

Date: February 16, 2015
To: All Texas Agents
From: David M. Hays, Underwriting Counsel
RE: Guide to Business Entities

With the increase in commercial closings, the underwriting counsel at FNTI thought it important to review some basic business entity information, guidelines, and FNTI underwriting requirements as they relate to verifying a business entity's authority to execute closing documents. Please keep in mind that these are general guidelines intended to aid the closing agent and examiner in the review of basic entity transactions. In addition, any requirements are those of FNTI and not of any other underwriter. If you are not issuing a title policy on FNTI, please contact the underwriter on which you intend to issue the policy.

Types of Business Entities

We are generally presented with the following basic business entities:

1. Corporation (Corp., Inc., or Company)
2. Limited Liability Company (LLC)
3. Limited Partnership (LP, Limited or LTD)
4. General Partnership (GP)
5. Joint Venture (JV)
6. Limited Liability Partnership (LLP)
7. Foreign Business Entity (FBE)

1. Corporations (For Profit, Non-Profit and Professional Corporations) - Inc., Corp., Company

Corporations are comprised of shareholders who elect a board of directors. The board of directors adopts by-laws (the internal document governing day-to-day operations of the corporation) and chooses officers to manage the day-to-day affairs of the corporation. Corporations must be registered with the Texas Secretary of State. In addition, Texas law requires an annual meeting of shareholders of a corporation in order to elect directors of the corporation who in turn elect the corporate officers.

When presented with a corporation in title, examiners and closers should require the following:

1. Certificate of Formation filed with the Texas Secretary of State (*Articles of Incorporation for corporations registered prior to January 1, 2006*).
2. Certificate of Filing issued by the Texas Secretary of State.
3. Printed copy of Franchise Tax Account Status (aka Certificate of Account Status fka Certificate of Good Standing) from the Texas Comptroller's office showing the entity in an "Active" status.

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4. By-Laws of the corporation.
5. Corporate Resolution/Annual Meeting minutes executed during the current year identifying the current board of directors and/or the present officers (president, vice president and secretary).
6. Corporate Resolution executed by the current board of directors or officers of the company identifying the property by legal description and specifically authorizing the proposed transaction and the authority of the individual(s) authorized to execute documents on behalf of the company. (The two corporate resolutions can be combined into a single corporate resolution containing all of the require information.)

2. Limited Liability Company - LLC (and Professional Limited Liability Companies - PLLC)

Limited Liability Companies have become the entity of choice for most entrepreneurs. LLCs are afforded a much more flexible operating environment making it easier for smaller entities (by number of controlling individuals) to maintain compliance with state regulations. LLCs can be composed of individuals and/or other business entities owning a percentage of the LLC's membership interest, called Members. An LLC will either be managed by its members (Member Managed) or by a manager that is appointed by the member(s) in which case the LLC is said to be a Manager Managed LLC. The internal affairs of an LLC are governed by a Company Operating Agreement (also referred to as Company Agreement or LLC Agreement or similar reference). A review of the LLC's Certificate of Formation and/or Operating Agreement will (a) show whether the LLC is Member Managed or Manager Managed; (b) list the original members of the LLC; (c) identify the manager of the LLC if it is Manager Managed; and (d) set forth the powers of the members and managers.

When presented with a Limited Liability Company in title, examiners and closing agents should require the following:

1. Certificate of Formation filed with the Texas Secretary of State.
2. Certificate of Filing issued by the Texas Secretary of State.
3. Printed copy of Franchise Tax Account Status (aka Certificate of Account Status fka Certificate of Good Standing) from the Texas Comptroller's office showing the entity in an "Active" status.
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4. Consent Agreement or Resolution signed by the all the existing members of the company identifying the property by legal description and specifically authorizing the proposed transaction and the authority of the individual(s) authorized to execute documents on behalf of the company. (May be waived by FNTI underwriting counsel.)
5. If the Manager of the LLC (or one of the members) is another business entity, the closing agent shall request the appropriate entity documentation (per this bulletin) based on the type of entity. When the signature block involves multiple, stacked business entities, the closing agent must drill down to an individual authorized to sign on behalf of any entity whether it is the primary entity in title or a sub-entity affiliated with the primary entity in title. For example, if XYZ, LLC has only a sole member and this sole member is ABC, LLC (a sub-entity), it is not enough to obtain items 1-3 above for the primary entity; we must verify if ABC, LLC, the sub-entity, is a valid entity and determine the individual authorized to act on behalf of ABC, LLC.

6. It is often the case that in the LLC Operating Agreement for a Manager Managed LLC, the “Management” section of the agreement generally authorizes the manager, or in the case of a Member Managed LLC, a single member, to deal with the real property owned by the company. In some instances, FNTI may require that all members of the LLC execute a Consent Agreement or Company Resolution to confirm that the members are aware of the sale and that there is no discord between the current members and/or managers of the company and that the member or manager who is proposing executed closing documents continues to be authorized to do so.

3. Limited Partnership – LP

Limited Partnerships are a very common form of business entity used by businesses in the real estate industry and businesses that own their own real estate due to the added protections such an entity affords its individual partners. It is important for the closing agent to understand the mechanics of a limited partnership before delving into the requirements.

Limited Partnerships are comprised of two distinct parts—limited partners, who are **prohibited** from being active in day-to-day operations of the company, and a general partner who **is responsible** for the day-to-day operations of the company. Both the limited partners and the general partner can be comprised of natural persons and/or sub-entities. Limited partners' roles are by definition “limited” to investing in the company and voting on matters that don’t concern the day-to-day operations of the company. A Limited Partnership’s internal governing document is typically referred to as a Limited Partnership Agreement. The LP Agreement sets forth the limited partners and the general partner as well as the power and authority of the general partner to act on behalf of the company. Similar to an LLC that may be comprised of sub-entities, if the LP Agreement designates a general partner, which itself is another business entity, (again this is the most common occurrence) the closing agent must drill down to an individual authorized to sign on behalf of the general partner entity by requiring the appropriate entity documents. For example, if *ABC, LP a Texas Limited Partnership* is vested in title, and a review of the LP Agreement indicates that XYZ, LLC is the named general partner, the closing agent should request the entity documents for XYZ, LLC in order to determine the individual authorized to sign on behalf of XYZ, LLC in its role as general partner of ABC, LP. As previously stated, the LP Agreement will set forth the authority of the general partner. Examiners and closing agents should review the management provisions of the LP Agreement as they will often require a vote of the limited partners for certain actions that are not considered being in the ordinary course of business. These “out of the ordinary acts” are typically defined in the LP Agreement. For instance, the LP Agreement for a limited partnership whose day-to-day business is the sale of automobiles, may contain a provision in the management section of the agreement requiring the limited partners to vote on the sale of any real property because the sale of real property is not part of the company’s day-to-day business operations. Even a limited partnership that **is** in the business of buying and selling real property may include a limiting provision in the LP Agreement that limits the authority of the general partner to act in certain instances. For example, a provision that the purchase or sale of any property in which the sales price exceeds \$500,000.00 requires the vote of a majority of the limited partners. Closing agents and examiners should be reviewing the LP agreement for such provisions.

When presented with a Limited Partnership in title, examiners and closing agents should require the following:

1. Certificate of Formation of Limited Partnership from Texas Secretary of State.
2. Certificate of Filing from Texas Secretary of State.
3. Printed copy of "Franchise Tax Account Status" from the Texas Comptroller's office showing the entity in an "Active" status.
4. Limited Partnership Agreement.
5. Entity documentation for the general partner.

4. General Partnership - GP

General Partnerships or sometimes simply Partnerships, arise when two or more individuals and/or business entities come together to form a relationship with the intention of carrying on a trade or business. General Partnerships are a rarely used form of business entity due the unlimited liability imposed on each individual partner for the acts of the partnership. General partners lack any of the formalities of the registered entities described above. General Partnerships are not required to file formation or registration applications with the Secretary of State. The partners need only a verbal agreement to form the partnership relationship for a general partnership to arise. However, in order to advertise using a business name, the General Partnership must file for and obtain an assumed name certificate from the Secretary of State and filed in the county in which the partnership is principally located. For example, if Horace Smith and Daniel Wesson agree to form a general partnership to go into business selling rifles and they wish to refer to their newly formed partnership as Smith & Wesson, they would need to obtain an assumed name certificate from the Secretary of State.

When presented with a General Partnership in title, examiners and closing agents should require the following:

1. Partnership Agreement if such an agreement exists.
2. Joinder of all Partners on closing documents.
3. Assumed Name Certificate if partners are doing business under some other trade name.

Note that there are no formal documents to be obtained from the state.

5. Joint Venture - JV

Joint Ventures are similar to General Partnerships in that they arise when two or more individuals, groups, associations, or entities come together to form a relationship with the intention of carrying on a trade or business. The key distinction between a GPs and JVs is that a JV is typically formed for a specific business purpose and for a defined, finite period of time. A joint venture may be comprised of two or more individuals or can be comprised of two or more business entities in order to limit individual liability. The need for a joint venture usually arises when a business entity that is an expert in one industry requires the expertise of a business entity in another industry for a particular purpose and time. For instance, the developer of a commercial subdivision might form a joint venture with a highly respected commercial real estate brokerage to market and sell the commercial units until such time as the units are 90 percent

sold. The JV agreement differs from a GP agreement in that it must contemplate more specific provisions such as division of profits, authority matters, and termination of the joint venture. However, the JV is similar to a GP in that, for the joint venture itself, there are no formal documents required to be registered with the State—although keep in mind that if the JVs is comprised of two or more, underlying registered business entities, closers and examiners are required to review entity documents for all of the partners in the joint venture. Also, like a GP, a JV will often operate under an assumed name. In such cases, the closing agent or examiner must be provided with an assumed name certificate.

When presented with a Joint Venture in title, examiners and closing agents should require the following:

1. Joint Venture Agreement.
2. Entity documents for any of the sub-entities making up the joint venture, per the guidelines herein.
3. Assumed Name Certificate if applicable.

6. Limited Liability Partnership - LLP

Limited Liability Partnerships are a rarely used business entity with the Texas Legislature's passage of the use of LLCs in 1991. However, we are presented with LLPs on occasion. Limited Liability Partnerships are similar to standard partnerships. The primary difference between the two entities is that while all of the partners of a general partnership maintain unlimited, personal liability for the acts of other partners, partners in an LLP are not liable for the negligence or misconduct of other partners. From a formation perspective, LLPs differ from general partnerships in that the LLP must register with the Secretary of State.

When presented with a Limited Liability Partnership in title, examiners and closing agents should require the following:

1. Certificate of Formation of Limited Partnership from Texas Secretary of State.
2. Certificate of Filing from Texas Secretary of State.
3. Printed copy of "Franchise Tax Account Status" from the Texas Comptroller's office showing the entity in an "Active" status.
4. Limited Liability Partnership Agreement.
5. Entity documentation for the general partner where necessary.
6. Assumed Name Certificate if partners are doing business under some other trade name.

7. Foreign Business Entities (Foreign Corporations, Foreign LLCs, Foreign LPs., etc.)

Foreign Business Entities (FBE) are entities registered or authorized under another state's laws but who intend to transact business in Texas. FBEs who "regularly transact business in Texas" are required to register with the Texas Secretary of State. There is not a black and white definition of what it means to regularly transact business. It is unlikely that a business entity that buys or sells a single property in a given year would be considered to be regularly transacting business. However, if the entity is in the business of buying and selling property and closes a number of transactions per year, it is likely that such an entity would be required to register with the State.

When presented with a Foreign Business Entity in title, examiners and closing agents should require the following:

1. Request any documentation from the client related to the registration of the entity in the foreign jurisdiction. Closing agents and examiners should be looking for documents similar to those required for domestic, Texas entities, as set forth herein.
2. Application for registration of the foreign entity with the Texas Secretary of State if it is known or believed by the closing agent or examiner that the entity regularly transacts business in Texas. If the closing agent is unsure of the business activities of the entity, the closing agent should ask the client.
3. Certificate of Filing from the Texas Secretary of State if FBE is registered with the State.