

PRESENTED AT

LLCs, LPs and Partnerships

July 12-13, 2018
Austin, TX

**Using the Concept of Units in
Operating Agreements for
LLC's and Limited Partnerships**

**Cliff Ernst
Robert R. Keatinge**

Author contact information:

Cliff Ernst
McGinnis Lochridge LLP
Austin, Texas
cernst@mcginnislaw.com
512-495-6012

Robert R. Keatinge
Holland & Hart LLP
Denver, Colorado
rkeatinge@hollandhart.com
303-295-8595

Using the Concept of Units in Operating Agreements for LLC's and Limited Partnerships

Table of Contents

	<u>Page</u>
I. Introduction	1
II. Drafting Examples	2
III. Reasons for Units.....	2
A. A Way to Designate Classes of Ownership	2
B. A Way to Facilitate Calculation of Percentages, Transfers of Ownership and Offerings	3
C. A Way to Facilitate Voting	3
IV. Authorized Units.....	4
V. Pitfalls	4
A. Creating Units in an Operating Agreement Does Not Automatically Create Certificated Interests or Impose UCC Chapter 8 Treatment	5
B. Interests in an Unincorporated Entity Are Not Fungible	5
C. The Concept of “Treasury Units” Raises Many Difficult and Unresolved Questions	6
D. Unit Ownership Versus Capital Accounts	9
E. Tax Problem –Divided Holding Period, Undivided Partnership Interest	10
VI. Conclusion	10

Using the Concept of Units in Operating Agreements for LLC's and Limited Partnerships

Cliff Ernst
McGinnis Lochridge LLP
Austin, Texas

Robert R. Keatinge
Holland & Hart LLP
Denver, Colorado

I. Introduction.

Many operating agreements for limited liability company agreements and limited partnerships use the concept of “units” to describe ownership interests in the entity. “Units” is not a concept or term used in the Texas Business Organizations Code¹ or the Delaware Limited Partnership Act² or the Delaware Limited Liability Company Act.³ The Texas Business Organizations Code uses the term “Member” to describe a person who has been admitted as a member of limited liability company⁴ and uses the term “Membership interest” to describe a member’s ownership interest.⁵ The Texas Business Organizations Code uses the term “Partner” to describe a limited partner or a general partner⁶ and uses the term “Partnership interest” to describe a partners’ interest in a partnership.⁷ The Delaware Limited Partnership Act defines an ownership interest in a limited partnership as a “Partnership interest”.⁸ The Delaware Limited Liability Company Act defines an ownership interest in a limited liability company as a “Limited liability company interest.”⁹

The concept of “units” is a concept borrowed from the corporate context,¹⁰ but the term “unit” generally represents a slightly different economic concept than does the corporate term “share.” The Texas Business Organizations Code and the Delaware General Corporation Law

¹ TEX. BUS. ORGS. CODE ANN. § 1.001 et seq.

² DEL. CODE ANN. Title 6 § 17-101 et seq.

³ DEL CODE ANN. Title 6 § 18-101 et seq.

⁴ TEX. BUS. ORGS. CODE ANN. §1.002(53).

⁵ *Id* §1.002(54).

⁶ *Id* §1.002(66).

⁷ *Id* §1.002(68).

⁸ DEL CODE ANN. Title 6 § 17-101(13).

⁹ *Id* § 18-101(8).

¹⁰ The Texas Business Organizations Code uses the term “Share” to define “a unit into which the ownership interest in a ... corporation . is divided.” TEX. BUS. ORGS. CODE ANN. §1.002(80).

contain extensive and detailed provisions about the issuance and management of shares.¹¹ No similar provisions appear about unitizing ownership interests appear in the Texas Business Organizations Code, the Delaware Limited Liability Company Act or the Delaware Limited Partnership Act. This places a burden on drafters of operating agreements for unincorporated entities to use thoughtfulness and care when incorporating the concept of “units” to avoid ambiguity and unintended consequences. This paper will examine some of the benefits of using the concept of “units” and, more importantly, some of the pitfalls to be avoided.

II. Drafting Examples.

A survey of limited liability company agreements and limited partnership agreements reveals that, as with most provisions of the operating agreements of unincorporated entities, these provisions can be drafted in a simple manner, or can be drafted in a manner whose complexity is only limited by the imagination and creativity of the draftsman. Examples of unit language are attached for purposes of illustration.¹² Attached to this paper as Appendix A is an example of simple provisions for units, including the accompanying definitions. Notice that these provisions do not attempt to replace the concept of “Membership Interests,” but only use the concept of “Units” as a way to calculate “Percentages.”¹³ Attached to this paper as Appendix B is an example of a complex provision for multiple classes of units with differing rights for each class.

III. Reasons for Units.

The major thrust of this paper will be an examination of problems encountered through the use of units as a way to describe ownership interests in limited liability companies and limited partnerships. But, despite the risks of potential problems, and with due reference to the discussions that follow, we will begin by describing why a draftsman might want to consider designating ownership interests as units.

A. A Way to Designate Classes of Ownership.

The Texas Business Organizations Code contemplates the operating agreement of a Texas limited liability company may establish classes of ownership¹⁴ and the Delaware

¹¹ See, for example: Title 2, Subchapter D. Shares, Options, & Convertible Securities, TEX. BUS. ORGS. CODE ANN. §21.151 through §21.173; Title 2, Subchapter F. Reductions in Stated Capital, Cancellation of Treasury Shares, TEX. BUS. ORGS. CODE ANN. §21.251 through §21.254; Title 2, Subchapter G. Distributions & Share Dividends, TEX. BUS. ORGS. CODE ANN. §21.301 through §21.318; and Delaware Corporation Laws Chapter 1, Subchapter V. Stock and Dividends § 151 through § 174.

¹² The sample provisions included in the appendices to this paper are included for purposes of illustration only and it is not suggested that this language is “form” language that should be inserted into operating agreements without careful consideration of all other relevant provisions of the agreement and appropriate editing to reflect the business terms of the transactions contemplated by the parties.

¹³ It is in this respect that the concept “unit” – which generally defines a share of profits, losses, operating distributions, and sometimes voting – differs from that of a corporate “share,” which represents a shareholder’s entire economic and voting interest in a corporation.

¹⁴ *Id* § 101.104.

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](https://utcle.org/elibrary)

Title search: Using the Concept of Units in Operating Agreements for LLC's and Limited Partnerships

Also available as part of the eCourse

[2018 LLCs, LPs, and Partnerships eConference](#)

First appeared as part of the conference materials for the
27th Annual LLCs, LPs and Partnerships session
"Units: Less There Than Meets the Eye"