

NEW YORK
CITY BAR

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April 19, 2006

The Honorable George E. Pataki
Executive Chamber
State Capitol
Albany, New York 12224

Re: S.6831 and A.10399 – Opposition to Certain Amendments to the
Limited Liability Company Law and the Partnership Law Relating
to Sanction for Non-Publication of Notices

Dear Governor Pataki:

The Committee on Private Investment Funds of the New York City Bar (the “*Committee*”) is composed of lawyers with diverse perspectives on investment advisory issues, including members of law firms and counsel to private advisory and financial services firms. The Committee focuses on, among other things, the issues, trends and regulations relating to a wide variety of private investment funds, including buyout funds, venture capital funds, mezzanine funds, distressed funds, hedge funds and funds of funds. (*A list of our current members is attached.*)

In many cases, private investment funds sponsored in the United States are organized as limited liability companies or limited partnerships under the laws of the State of Delaware and, in some instances, qualify to do business in the State of New York. The general partners or managers who operate or advise these private investment funds are themselves typically organized as limited liability companies or limited partnerships under the laws of the State of New York or under the laws of the State of Delaware and, if necessary or appropriate, qualify to do business in the State of New York.

The Committee strongly opposes S.6831 and A.10399 (the “*Proposed Amendments*”), which propose to amend Chapter 767 of the laws of 2005 (“*Chapter 767*”) by, among other changes, amending the proposed sanction for failure to comply with the publication requirements

under the New York Limited Liability Company and New York Partnership Laws. Pursuant to the Proposed Amendments, noncompliance with the publication requirements results in joint and several liability for the owners of limited liability companies or limited partnerships. The issues raised by the Proposed Amendments have significant and serious consequences for the community of private investment funds and their general partners or managers that engage in business in the State of New York. Accordingly, we respectfully ask you to consider the following arguments against the bill.

Legislative Uncertainty and Controversy. The legislative purpose of the Proposed Amendments was to make technical and clarifying amendments to Chapter 767 in order to remedy the state of the current law. The sponsoring memos provide that the bill was introduced at your request for this very purpose. Chapter 767 previously amended the New York Limited Liability Company Law and the New York Partnership Law (among others) by replacing the previously existing sanction for noncompliance with the publication requirement (the prohibition from maintaining any action or special proceeding in the State of New York) with a new sanction (the suspension of authority to carry on, conduct or transact any business in the State of New York). The new sanction was not clearly defined in the law; on the contrary, the law provided the assurance that neither the failure of the entity to publish nor its suspension due to such failure will limit or impair the validity of any contract or act of such entity or any right or remedy of any other party under or by virtue of any contract, act or omission of such entity. Accordingly, under the current law, it is unclear what exactly the sanction for failing to publish is.

The Proposed Amendments were intended to remedy this lack of clarity. However, they astonishingly avoided providing a meaningful clarification and instead inserted a radical position in its place – the removal of limited liability protection from the owners of these entities. This new sanction resulting from a failure to comply with the publication requirements, rather than clarifying the law, increases the uncertainty surrounding such noncompliance. This is especially the case for foreign entities that were formed outside the State of New York and have qualified or intend to qualify to do business in the State of New York. These foreign entities are governed by the laws of the jurisdiction in which they were formed in matters of personal liability of their owners. As a result, we believe that it is unlikely that this law will withstand a constitutional challenge for restricting interstate commerce. Instead of clarifying the law, the Proposed Amendments introduce a new and controversial provision, which will in itself cause much uncertainty, legal challenge and discredit for the laws of the State of New York.

Fiscal Implications - Loss of Revenue to the State. Contrary to the statement in the sponsoring memos of the Proposed Amendments that these amendments will have no fiscal implications, we believe that the effect of the new sanction will be to deter persons from forming such entities under New York law altogether, thus depriving the State of New York of income it would have derived from the registration of such entities. Since entities formed in the State of New York would be subject to the new law, they would become the only such entities to be penalized by the new sanction, and therefore would be at a severe disadvantage (as compared to foreign entities such as Delaware entities that are not subject to such penalties). The main impact of such a severe imbalance between locally formed entities and foreign entities would be to completely

deter people from forming limited liability companies or partnerships in the State of New York. Significantly, many investment managers conduct their business in the State of New York (in whole or in part) through non-New York entities. To the extent a nexus to the State of New York might raise an issue as to limited liability, an investment manager might choose to close its New York office to avoid any connection to the State of New York. This could lead to a dramatic loss in revenues.

Harm to Investors. Subjecting owners of limited liability companies and partnerships to the risk of joint and several liability far outweighs any supposed benefit that the State of New York would reap from increased compliance with the publication requirement, and indeed is completely disproportional to the effect of a failure to publish. Signing the Proposed Amendments in their current state into law would potentially expose thousands of unsuspecting owners of such entities (including passive investors with no ongoing responsibility or control of the businesses in which they invest) to personal liability and significant financial risk that could be enforced by creditors of such entities to the financial ruin of investors. These investors often include individuals as well as institutional investors. Further, many state and local government pension plans are active investors in private investment funds. The Proposed Amendments will potentially subject all of the assets of those plans to claims of an investment fund's creditors if the investment manager, through no fault of the investor (and without the investor's knowledge) fails to comply with the publication requirement.

The Committee does not contest the Proposed Amendments on the whole and believes that they encompass an important provision that would remedy a serious problem introduced by Chapter 767 – that of eliminating the publication of the names of the “top ten” persons holding interests in the entities. This requirement serves no legitimate consumer protection purpose. Chapter 767's “top ten” names publication is not only a violation of legitimate expectations of privacy, but also creates numerous interpretive problems and inconsistencies. We support the Proposed Amendments' rollback of this provision.

While the Committee believes that the best course for the State of New York is to do away with the publication requirement entirely (in most other states, the modern trend has been against publication altogether), it is our belief that it is much more important to seek removal of the threatened sanction in the Proposed Amendments, while at the same time preserving the core of the Proposed Amendments (which is the removal of the “top ten” publication requirement). The Committee also opposes the additional measures in the Proposed Amendments that require notices to be published for 6 weeks (instead of the current 4 weeks) and require entities to comply within 120 days (instead of the current 18 months).

* * *

The proposed sanction of removing the limited liability protection of owners of limited liability companies and partnerships due to a lack of publication, as contemplated by the Proposed Amendments, represents a disproportionate and extreme penalty under the laws of the State of New York. We very much hope that these

comments and observations will persuade you to cause the necessary changes to be made to S.6831 and A.10399, or to veto them in their current state.

The comments and observations set forth in this letter by the Committee do not necessarily represent the views of the firms or companies with whom the Committee members are associated or the clients that they represent.

Very truly yours,

A handwritten signature in black ink, appearing to read 'M. Masotti', written over a horizontal line.

Marco V. Masotti, Chair
Committee on Private Investment Funds

cc: Senator Joseph L. Bruno, Senate Majority Leader
Assemblyman Paul A. Tokasz, Assembly Majority Leader
Richard Platkin, Counsel to the Governor
Jeffrey Lovell, Senior Policy Advisor to the Governor
John Haggerty, State Government and Legislative Affairs Executive Director

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