

New York Requires Limited Liability Entities to Disclose Largest Interest Holders and Suspends Authority to Do Business for Non-Compliance

Senate Bill 85-A which amends the publication requirements applicable to foreign and domestic limited liability companies, limited partnerships and limited liability partnerships, was signed into law by Governor Pataki on February 3, 2006, with an effective date of June 1, 2006. The Bill had been strongly opposed by major bar associations in New York State. This memo will not discuss questions regarding alleged legislative purposes or political pressures, except for the speculation in the last paragraph.

The most important changes effected by this new law, now referred to as Chapter 767 of 2005, are:

- Entities must now disclose the names of the ten (or fewer) members or partners who are actively engaged in the business and affairs of the entity and who have the most valuable membership or partnership interests.
- The penalty for failure to comply with the publication requirement is suspension of the authority of the entity to carry on, conduct or transact any business in New York State during the pendency of non-compliance (as compared to the inability to maintain an action or special proceeding in New York State as the law previously provided). For new entities, the prescribed period of filing the affidavit of publication is 120 days from the date of formation.
- The suspension penalty will also apply to pre-existing entities (i.e., those formed before the effective date) who did not meet the publication requirement under the law as it previously existed. To meet the publication requirement, a notice must be published for 6 weeks and an affidavit of publication filed by June 1, 2006. For pre-existing entities who have not met the publication requirement, the cure period for compliance runs 18 months from the effective date (through December 1, 2007).

Suspensions can be "annulled" once an entity complies with publication.

The law requires the publication of the names of the ten persons actively engaged in the business and who have the most valuable membership or partnership interests in the limited liability company or partnership. If after the completion of the first weekly publication there is a change in any of the information in the notice (e.g., the persons with the most valuable interests), no further or amended publication would be required. Therefore, the use of holding companies, shelf companies, or "straws," appears to be permitted.

Investment advisers (as defined in the Investment Advisers Act of 1940; this definition includes investment advisers that are not registered), commodity pool operators and commodity trading advisors (as defined in the Commodity Exchange Act), and any collective investment vehicle or any direct or indirect subsidiary or affiliate sponsored, advised or managed by an investment adviser, commodity pool operator or commodity

trading advisor, are exempt from the “ten persons” disclosure, but are not exempt from the publication requirement or the suspension penalty for non-compliance.

This represents a significant increase in the penalties for non-publication. Prior to this law the statutory penalty was inability to maintain an action. It is believed that the penalties for non-publication were significantly increased because some persons had delayed publication unless and until it was necessary to maintain an action.

Professional limited liability companies and limited liability partnerships are also covered. Entities that are theatrical production companies are exempt from the publication requirements.

The suspension will be automatic and without notice. The consequences of a suspension are unclear. There is some concern that persons who thought they were conducting business as members of a New York limited liability company or as limited partners of a New York limited partnership or as partners in a New York limited liability partnership could lose the protection of the limited liability entity and become “an association of two or more persons to carry on, as co-owners, a business for profit.” Although the suspension can be “annulled” once the entity complies with publication, it is not clear that any loss of limited liability protection would be cured retroactively. This concern may not apply to foreign limited liability entities doing business in New York State who may claim that the internal affairs doctrine embodied in New York statutes (see e.g. NYLLC § 802 and NYPL § 121-901), or the doctrines of comity or full faith and credit, may avoid this possible claim.

Although the requirement that the notice of formation be published once a week for a period of six weeks has been reduced to once a week for a period of four weeks, the number of lines that must be published has increased. Further, the notice must be published “as though the copy or notice were a notice or advertisement of judicial proceedings.” These changes may increase the cost of publication.

The law poses many interpretative questions, for example, in determining whether limited partners are “actively engaged,” treatment of newly-formed or shelf entities, the meaning of “suspension” and the meaning of “valuable interest.”

It is now rumored that, as part of the politics leading to the signing of Chapter 767, the law will be further amended to (i) eliminate the need to publish the names of the largest interest holders, (ii) increase the number of weekly publications from 4 back to 6, (iii) cut the cure period for existing entities from 18 months to 120 days, and (iv) provide expressly that all members or partners of a domestic or foreign entity which does not publish are jointly and severally liable for the debts and obligations of the entity arising in New York whether before or after such failure to publish.