, subject to any provisions in an operating agreement restricting or enlarging such management rights and duties. Wis. Stat. § 183.0401(2).

- Accordingly, a member-managed LLC permits all members to participate in the management and operation of the LLC, as in a partnership, whereas management control is limited to and centralized in the manager or managers in a manager-managed LLC, as in a corporation.

- A manager-managed LLC permits day-to-day management of the business of the LLC to be handled by the manager or managers without the necessity of material involvement by the members.

- A manager-managed structure generally provides for the most flexibility in structuring management rights and responsibilities with respect to the management of the LLC.

    - For instance, numerous management structures can be created under the LLC's operating agreement, including, for instance, (1) appointment of a single member as the manager; (2) appointment of a non-member as manager; (3) appointment of a board of managers which allows the LLC to managed in a manner similar to a corporation with a board of directors; and (4) appointment of managers to serve as officers of the LLC in a manner similar to a corporation.

    - In all such cases, duties of the manager or managers, as well as the manner of their appointment, replacement, etc., can be structured as the members may set forth in the LLC's operating agreement.

- Managers are elected, removed and replaced by members holding a majority of the value of total contributions to the LLC unless a different method of member vote is provided in the LLC's operating agreement. Wis. Stat. §§ 183.0401(2)(a) and 183.0404(b).

- As stated, above, the determination of whether a Wisconsin LLC is member-managed or manager-managed is made in the LLC's articles of organization. Wis. Stat. § 183.0202(4).

- As referenced above, a key feature of the LLC organizational form is the flexibility afforded under Chapter 183 to craft the management, member and manager voting rights, and other pertinent governance provisions in such manner as the members of the LLC deem appropriate.

(b) **Agency Powers**

- Member-Managed LLCs.

    - The apparent authority of a member of a member-managed LLC is comparable to that of a partner — that is, each member has power to bind the LLC for any act that is for apparently carrying on the business of the LLC in the usual and ordinary way. Wis. Stat. § 183.0301(1)(b). *See also* Wis. Stat. § 183.0301(1)(a). ("Each member is

an agent of the limited liability company, but not of the other members or any of them, for the purpose of its business.").

- Even if an action is not in the ordinary or usual course of business, the remaining members may confer upon a member actual authority to bind the LLC to an action. Wis. Stat. § 183.0301(1)(b).

➢ Conversely, the remaining members may withdraw the actual authority of a member to take a certain type of action that is in the ordinary and usual course of business. Wis. Stat. § 183.0301(1)(b). ("The act of any member, including the execution in the name of the [LLC] of any instrument, for apparently carrying on the business of the [LLC], binds the limited liability company unless the member has, in fact, no authority to act for the [LLC] in the particular matter, and the person with whom the member is dealing has knowledge that the member has no authority to act in the matter.").

- In such case, if the member takes an action, the LLC will be bound by virtue of the member's apparent authority, but the member may be obliged to indemnify the LLC for any loss that results from his or her contravention of the other members' withdrawal of authority.

❖ Manager-Managed LLCs.

➢ In a manager-managed LLC, the rules concerning authority are comparable to that of corporations — that is, typically only the managers have apparent authority to bind the LLC.

➢ Members of a manager-managed LLC have no apparent authority to bind the LLC, just as shareholders have no apparent authority to bind a corporation. Wis. Stat. § 183.0301(2)(a).

➢ A manager in a manager-managed LLC has partner-like apparent authority—that is, each manager is an agent of the LLC (although not of any of the members) and has equal authority for purposes of the LLC's business unless otherwise provided in the LLC's operating agreement, if any. Wis. Stat. § 183.0301(2)(b).

- The act of any manager for apparently carrying on the ordinary course of the LLC's business binds the LLC unless the manager has, in fact, no authority to so act and the person with whom the manager is dealing has knowledge that the manager has no authority to so act. Wis. Stat. § 183.0301(2)(b).

(c) **Voting**

❖ Member-Managed LLCs

➢ Unless otherwise provided in an operating agreement, and subject to certain actions where unanimous vote is required (see below), the affirmative vote or approval of members whose interests in the LLC represent more than 50% of the value of the total contributions made to the LLC is required to decide any matter connected to the LLC. Wis. Stat. § 183.0404(1)(a).

- Manager-Managed LLCs

  - Unless otherwise provided in an operating agreement and subject to certain actions where unanimous member vote is required (see below), the affirmative vote or approval of more than 50% of the managers is required to decide any matter connected to the business of the LLC. Wis. Stat. § 183.0404(1)(b).

- Unanimous Consent Required

  - Notwithstanding the above voting requirements for a member-managed and manager-managed LLC, unless otherwise provided in an operating agreement, the affirmative vote or approval of all members is required to undertake certain fundamental actions, including the following:
    - Amend the articles of organization;
    - Issue an interest in the LLC;
    - Adopt, amend or revoke an operating agreement;
    - Allow an LLC to accept an additional contribution from a member;
    - Allow a partial redemption of an LLC interest; or
    - Authorize a manager, member or any other person to do any act on behalf of the LLC that contravenes an operating agreement.

    Wis. Stat. § 180.0404(2).

- As stated above, one of the key features of the LLC organizational form is that there is wide latitude to modify the above default provisions through an operating agreement. This flexibility makes an LLC a desirable entity from a governance standpoint.

2. Fiduciary Duties

- The fiduciary duties of managers and members of LLCs are largely unspecified in Wisconsin's LLC statute, Wis. Stat. § 183.

- The duties and obligations of LLC members and managers to the LLC and to each other, including fiduciary obligations, may be largely governed by the LLC's operating agreement, if any.

- It should be noted that Chapter 183 includes certain default provisions concerning particular issues pertinent to concepts of fiduciary duty.

- Wis. Stat. § 183.0402(1) sets forth a series of four default duties of LLC members and managers toward the LLC and other members (which can be modified by an operating agreement), consisting of the prohibitions of the following acts:
  - Willful failure to deal fairly with the LLC and its members in connection with a matter in which the member or manager has a material conflict of interest;
  - A violation of criminal law, unless the member or manager has reasonable cause to believe that his or her conduct was lawful and a no reasonable cause to believe that such conduct was unlawful;
  - A transaction from which the member or manager derived an improper personal profit; and
  - Willful misconduct.

- As stated, above, the above duties applicable to members and managers of an LLC may be modified by the LLC's operating agreement.

  - This should be compared to Wis. Stat. § 180.0828(1), which sets forth analogous prohibitions for directors of a corporation as exceptions to the limited liability of directors but expressly provides such prohibitions can only be expanded and not restricted.

- Under Wis. Stat. § 183.0402(2), an LLC member and manager must account to the LLC and hold as trustee for the LLC any improper personal profit derived by that member or manager without the consent of a majority of disinterested members or managers from any of the following:

  - A transaction connected with the organization, conduct or winding up of the LLC; or
  - A use by a member or manager of the property of the LLC, including proprietary or confidential information or other matters entrusted to the person as a result of the person's status as a member or manager.

- Wisconsin case law indicates that, in light of the language of Wis. Stat. § 183.0402(1), common law fiduciary duties do not apply to members or managers of a Wisconsin LLC and that the rights and duties of members of an LLC to each other can be governed by an operating agreement between the members, if there is one.
  - This constitutes a material difference between the fiduciary duties applicable in the LLC context and fiduciaries applicable in the context of corporations.

- Although, as stated above, Wis. Stat. § 183.0402(1) sets forth the above-referenced basic statutory duties of fairness, etc., those duties can generally be limited or otherwise affected by the terms of the operating agreement, if there is one. *Gottsacker v. Monnier,* 269 Wis. 2d, 667, 676 N.W.2d 533 (Ct. App. 2004), *review granted*, 273 Wis. 2d 654, 684 N.W.2d 136 (2004), *reversed and remanded*, 281 Wis. 2d 361, 697 N.W.2d 436 (2005), *on remand*, 2006 WL 3477191.

- It should nonetheless be noted that the issue of whether an LLC member or manager has a fiduciary duty to the LLC or other members is subject to ongoing discussion and debate.

- Both *Gottsacker* and other recent cases suggest that courts will be reluctant to reach too far to find that an operating agreement eliminates all of the above-referenced statutory default rules of Wis. Stat. § 183.0402, so if that it is intended that an operating agreement substantially modify such default rules, the operating agreement language doing so should be clear and conspicuous in that regard. *See Lenticular Europe, LLC v. Cunnally*, 279 Wis. 2d. 385, 693 N.W.2d 302 (Ct. App. 2005) (stating that if an operating agreement is ambiguous as to whether the members intend to override a particular statutory default term, the statutory default term governs). *See also Kasten v. Doral Dental USA, LLC,* 301 Wis. 2d 598, 733 N.W.2d 300 (2007).

- Further, it is advisable to consider reciting in the operating agreement the reasons or rationale for limiting such duties and/or setting forth notice, appraisal and other protective procedures in the operating agreement.

- It should be noted that, even if the operating agreement is drafted so as to clearly and expressly eliminate the fiduciary duties imposed by Wis. Stat. § 183.0402, it should not be assumed that courts will give members a free reign to act oppressively or injuriously with respect to each other.

- Inasmuch as there continues to be discussion and debate regarding the issue of fiduciary duties in the context of LLCs, some Wisconsin practitioners advise their clients that in appropriate cases Wisconsin courts will likely decide that LLC members have a fiduciary duty to the LLC and other members that cannot be fully eliminated or waived. *See* Boucher and Kampershcroer, *The First Case*, 78 Wisconsin Lawyer 12 (Sept., 2005).

H. Benefit Corporations

1. For the most part, it appears that the general fiduciary duty rules applicable to directors and officers of a business corporation will be applied to a benefit corporation. *See* Wis. Stat. §§ 204.301(3), 204.302(5), and 204.303(3). Perhaps the key distinction is that Chapter 204 expressly provides that "in discharging the duties of their respective positions, the board of directors, committees of the board, and individual directors of a benefit corporation, in considering the best interests of the benefit corporation, shall consider the effects of any action or inaction" on the various general and specific public benefit purposes.

- Note: It would appear that the consideration of such outside constituencies is already allowed in the Chapter 180 business corporation context. *See* Wis. Stat. § 180.0827. Apparently to avoid any implication to the contrary, Wis. Stat. § 204.101(2) provides that "[t]he existence of a provision of this chapter shall not of itself create an implication that a contrary or different rule of law is applicable to a business corporation that is not a benefit corporation."

I. Fiduciary Duty Towards Creditors.

1. In *Beloit Liquidating Trust v. Grade*, 2004 WI 39, 270 Wis.2d 356, 677 N.W.2d 298, the Wisconsin Supreme Court held that corporate officers and directors owe no fiduciary duty to creditors until the corporation is ***both*** insolvent ***and*** no longer a going concern. *See Beloit Liquidating,* 2004 WI 39, ¶¶ 2, 36-37, 42, 270 Wis.2d 356, 677 N.W.2d 298.

- In *Beloit Liquidating*, Beloit Corporation filed for bankruptcy. For a period of years leading up to the bankruptcy, various officers and directors allegedly mismanaged the corporation and breached their fiduciary duties. A "committee" of unsecured creditors sought the right to sue the officers and directors "on behalf of" the corporation for breach of fiduciary duty. The creditors received "title" to the corporation's assets, including the corporation's claims for breach of fiduciary duty, and the committee commenced suit. Shortly thereafter, a "trust" was created to liquidate the corporation's remaining assets, and the trust replaced the committee as plaintiff.

- The trust alleged that the officers and directors breached their fiduciary duties to both the corporation and its creditors. The officers and directors moved for judgment on the pleadings, arguing that the trust failed to state a claim upon which relief could be granted. The circuit court granted the motion, but this was reversed on appeal by the Wisconsin Supreme Court, which concluded that the corporation was a going concern during the relevant period of time and, therefore, "any claim asserted by Beloit Corporation's creditors for breach of fiduciary duty during this time frame is not actionable, and any claim on behalf of Beloit Corporation resulted in no injury to the corporation." *Id*. at ¶ 40.

2. While *Beloit Liquidating* remains the law in Wisconsin, the decision has been criticized—most notably by the Wisconsin Court of Appeals in *Polsky v. Virnich*, 2010 WI App 20, 323 Wis. 2d 811, 779 N.W.2d 712, which reluctantly applied its principles to dismiss the breach of fiduciary duty claims of a state law receiver against a corporation's officers, stating:

   "The problem, as we see it, is this: A business can be run as a "going concern," well after it is insolvent, thus making it a relatively simple matter for the officers and owners of a closely held corporation to strip many of the remaining assets of the "sinking ship" without fear of running afoul of a duty to creditors …. Therefore, it appears to us that corporations as a whole would benefit if our supreme court modified the Beloit Liquidating holding to bring it into line with the majority of other jurisdictions. Lacking the authority to do that, we apply Beloit Liquidating and affirm."

   Id. at ¶ 15.

J. Summary

1. Governance

- In the area of governance, the sole proprietorship provides perhaps ultimate simplicity in that the proprietor is essentially the alter ego of the proprietorship for purposes of decision-making and there is no hierarchy or organizational or decision-making structure (unless there are employees) to be maintained, as is the case for other organizational forms.

- The corporation provides for the greatest degree of centralization with respect to governance by localizing the management and control of the corporation's affairs in a board of directors, which delegates day-to-day execution to officers, with the corporation's shareholders having control of the board through voting power but not having any day-to-day decision-making or agency authority.

- By contrast, LLCs provide for a substantial degree of latitude in structuring governance and decision-making procedures by permitting the LLC to operate in the nature of a partnership by being member-managed if management in control on the part of all entity participants is desired, or, alternatively, to operate more akin to a corporation by electing to be manager-managed if centralization of management in control in a manager or managers, rather than members, is desired.

- Either way, the LLC provides for additional flexibility by allowing members to structure the LLC's governance procedures in a wide variety of ways in an operating agreement, subject to minimal restrictions.

- ➢ At the opposite end of the spectrum from a corporation's centralized governance features, a general partnership (as well as an LLP) provides for decentralization of management and control by virtue of the default rules under the Wisconsin partnership statute which provide each partner with an equal right to participate in the management of the partnership and to bind the partnership, although, as with an LLC, these default concepts may be modified by agreement between the partners.

- ➢ The limited partnership centralizes management and control functions in the general partner or partners (the governance concepts applicable to general partnerships being largely controlling where there are multiple general partners in a limited partnership), with limited partners having little or no participation in management other than voting on limited fundamental changes in the partnership; to the extent that a limited partnership is structured in a way that allows limited partners to participate in management decisions or have the right to vote on additional matters other than simply fundamental changes, the limited liability shield generally accorded limited partners may be impaired.

- ❖ In sum, if the entity organizer is looking to centralize management and control in a few people and insulate other participants from such involvement, as in the case of a business enterprise with passive investors, a corporation would be a desirable organizational form.

- ❖ Likewise, a manager-managed LLC or a limited partnership would provide similar management centralization characteristics — these entities also provide a certain degree of flexibility relative to a corporation in that management features can be more easily tailored by agreement than in a corporation, where respective functions or directors and officers are more specifically delineated by statute.

- ❖ If the organizer's priority is to assure management and control functions by all entity participants and equality of authority as between entity participants, a general partnership or a member-managed LLC would be a preferred organizational form.

2. Fiduciary Duties

- ➢ From the standpoint of fiduciary obligations as between entity participants, the sole proprietorship is, by definition, the simplest organizational form because there are no other participants involved in the enterprise to which the proprietor would owe such duties.

- ➢ The LLC provides materially more flexibility than a corporation for restricting fiduciary obligations as between entity participants because the statutory "default" duties of an LLC member or manager pertaining to fiduciary-type duties (i.e., willful failure to deal fairly in a conflict of interest situation, criminal law violation, improper personal profit, willful misconduct) may be modified and restricted by the LLC members, although likely not entirely eliminated or waived, through an operating agreement.

- A corporation provides for perhaps the most specific and extensive fiduciary duties of all of the organizational forms, imposing on directors and officers duties of loyalty, due care, fair dealing and restrictions on corporate opportunities (as well as fiduciary duties of majority shareholders with respect to minority shareholders) which are generally not considered waivable by agreement.

- As between an LLC and a general partnership, Wisconsin's partnership statute provides for a more express statement of fiduciary duties for partners than does Wisconsin's LLC statute with respect to members and managers, where fiduciary duties in the LLC context are largely unspecified and there, in fact, continues to be debate regarding whether such fiduciary duties even exist.

  - In any event, there is considerable freedom in an LLC to expand or contract fiduciary duties by agreement of the members; there is less express authority for partners to modify or lessen partners' fiduciary duties to each other, although some reasonable restrictions may be permitted.

- As for the fiduciary duties of general partners in an LLP or a limited partnership, the analysis is fundamentally the same for these organizational forms as for general partnerships.

- In sum, if an entity organizer is looking for maximum freedom in restricting or otherwise tailoring the fiduciary duties as between entity participants, an LLC may be preferable because of the lack of specific statutory provisions setting forth such duties and the ability to modify fiduciary duty notions by agreement.

- If the features of a general partnership, LLP, or limited partnership are otherwise preferred, fiduciary duties as between participants in these entities may also be capable of being modified to a limited extent by agreement.

- If binding the controlling or managing entity participants to a clear set of fiduciary obligations is a priority, a corporation may be a preferred entity choice.

III. Other Bankruptcy Considerations

A. Derivative Actions and Breach of Fiduciary Duties to Creditors in Bankruptcy

1. The general rule appears to be that once a bankruptcy is filed by an entity, creditors will lack standing to bring any derivative actions on behalf of the debtor-entity for pre-petition breaches of fiduciary duty by any executives, directors, members, partners, etc.—only the trustee will typically have standing to bring such claims on behalf of the bankruptcy estate. *See Koch Refining v. Farmers Union Central Exchange, Inc.*, 831 F.2d 1339, 1343 (7th Cir. 1987) ("[R]ights of action against officers, directors and shareholders of a corporation for breaches of fiduciary duties, which can be enforced by either the corporation directly or the shareholders derivatively before bankruptcy, become property of the estate which the trustee alone has the right to pursue after the filing of a bankruptcy petition.") (citing *Pepper v. Litton,* 308 U.S. 295, 306-07 (1939)).

2. Nonetheless, courts have held that creditors can bring derivative claims on behalf of the bankruptcy estate in other limited circumstances.

- For example, creditors may be able to bring derivative claims if (i) they have a colorable claim; (ii) the trustee refused to pursue the claim (in Chapter 11 this may be more likely as the trustee will likely be the debtor-in-possession); and (iii) the bankruptcy court granted permission to initiate the action. *See In re Optim Energy, LLC*, 527 B.R. 169, 173 (D. Del. 2015).

- A creditor may also be able to bring such a claim if the creditor can show some it suffered some individual harm outside of that experienced by the entity. *See generally Samson Energy Resources Co. v. Semcrude L.P. (In re Semcrude, L.P.*), 796 F.3d 310 (3d Cir. 2015). However, in this circumstance the courts are really just recognizing the creditor's ability to bring a direct claim.

- At the end of the day, although the general rule will be that creditors lack standing to bring derivative claims, a highly factual inquiry will be required to make a final determination and courts may otherwise be inclined to allow such claims if equity requires it.

3. Presumably, the restrictions on standing with regard to derivative actions initiated on a debtor-entity's behalf would not apply to a creditor seeking to assert claims against an executive or director for that individual's alleged breach of fiduciary duty to creditors. *See Beloit Liquidating Trust v. Grade*, 2004 WI 39, 270 Wis. 2d 356, 677 N.W.2d 298.

4. Also appreciate that federal law will control whether a fiduciary exists with regard to any bankruptcy provisions premised on a finding of a fiduciary duty, such as 11 U.S.C. § 523(a)(4). *See Follett Higher Educ. Group, Inc v. Berman (In re Berman)*, 629 F.3d 761, 767 (7th Cir. 2014); *see also Davis v. Aetna Acceptance Co.,* 293 U.S. 328, 333 (1934). Accordingly, the fiduciary duties described above that are premised on Wisconsin law may or may not control a bankruptcy court's finding of whether a fiduciary duty exists for the purpose of any particular provision under the bankruptcy code.

B. Charging Orders

1. Courts are beginning to hold that when a sole member or owner of an entity files bankruptcy individually, the trustee stands in the shoes of that individual with respect to the entity and obtains complete control over it, rejecting arguments that the trustee is no more than an assignee with a charging order. *See, e.g., In re B & M Land & Livestock, LLC,* 498 B.R. 262, 267 (Bankr.D.Nev.2013) (noting that "[s]tate law does not control the administration of property interests that are part of the bankruptcy estate"); *In re Cleveland*, 519 B.R. 304, 306–07 (D. Nev. 2014); *In re Albright,* 291 B.R. 538, 541 (Bankr.D.Colo.2003). *See also In re Wallace,* 2013 WL 1681780, at *3 (Bankr. D. Idaho Apr. 17, 2013) (noting this principle had been extended to multiple entity forms).

2. This principle is even more prevalent when the court concludes the operating agreement governing the non-debtor entity is not an executory contract. *See, e.g., In re First Protection, Inc.,* 440 B.R. 821, 830–33 (9th Cir. BAP 2010).

3. For all intents and purposes, it appears that charging orders in bankruptcy now only have an impact on creditors who seek to enforce their charging orders as judicial liens (see below) or perhaps in situations where only one member, director, partner, executive, etc. files bankruptcy but multiple other individuals have an ownership stake in the non-debtor

entity. *See Northwest Wholesale, Inc. v. Pac Organic Fruit, LLC*, 184 Wash. 2d 176, 357 P.3d 650, 657–58 (Wash. 2015) (noting that *First Protection* would not presumably apply to multiple-member entities). *See also In re Cutler,* 165 B.R. 275, 282 (Bankr. D.Ariz.1984) (treating trustee of bankrupt partner as the equivalent of a creditor holding a charging order).

4. It does not appear any courts in the Seventh Circuit have addressed this issue directly.

C. Fraudulent Conveyances and Other Avoidance Considerations

1. The trustee's avoidance powers will apply to transfers by entities as they do to transfers by individual debtors.

2. Of course, the two most common are the avoidance of preferential transfers and fraudulent conveyances.

   - Under 11 U.S.C. § 547, a trustee may avoid any transfer of an interest of the debtor in property that is made (i) to or for the benefit of a creditor; (ii) to satisfy an antecedent debt; (iii) the transfer is made while the debtor is insolvent; (iv) the creditor receives more than it would be entitled to in a Chapter 7 or if the transfer had not occurred; and (v) the transfer is made within 90 days of the debtor's petition. *See* 11 U.S.C. § 547(b)(1)–(4)(A). When a transfer is made to an insider, the preferential transfer period is extended to one year. *See* § 547(b)(4)(B).

   - Under 11 U.S.C. § 548, a trustee may avoid any transfer that involves a situation where the debtor transfers an interest of the debtor in property or incurs an obligation within two years of the debtor's bankruptcy petition and (i) the debtor made such transfer or incurred such obligation with the intent to defraud, hinder, or delay a creditor, *see* 11 U.S.C. § 548(a)(1)(A), or (ii) the debtor receives less than a reasonably equivalent value in exchange for the transfer; and (a) the debtor is insolvent at the time of the transfer; (b) the debtor was engaged in a business or transaction where any property remaining with the debtor was a unreasonably small capital; (c) the debtor intended to incur or believed it incurred debts it would be unable to pay; or (iv) the debtor made such transfer or incurred such obligation with an insider under an employment contract outside of the normal course of business.

3. Given the broad scope of a "debtor's interest in property" and broad interpretation of "transfer" under the bankruptcy code, 11 U.S.C. § 541(a), and whatever underlying state law may apply, these avoidance powers can reach various pre-petition acts by entities—and sometime the acts of their officers, directors, partners, members, managers, etc.—before bankruptcy that may be somewhat surprising. *See, e.g., In re United Food Companies, Inc.*, 33 B.R. 217, 218 (Bankr. S.D. Fla. 1983) (holding that transfer of funds from debtor corporation's accounts receivable from vice-president of debtor corporation intended to be a loan to a separate individual could be avoided as a preferential transfer when the money transferred was used to pay a debt of the debtor corporation); *Ohio Fuel Sales Co. v. Keffler & Rose Enters. (In re Ralph A. Veon, Inc.)*, 17 B.R. 590, 593 (Bankr. W.D. Penn. 1982) (concluding pre-petition transfer of coal was an avoidable preference); *Templeton v. O'Cheskey (In re Am. Housing Foundation),* 785 F.3d 143, 158–59 (5th Cir. 2015) (general partner's transfer of funds from limited partnership's bank account to another partner could potentially constitute an avoidable preference). *See also In re Sundstrom*, 374 B.R. 663, 669 (Bankr. E.D. Wis. 2007) (concluding a transfer occurred

when sole proprietor placed sole proprietorship assets wholly owned by her into a corporation wholly owned by her);

4. Specific to charging orders, creditors should also be aware that if a charging order has not been entered at the time bankruptcy is filed, the creditor's interest has likely not been perfected and any interest in the pending charging order can likely be avoided by the trustee under 11 U.S.C. § 544. *See, e.g., In re Jaffe*, 235 B.R. 490, 491–92 (Bankr. S.D. Fla. 1999) (applying Florida law).