A DYNAMIC DUO: SOUTH DAKOTA'S TRUST LAWS & BUSINESS ENTITY STATUTES

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There are several reasons for the robust growth of South Dakota's trust industry. Not to be overlooked as a catalyst for that growth are South Dakota's much heralded business entity statutes. Pairing a South Dakota limited liability company or limited partnership with a South Dakota trust provides families with a dynamic duo that achieves a multitude of planning objectives. This article will survey South Dakota's entity choices and generally discuss opportunities to pair South Dakota entities and trusts.

I. INTRODUCTION

When a South Dakota trust is combined with a South Dakota limited liability company or limited partnership, a dynamic duo is unleashed. A dynamic duo is defined as "a powerful pair of people or things each with special abilities."[2] The most relatable dynamic duo screams back to childhood and Batman and Robin of DC comics fame. As the years—and experiences—pile up, we become familiar with dynamic duos in music, movies, comics, food pairings, and wine pairings. Upon encountering a dynamic duo, the special abilities of each partner in the duo and what makes them great together are self-evident. To meet the needs of families who require powerful planning options to achieve their goals and objectives, their advisors seek a jurisdiction that satisfies client demands. South Dakota offers families and their advisors the dynamic duo of its trust laws and business entity statutes, each with their own special abilities. Other articles in this symposium edition will discuss the special attributes of South Dakota's trust laws. This

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[2] *Dynamic Duo*, THE DICTIONARY OF AMERICAN SLANG (4th ed. 2007).

article will survey South Dakota's limited liability company and limited partnership statutes and generally discuss planning opportunities to pair a South Dakota entity with a South Dakota trust.

The growth of South Dakota's trust industry is remarkable, but not accidental. As of July 2016, South Dakota possessed 84 state chartered, non-depository, trust services only private and public trust companies with a total of $226 Billion in assets under management.[3] The steady growth of the trust industry marks its beginning in 1997 when Governor Bill Janklow created the Governor's Task Force on Trust Administration Review and Reform ("TTF").[4] This partnership between representatives from the trust industry and state government working together to enhance South Dakota's trust laws in a balanced and prudent fashion has proven effective. No other state has such a partnership.

The TTF confines its legislative recommendations to trust law. However, working closely with members of the TTF, the State Bar of South Dakota Business Law Committee tends to South Dakota's business laws to hone their special abilities as the other half of the dynamic duo.[5] In support of the effectiveness of South Dakota's dynamic duo, take note of the annual article published by *Trusts & Estates Magazine*, which compares and ranks the states who actively compete for clients to utilize the laws of their state to accomplish planning goals.[6] Since the inception of the annual rankings by the authors of *Trusts & Estates Magazine*, South Dakota

[3] SOUTH DAKOTA DEP'T OF LABOR & REGULATION, DIV. OF BANKING, TRUST COMPANIES LICENSED TO DO BUSINESS IN SOUTH DAKOTA AS OF JULY, 2016. Note these numbers do NOT include depository banks with trust departments. Doing so would swell these numbers even more. For comparison, in 2011, South Dakota had 55 state chartered trust companies with $104 Billion under management.

[4] The author has served on the TTF since its inception in 1997 and annually testifies on TTF legislation introduced in the South Dakota legislature.

[5] The author has been a member of the Business Law Committee of the State Bar of South Dakota since 1994 and served as its Chair from 1999-2005 & 2007-2011, at which point the author became State Bar President. He continues to serve on the Business Law Committee.

[6] Daniel G. Worthington & Mark Merric, *Which Situs is Best in 2016?*, TRUSTS & ESTATES, Jan. 2016, at 62-63.

has finished in the top-tier every year.[7] In fact, in 2007, prior to grouping the states by tiers, South Dakota was ranked as the number one trust jurisdiction by *Trusts & Estates Magazine*.[8]

One key component to the rankings is the comparison of asset protection features of each state's limited liability company and limited partnership statutes.[9] Annually, South Dakota's entities have enjoyed the label of a "Best" jurisdiction for asset protection purposes.[10]

This article will discuss the South Dakota limited liability company ("LLC") and limited partnership ("LP") acts. The statutory provisions for South Dakota's LLCs are found at South Dakota Codified Laws ("S.D.C.L.") Chapter 47-34A.[11] The statutory provisions for South Dakota's LPs are found at S.D.C.L. Chapter 48-7.[12] Both entity choices feature a substantial asset protection shield, flexibility in structuring the governance of the entity to achieve centralization of management and impose transfer restrictions to protect the assets owned by the entity from the risks posed by a member's or partner's creditors, predators, in-laws, and outlaws.

An important distinction needs to be observed regarding how a LLC or LP is used in alliance with a South Dakota trust. The discussion in this article focuses on protecting the assets owned by the entity from the hazards of life and those who prey on, or obtain judgments against, members, partners, or beneficiaries of entities and trusts. This article is not a discussion of using the LLC or LP to shield the member or partner from the risk of liability for the business activities conducted by the LLC or LP. There is no doubt about the efficacy of the LLC or LP as a shield for the member's and partner's against unlimited exposure to liability for the activities of a business operated by a limited liability entity, or as a shield against the liability of other members

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[7] *Id.* at 62-63.
[8] Daniel G. Worthington, *Perpetual Trust States—The Latest Rankings: A Guide to Picking the Best Jurisdiction for Your Client*, TRUSTS & ESTATES, Jan. 2007, at 59.
[9] Worthington & Merric, *supra* note 6, at 81.
[10] *Id. See infra*, Part II.A.
[11] S.D.C.L. ch. 47-34A (2007 & Supp. 2015).
[12] S.D.C.L. ch. 48-7 (2004 & Supp. 2015).

or partners.[13] However, pairing a LLC or LP with a South Dakota trust provides a dual shield to protect assets. The first shield wraps the closely held business interest, portfolio of marketable securities, or real property, in a LLC or LP. The next shield is created when the units issued by the entity are transferred to a South Dakota trust.[14] The dual shield provided by a South Dakota trust and limited liability entity creates a dynamic duo which stands as guardian and sentinel, vigilantly protecting the family's assets from attack by nefarious characters seeking to take advantage of a member, partner, or beneficiary.

II. ANALYSIS

A. THE LEAD NOTE IN THE ASSET PROTECTION DISCUSSION: THE CHARGING ORDER REMEDY

The lead note in the asset protection discussion is the strength of South Dakota's statutory language which describes a judgment creditor's very limited rights under a charging order against a member of a LLC[15] or a partner in a LP.[16] A charging order constitutes a lien on the partner's or member's distributional interest in the entity.[17] In other words, the charging order limits a judgment creditor's remedy against a partner or member to a lien on the partner's or member's distributions from a LLC or LP and prohibits the creditor from seizing or selling assets owned by the entity. The charging order creates a significant roadblock to the disruption of the entity's business by a creditor-plagued member or partner.[18]

In connection with a LLC, S.D.C.L. section 47-34A-504 now states:

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[13] *See generally* Thomas E. Rutledge, *Limited Liability (or Not): Reflections on the Holy Grail*, 51 S.D. L. REV. 417 (2006) (defining the uses of LLCs and LLPs and identifying statutory exceptions which take away from both entity's ability to act as a shield against liability).
[14] *See infra* Part II.D.
[15] *See* S.D.C.L. § 47-34A-504 (2007 & Supp. 2015).
[16] *See* S.D.C.L. § 48-7-703 (2007 & Supp. 2015).
[17] S.D.C.L. § 47-34A-504(b). *See also* LARRY E. RIBSTEIN & ROBERT R. KEATINGE, 1 RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 7:8 (2d ed. 2013) (explaining a charging order is a remedy only available to a judgment creditor and is not available to divorced spouses under an alimony decree and others with rights against a member or partner).
[18] William S. Forsberg, *Asset Protection and the Limited Liability Company: Not the Panacea of Creditor Protection that you Might Think!*, PROBATE & PROPERTY, Nov./Dec. 2009 Vol. 23 No. 6, at 39.

(a) On application by a judgment creditor of a member of a limited liability company or of a member's transferee, and following notice to the limited liability company of such application, a court having jurisdiction may charge the distributional interest of the judgment debtor to satisfy the judgment.
(b) A charging order constitutes a lien on the judgment debtor's distributional interest.
(c) A distributional interest in a limited liability company which is charged may be redeemed:

(1) By the judgment debtor;

(2) With property other than the company's property, by one or more of the other members; or

(3) With the company's property, but only if permitted by the operating agreement.

(d) This chapter does not affect a member's right under exemption laws with respect to the member's distributional interest in a limited liability company.
(e) This section provides the exclusive remedy that a judgment creditor of a member's distributional interest or a member's assignee may use to satisfy a judgment out of the judgment debtor's interest in a limited liability company. No other remedy, including foreclosure on the member's distributional interest or a court order for directions, accounts, and inquiries that the debtor member might have made, is available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's interest in the limited liability company.
(f) No creditor of a member or a member's assignee has any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the company.
(g) This section applies to single member limited liability companies in addition to limited liability companies with more than one member.[19]

Concerning a LP, South Dakota Codified Law section 48-7-703 now states:

On application to a court of competent jurisdiction by any judgment creditor of a partner, the court may charge the partnership interest of the partner with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the partnership interest. This chapter does not deprive any partner of the benefit of any exemption laws applicable to the partner's partnership interest.

This section provides the exclusive remedy that a judgment creditor of a general or limited partner or of the general or limited partner's assignee may use to satisfy a judgment out of the judgment debtor's interest in the partnership. No other remedy, including foreclosure on the general or limited partner's partnership interest or a court order for directions, accounts, and inquiries that the debtor, general or limited partner might have made, is available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's interest in the

[19] S.D.C.L. § 47-34A-504.

> limited partnership. No creditor of a partner or a partner's assignee has any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the partnership.[20]

Earlier versions of S.D.C.L. sections 47-34A-504 and 48-7-703 were unaltered from uniform acts authored by the National Conference of Commissioners on Uniform State Laws ("NCCUSL").[21] While the statutes describing the limited rights of a judgment creditor under the respective uniform acts appeared to be clear and unambiguous, wily judgment creditors could exploit the statutes for what they did not state. The threat posed by a court finding a legal or equitable basis to force the transfer of assets owned by the entity directly to a judgment creditor, which allowed the creditor to judicially foreclose on a member's or partner's interest, or allowed the judgment creditor to exercise management control over the entity was unacceptable. Any of these results would be devastating. To eliminate the threat, South Dakota law provides that a judgment creditor's sole and exclusive remedy is to obtain South Dakota's version of a charging order against a member's or partner's distributions from the entity.[22] South Dakota's statutory language is even more clear and unambiguous in declaring the very limited rights of a judgment creditor and the prohibition of a court to expand the creditor's sole and exclusive remedy.

Illustrating South Dakota's commitment to clarity, when commentators speculated whether the charging order remedies could be enforced against a single member LLC ("SMLLC"), the South Dakota Legislature responded again by adding S.D.C.L. section 47-34A-504(g), which states, "This section applies to single member limited liability companies in

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[20] S.D.C.L. § 48-7-703 (2004 & Supp. 2015).

[21] UNIF. LTD. P'SHIP ACT § 504 (UNIF. LAW COMM'N 1996), http://www.uniformlaws.org/shared/docs/limited%20liability%20company/ullca96.pdf
The pre-2007 version of S.D.C.L. § 48-7-703 stated: "On application to a court of competent jurisdiction by any judgment creditor of a partner, the court may charge the partnership interest of the partner with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the partnership interest. This chapter does not deprive any partner of the benefit of any exemption laws applicable to his partnership interest." Unif. Ltd. P'ship Act Enacted, 1986 S.D. Sess. Laws, ch. 391, § 703 (referencing the UNIF. LTD. P'SHIP ACT).

[22] S.D.C.L. § 47-34A-504 (2012 & Supp. 2015); S.D.C.L. § 48-7-703.

addition to limited liability companies with more than one member."[23] The basis for speculation arose from the charging order's roots in partnership law.[24] Under partnership law, the intention of the charging order was to protect the interest of the other partners in the partnership.[25] A SMLLC has no other members in need of protection. As a result of this distinction, commentators opined there was support for refusing to limit creditors to the charging order remedy in a SMLLC.[26] The South Dakota Legislature squelched this speculation by amending S.D.C.L. section 47-34A-504 to make it crystal clear the charging order is the judgment creditor's sole and exclusive remedy against the member's interest even in a SMLLC.[27]

In exchange for paying attention to detail in statutory drafting, South Dakota has been awarded with the "Best" designation by the authors conducting the rankings of jurisdictions in the *Trusts & Estates Magazine*.[28] To achieve the "Best" ranking, jurisdictions must have a charging order statute that prevents: "(1) the judicial foreclosure sale of the partner's or member's interest; and (2) provides either a provision denying any legal or equitable remedies against the [entity] or a provision preventing a court from issuing a broad charging order interfering with the activities of the partnership."[29] South Dakota shares the "Best" ranking with seven other states.[30] However, South Dakota's charging order remedy is among the few states that enjoys the rankings trifecta by preventing judicial foreclosure, denying legal or equitable remedies against the entity, *and* preventing a court from issuing a broad charging order.[31]

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[23] S.D.C.L. § 47-34A-504(g).
[24] *See* RIBSTEIN & KEATINGE *supra* note 17, § 7:8.
[25] *Id.*
[26] *Id.*
[27] *See* S.D.C.L. § 47-34A-504(g).
[28] *See supra* notes 19-24 (addressing how South Dakota enacted superior laws pertaining to charging orders).
[29] *See* Worthington & Merric, *supra* note 6, at 75.
[30] *Id.*
[31] To the knowledge of this author, no court opinion has interpreted S.D.C.L. § 47-34A-504 or S.D.C.L. § 47-7-703 as revised. It should also be noted a member or partner who is not a South Dakota resident may be vulnerable to attack by a judgment creditor applying the charging order remedies of the state in which the member or partner

The mere fact a LLC or LP has been formed does not assure asset protection without proper attention to the terms of the organizational documents. The organizers must take care to avoid including terms in the organizational documents that backslide on the creditor protection provisions afforded by statute. For example, if the documents contain language that states members are personally liable for the debts and obligations of the entity, or that a member shall be indemnified and held harmless for their acts, or require a member's mandatory obligation of contribution and indemnity, the asset protection features afforded by state law may be eroded.

Following the lead note struck by the charging order rules in South Dakota, the chorus of good news regarding South Dakota's entity choices continues in the areas of flexible governance structures and the imposition of transfer restrictions on the interests held by members and partners. Each of these features will be generally discussed in the discussion of each entity that follows.

B. Overview of South Dakota Limited Liability Company Statutes

A distinguishing feature of South Dakota trust law is the nineteen-year tradition of settlor sovereignty that has been preserved and enhanced in the revisions to South Dakota's trust laws.[32] The South Dakota Limited Liability Company Act ("SDLLCA"), codified in S.D.C.L. Chapter 47-34A, shares the sovereignty distinction associated with South Dakota's trust laws by containing key provisions that promote organizer sovereignty in the organizational documents that govern a South Dakota LLC. The features of the SDLLCA that manifests organizer

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resides. This result turns on a conflict of laws analysis of the nature of the interest a partner or member has in the entity. If the LLC interest is determined to be personal property, the laws of the state of the owner of the interest applies. If the laws of the partner's or member's state of residence have a more liberal charging order statute, the judgment creditor may obtain additional rights not available under the South Dakota's statutory regime. *See generally Wells Fargo Bank, N.A. v. Barber*, 85 F. Supp. 3d 1308 (M.D. Fla. 2015) (involving a Florida resident who was a member of a foreign SMLLC).

[32] This observation is attributed to former State Sen. Dave Knudsen, who was Co-Chair of the Governor's Trust Taskforce for several years while he was in the South Dakota State Senate.

sovereignty are the flexibility associated with the Act,[33] the statutory authorization to include governance provisions, and transfer restrictions in an operating agreement that fit the family circumstances, limited only by the prohibition to alter non-waivable provisions set forth in the Act,[34] and the South Dakota legislature's pronouncement that the policy espoused by the SDLLCA is freedom of contract.[35] Each manifestation will be discussed below.

The SDLLCA grants organizers the flexibility to fashion an operating agreement as they see fit.[36] The operating agreement regulates "the affairs of the company and the conduct of its business."[37] It also governs the "relations among the members, managers, and the company."[38] The terms of the operating agreement have no limitation, except as provided for in S.D.C.L. section 47-34A-103(b), the non-waivable provisions, which are discussed below.[39] South Dakota Codified Laws section 47-34A-103(a) provides the foundation for flexibility in drafting terms of an operating agreement that make sense for the family.

As new members are added to the LLC, they are deemed to assent to the operating agreement. Thus, the organizers of the LLC (usually the senior generation) can draft an operating agreement with terms the senior generation deems appropriate. When individuals in the junior generation or a trust join the company as new members, they are subject to the terms of the operating agreement, without having to obtain their affirmative consent.[40]

The terms of the operating agreement are limited only by the non-waivable provisions set forth in state law. The SDLLCA lists five provisions that cannot be waived in an operating

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[33] *See* S.D.C.L. § 47-34A-103(a) (2012 & Supp. 2015).
[34] *See id. See also* S.D.C.L. § 47-34A-103(b).
[35] S.D.C.L. § 47-34A-114 (2012 & Supp. 2015).
[36] *See generally* Patrick G. Goetzinger et. al., *The South Dakota Limited Liability Company Act: The Next Generation Begins*, 44 S.D. L. REV. 207 (1999).
[37] S.D.C.L. § 47-34A-103(a); *see also* Goetzinger, *supra* note 36, at 212.
[38] S.D.C.L. § 47-34A-103(a).
[39] *See id. See also* § 47-34A-103(b).
[40] *See id.*

agreement.[41] Even if the members unanimously agree to an operating agreement that waives all or any of these provisions, such waivers would not be enforceable.[42] The five non-waivable provisions are summarized as follows. First, the duty of loyalty may not be eliminated.[43] However, two circumstances are described by statute where the duty of loyalty may be relaxed. The operating agreement may specify activities which members can engage in if the activities are not manifestly unreasonable, and, after full disclosure, allow for the ratification of acts that would otherwise violate the duty of loyalty.[44]

Second, the obligation of good faith and fair dealing may not be eliminated, but the agreement can set the standard by which this obligation is measured, as long as it is not manifestly unreasonable.[45] Third, the right to expel a member, under the circumstances described in the statute, may not be varied.[46] Fourth, a variation of the requirement to wind up the company's business may not be varied.[47] Finally, restrictions imposed on the rights of a person, other than a manager, member, or transferee of a member's distributional interest, except as provided by the SDLLCA, are non-waivable.[48]

Further, if not manifestly unreasonable, the operating agreement may also restrict a member's right to information, access to records, reduce the duty of care, and alter any other fiduciary duty (including elimination of particular aspects of that duty).[49] The SDLLCA gives specific direction to the court in deciding whether an operating agreement provision is manifestly

[41] *Id.*
[42] *Id. See also* Goetzinger, *supra* note 36, at 221.
[43] S.D.C.L. § 47-34A-103(b)(1)
[44] S.D.C.L. §§ 47-34A-103(b)(1)(ii), (2). *See also* Goetzinger, *supra* note 36, at 221.
[45] S.D.C.L. § 47-34A-103(b)(2).
[46] *Id.* § 47-34A-103(b)(3).
[47] *Id.* § 47-34A-103(b)(4).
[48] *Id.* § 47-34A-103(b)(5).
[49] *Id.* § 47-34A-103(c)(1)-(3).

unreasonable.[50] These features of the SDLLCA further highlight the flexibility of the LLC as an entity of choice to comprise the other half of the dynamic duo.

Another important nuance of the SDLLCA is to understand how the default rules embedded throughout the SDLLCA apply to a company's operating agreement and how they can be disengaged through a drafting technique of the operating agreement. South Dakota Codified Laws section 47-34A-103(a) states, "To the extent the operating agreement does not otherwise provide, this chapter governs relations among the members, managers, and company."[51] This statute introduces the concept of default rules contained in the SDLLCA. The default rules allow for a LLC to be formed without a written operating agreement.[52] Members can elect not to put in place an operating agreement and instead allow the terms of the SDLLCA govern the conduct of the members. Alternatively, members can agree to a bare bones operating agreement which alters a handful of default provisions and then defer to the default rules of the SDLLCA on every other issue. An unwritten operating agreement, a bare bones operating agreement, or an operating agreement that allows the statutory default rules to govern is decidedly not a prudent choice for the family that desires centralization of management, transfer restrictions, and protection against predators, creditors, in-laws, and outlaws. Consequently, the operating agreement should contain a provision clearly eliminating all default rules and stating the operating agreement controls all matters between members and managers to the exclusion of all default rules contained in S.D.C.L. chapter 47-34A.[53]

Another drafting tip for the operating agreement is to require all amendments be in writing. This mandate will assist in blocking arguments that course of dealing, course of

[50] *Id.* § 47-34A-103(d).
[51] *See id.* § 47-34A-103.
[52] *Id.* § 47-34A-103(a).
[53] *See* Goetzinger, *supra* note 36, at 222.

performance, and usage of trade are available to determine the terms and meaning of the operating agreement.[54]

The exclamation point to the concept of organizer sovereignty is SDLLCA's freedom of contract statute, which states, "[i]t is the policy of this chapter *and this state* to give maximum effect to the principles of *freedom of contract* and to the enforceability of operating agreements."[55] Adding the references to "this state" and "freedom of contract" in this statute is important because it underscores the legislative intent to treat the operating agreement as a statutory form of contract and the freedom of organizers to determine the terms of that contract.[56] It signals to organizers, members, managers, and courts that it will be extremely difficult to judicially set aside terms in the operating agreement.[57] The bedrock principles of freedom of contract give families confidence that their well-thought-out operating agreements will be enforced. It signals to disgruntled members or those seeking to dismantle an operating agreement that their attempts face a steep uphill grade under the freedom of contract statute.

Other considerations to address in the design of an effective family LLC involve centralization of management decisions and transfer restrictions. Each will be discussed below.

An important choice for advisors to address is whether the family prefers a manager-managed LLC[58] or a member-managed LLC.[59] The fundamental difference between the choices

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[54] *Id.*
[55] S.D.C.L. § 47-34A-114 (emphasis added) (2007 & Supp. 2015).
[56] *Id.*
[57] *Id.* Compare to Delaware Code Section 18-1101(b) which also contains the freedom of contract language. DEL. CODE ANN. tit. 6, § 18-1101(b) (2013). It, however, makes no reference to "this state" in its language. *Id.* It states, "[i]t is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements." *See also* Joan MacLeod Hemingway, *The Ties That Bind: LLC Operating Agreements As Binding Commitments*, SMU LAW REVIEW, Vol. 68, No. 3, Summer 2015, at 811 ("LLC law performs the same function for operating agreements that contract law provides for contracts – namely, it establishes the rules for determining when the terms of a consensual relationship resulting in the formation and maintenance of a LLC are valid, binding on the parties, and enforceable by one party against another as a matter of law. One might then observe that an operating agreement is a statutory form of contract, rather than a common law contract – one with its own legal rules.")
[58] S.D.C.L. § 47-34A-101(11) (2012 & Supp. 2015).

is who has the authority to manage and bind the LLC. In a member-managed LLC, each of the members is vested with the authority to act on behalf of the LLC, much like the governance structure of a general partnership. In a manager-managed LLC, the management of a LLC may be delegated in whole or in part to one or more managers who need not be members.[60] The manager has the sole authority to make business decisions regarding the LLC.[61] The key consideration is whether the family desires centralized management with authority vested in a manager or board of managers, or shared management where all members can bind the LLC. South Dakota law authorizes the distinction between a management class and an economic class of members. This distinction permits the senior generation who organizes the LLC to centralize management control in a single person, multiple individuals, or another entity. Moreover, the option of selecting a manager who is not also a member allows for a broader universe of manager choices and management structures for the LLC.

Providing for an economic class of members, which is distinguished from a management class, allows members to receive distributions from the LLC while confining the members of the economic class to a passive role in the management of the LLC regardless of their ownership interest.[62] The ability to segregate the distributional interest from the management of a LLC promotes creativity in structuring the LLC. If a planning objective is to vest control over the assets owned by the LLC into a management class comprised of a selected family member(s) or trusted family associate(s), which is separate and distinct from a passive membership class who enjoys the economic benefits of the LLC, then a South Dakota manager-managed LLC is the preferred option. The articles of organization should clearly state the LLC is a manager-

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[59] *Id.* § 47-34A-101(13).
[60] *Id.* §§ 47-34A-101(10); 47-34A-404.1(b) (2012).
[61] *Id.*
[62] *Id.* § 47-34A-101(6); *see* RIBSTEIN & KEATINGE, *supra* note 17, § 8.4.

managed LLC.[63] The operating agreement should explicitly set forth the degree of control vested in the management class. Coupled with the freedom to structure the management of the LLC as the organizers see fit, the operating agreement may vest control in a management class (who need not be members) without changing the economic interest of the members.[64]

A common objective in a family LLC is the desire to limit the ownership of LLC interests to family members or other permitted transferees. A distributional interest means only the member's financial interest in the LLC and not the member's management rights.[65] The member's interest is the equivalent to the shareholder's stock in a corporation and analogous to the limited partner's interest in a LP.[66] An operating agreement that includes restrictions that limit the transferability of a member's interest through the imposition of firm but reasonable requirements to comply with before transfers can occur will accomplish this objective.

Structuring the organizational documents for a South Dakota LLC to provide for centralization of management and limit the transferability of an interest sets up the opportunity to apply discounts on the value of a membership unit. An in-depth discussion of discount theory, however, is beyond the scope of this article.[67] If discounts are important to the planning objectives of the family, the content of the organizational documents for the LLC must contain the terms supporting the discounts, the formalities of acting like a LLC should be observed and the LLC must be formed for legitimate, significant non-tax reasons.[68] The LLC documents should demonstrate a valid business purpose for forming the LLC and significant non-tax

[63] S.D.C.L. § 47-34A-203(a)(6) (2012).
[64] RIBSTEIN & KEATINGE, *supra* note 17, § 8.4.
[65] S.D.C.L. § 47-34A-101(5)-(6) (2012 & Supp. 2015); *see also,* RIBSTEIN & KEATINGE, *supra* note 17, § 6.1.
[66] RIBSTEIN & KEATINGE, *supra* note 17, § 6.6-6.7.
[67] Take note of the expected IRS publication on guidance, final regulations or proposed regulations regarding 26 I.R.C. § 2704 (2012) that may have a material impact on discounts on interests in certain LLCs or LPs.
[68] *See generally* Estate of Holliday v. Comm'r, 111 T.C.M. (CCH) 1235 (T.C. 2016) (discussing discount theory in the context of a LP and found protection from trial attorney extortion and potential undue influence of caregivers were not significant, non-tax reasons sufficient to support discounts).

reasons for adopting the features that support taking discounts of the value of LLC units. Significant and legitimate non-tax reasons may include: facilitating the purchase of membership interests between the generations or members; establishing governance rules to deal with non-business members in a LLC; protecting members who are active in the business; consolidating assets to facilitate economies of scale and efficiencies in managing assets under one umbrella; protecting assets from predators, creditors, in-laws, and outlaws; allowing non-business heirs to share in the value of the business as passive members; and to achieve fair versus equal objectives between family members who are active in the business and those who are not.

To further support discounts, the LLC operating agreement must contain provisions that support the fundamental factors that generate discounts for lack of control or centralization of management. To support the discount, the structure of the LLC should be a manager-managed LLC. The rights of members should be substantially limited. However, care should be taken to avoid the inadvertent inclusion of restrictions that backslide on discount objectives. Are the transfer restrictions too restrictive to be considered unreasonable and void? Are the powers of the managers so broad it invites the argument a manager has so much power its as if the assets had not been transferred to the entity at all?

Once in operation, the managers of the LLC must observe the formalities of operating the LLC as a separate and distinct entity to avoid others from successfully piercing the company veil. A detailed discussion of piercing the company veil principles is beyond the scope of this article.[69] However, advisors should be well-versed in counseling clients on how to honor the formalities of acting like a LLC, such as being sufficiently capitalized, adequately insured, filing separate tax returns, avoid commingling personal assets with company assets, and avoid using the LLC to directly pay personal expenses.

[69] *See generally*, RIBSTEIN & KEATINGE, *supra* note 17.

A handful of South Dakota cases have analyzed the application of discounts to the value of a business interest. The application of discounts to the value of bank stock in a sale between unrelated parties was successfully challenged in *First Western Bank Wall v. Olsen*.[70] The court found minority and marketability discounts were inappropriate because a market existed for the shares.[71] The court further observed the application of a lack of marketability discount would unfairly enrich the majority who would reap a windfall.[72]

In *In Re Dissolution of Midnight Star Enterprises*[73] the court engaged in a good discussion of discount and valuation theory in a non-family business dissolution dispute.[74] The court in *Link v. L.S.I., Inc.*[75] applied the same policy as in *First Western Bank Wall* to non-bank corporations.[76] In contrast, in valuing business interests in a divorce case, the court in *Priebe v. Priebe*[77] upheld a forty percent discount for a minority interest in a family business.[78]

Another option offered by the LLC entity that is unavailable for a LP is the use of a single-member LLC ("SMLLC"). South Dakota partnership law requires two or more individuals to form a partnership.[79] A LLC has no requirement on the number of members. A SMLLC is permitted under South Dakota law.[80] One advantage of a SMLLC is its status as a disregarded entity for federal tax purposes. Several planning options, discussed below, call for a trust as the single member of a South Dakota LLC.

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[70] 2001 SD 16, 621 N.W.2d 611.
[71] *Id.* ¶ 28, 621 N.W.2d at 619.¶
[72] *Id.* ¶ 20, 621 N.W.2d at 618.
[73] 2006 SD 98, 724 N.W.2d 334.
[74] *Id.* ¶¶ 16-24, 724 N.W.2d 337-39.
[75] 2010 SD 103, 793 N.W.2d 44.
[76] *Id.* ¶ 12, 793 N.W.2d at 48-49.
[77] 556 N.W.2d 78 (S.D. 1996).
[78] 556 N.W.2d at 83 (S.D. 1996).
[79] S.D.C.L. § 48-7A-202(a) (2012).
[80] *Id.* § 47-34A-202.1(a); S.D.C.L. § 47-34A-101(15) (2012 & Supp. 2015).

While breaking up a South Dakotan LLC is hard to do, the South Dakota Supreme Court in *Kirksey v. Grohmann*[81] ordered the dissolution of Kirksey Family Ranch, LLC, a family LLC that owned ranch land in western South Dakota.[82] In *Kirksey*, the LLC was formed by four siblings, each with an equal interest in the management of the LLC.[83] The ranch land was leased back to the family member who was operating the family ranch.[84] A dispute erupted over several aspects of managing the LLC.[85] The relationship between the members deteriorated, communications broke down, information was suppressed, and information that was distributed was inaccurate.[86] The members were deadlocked on all matters regarding the operation of the LLC.[87] Communication broke down between the manager and members.[88] For these reasons, the court concluded the economic purpose of the LLC was unreasonably frustrated, and it was not reasonably practicable to carry on the LLC's business in conformity with its articles of organization and operating agreement.[89] The court ordered "judicial dissolution and winding up of the company's business under S.D.C.L. section 47-34A-806."[90]

Several important lessons are illustrated by *Kirksey*. First, the LLC was formed by siblings who inherited the ranch land in equal shares from their parents under their estate plan.[91] Siblings, each with an equal share, will produce a vastly different operating agreement than parents seeking to allow children to share in the economic benefit of the assets owned by the LLC while vesting management control in the on-ranch heir. Second, all four siblings had equal

[81] 2008 SD 76,754 N.W.2d 825.
[82] *Id.* ¶ 30, 754 N.W.2d at 831.
[83] *Id.* ¶ 2, 754 N.W.2d at 825.
[84] *Id.* ¶¶ 4-5, 754 N.W.2d at 826.
[85] *Id.* ¶¶ 6-9. 754 N.W.2d at 826-27.
[86] *Id.*
[87] *Id.*
[88] *Id.*
[89] *Id.* ¶ 30, 754 N.W.2d at 831.
[90] *Id.*
[91] *Id.* ¶ 1, 754 N.W.2d at 825.

management rights in the LLC.[92] The opinion is silent as to whether the LLC was formed as a manager-managed LLC or a member-managed LLC. With each member having equal control, the inference is the LLC was member-managed. Third, the operating agreement contained no provisions to resolve a deadlock in the management of the LLC.[93] Fourth, the conduct of the members, their failure to communicate, suppression of information, and distributing inaccurate information were key facts justifying court ordered dissolution.[94] The final lesson is the proper choice of entity that would have avoided the problems identified in *Kirksey*, a manager-managed South Dakota LLC or LP.

C. Overview of South Dakota Limited Partnership Statutes

As discussed previously, South Dakota put its brand on LLCs and LPs by modifying the charging order statutes in support of its status as a premier asset protection jurisdiction.[95] The LP is a partnership with two distinct classes of partners–a general partnership class and a limited partnership class.[96] The management of the LP is statutorily reserved to the general partnership class.[97] The partnership agreement can be drafted to provide that the limited partners are passive in the management of the LP and share only in the economic activity of the LP.[98] The LLC discussion relating to centralization of management and transfer restrictions applies equally to the LP choice.[99]

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[92] *Id.* ¶ 2, 754 N.W.2d at 825.
[93] *Id.* ¶ 12, 754 N.W.2d at 827.
[94] *See generally id.* ¶¶ 12-30, 754 N.W.2d at 827-31.
[95] *See supra* Part II.A.
[96] S.D.C.L. § 48-7-101(5)-(7) (2012).
[97] *Id.* §§ 48-7-403, -406 (2012).
[98] *Id.* § 48-7-303(b)-(c) (2012). *See also*, Ribstein & Keatinge, *supra* note 17, at 165. The passive position of the limited partner is established under both state law and historical experience. Both ensure the limited partners clearly recognize their passive role in the management of the LP.
[99] *See supra* Part II.B. (discussing LLCs' centralized management considerations). *See also*, Ribstein & Keatinge, *supra* note 17, § 8.3 (discussing the comparative nuances of the LP and LLC).

The limited partners enjoy limited liability exposure for the activity of the LP.[100] On the other hand, the general partner has unlimited liability exposure for the activity of the LP.[101] Thus, the role of general partner carries with it the risk of unlimited liability exposure, unless the LP affirmatively registers as a Limited Liability Limited Partnership ("LLLP") with the Secretary of State and the partnership agreement includes provisions that authorize the LLLP designation.[102] South Dakota was also an early adopter of the provisions that authorized the registration of a LP as a LLLP. The LLLP is to be distinguished from the limited liability partnership ("LLP"). In the family of Ls and Ps, the LP and LLLP are distinctly different from the LLP.[103]

Before the existence of the LLLP, the choice for general partner involved additional planning to address the unlimited exposure to liability that comes with the general partner position. Individuals were reluctant to serve as general partners because of the exposure to liability. To address this concern, a corporation or LLC would be formed for the sole purpose of serving as the general partner.[104] This extra layer of protection may be burdensome, but necessary to achieve maximum protection from liability. Exposing the general partner to unlimited exposure to liability placed the LP at a distinct disadvantage to the LLC choice–until the advent of the LLLP.

The LLLP is a recent phenomenon in the world of entity choices. By simply taking the extra step to register the LP as a LLLP as directed by state law, the general partner will be protected from unlimited exposure to liability. The partnership agreement should also authorize

[100] S.D.C.L. § 48-7-303(a).
[101] *Id.* § 48-7-403 (2012).
[102] *Id.* § 48-7-1106 (2012).
[103] The discussion of the LLP is beyond the scope of this article. *See generally* S.D.C.L. §§ 48-7A-1001-1004.1 (2012 & Supp. 2015).
[104] S.D.C.L. § 48-7-406 (2012).

the LLLP designation and acknowledge the limited liability protections of the general partner. The ability to limit the general partner's liability places it on equal footing with the manager-managed LLC as a preferred planning vehicle.

As between the manager-managed LLC and a LLLP, which is the better choice? Aside from tax considerations (which are beyond the scope of this article), it is like asking: "Are you a Ford person or a Chevy person?" "Do you like caramel on your ice cream or butterscotch?" They both sound great.

One feature of the LP to keep in mind is that the LP statutes are not freestanding as is the SDLLCA.[105] The LP statutes incorporate provisions of the partnership law. South Dakota's LP Act is linked to South Dakota's Uniform Partnership Act.[106] Thus, practitioners need to keep in mind reference to South Dakota's Uniform Partnership Act codified in S.D.C.L. Chapter 48-7A may be necessary to determine the rights of the partners on matters not addressed in South Dakota's Limited Partnership Act, codified in S.D.C.L. Chapter 48-7.[107]

D. PLANNING OPTIONS WITH A SOUTH DAKOTA TRUST

Planning opportunities with South Dakota LLCs and LPs are plentiful. A few of those options will be generally discussed below.[108] The art of matching a client's planning objectives with South Dakota entity and trust varieties involves as much creative thought as it does critical thinking. The trust and entity design phase is limited only by the advisor's imagination—and a few fundamental statutory requirements.

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[105] RIBSTEIN & KEATINGE, *supra* note 17, at 388.
[106] S.D.C.L. § 48-7-1105 (2012).
[107] *See generally,* Gibson v. Gibson Family Ltd. P'ship, 2016 S.D. 26, 877 N.W.2d 597 (regarding a very recent decision that rejected a limited partners attempt to dissociate from a South Dakota LP, also discussing the linkage between LP and general partnership statutes).
[108] The options discussed in this article are not an exhaustive list. Tax considerations of each option are beyond the scope of this article.

The typical method of utilizing a South Dakota entity with a South Dakota trust is to have the grantor form a South Dakota LLC or LP and contribute assets to the entity. In exchange for transferring the assets to the entity, the grantor receives units or interests. The grantor then transfers the units or interests to a South Dakota trust by gift or sale. This method is contrasted with having the grantor transfer the asset directly to the trust without the additional layer of protection and management efficiency provided by the South Dakota entity. There is a distinct difference in having the trust own and administer the asset directly (e.g., marketable securities, real property, homes, etc.) and having the trust own units in an entity in which it is a passive member or limited partner. By creating an entity to own the underlying asset, management of the asset is retained at the entity level. Administrative burdens imposed on the trustee or trust advisor are lessened. Another layer of protection for the assets is applied. The risk to other assets owned by a trust posed by owning the assets directly by the trust is substantially lessened.

1. Investment LLC or LP

The investment LLC or LP is a formidable ally with a South Dakota trust. Rather than having the investments owned directly by a trust, the investments can instead be owned by a LLC or LP. A South Dakota investment SMLLC with the trust as the sole member is a common structure.[109] The investments are owned and managed by the SMLLC. The trust owns the units of the SMLLC. If desired, the investment LLC or LP can have multiple members or partners.[110]

An investment LLC paired with a trust provides administrative efficiency by streamlining the investment management of the assets, can also reduce trustee fees and provide a "second

[109] Note that a LP must have two or more partners. *See supra* Part II.C.

[110] South Dakota has not (yet) authorized the use of the series LLC. The series LLC designates a series of managers, members, or LLC interests with separate rights, powers, or duties that apply to different property or obligations with separate business purposes or investment objectives. RIBSTEIN & KEATINGE, *supra* note 17, § 4.17.

layer of asset protection for the trust assets."[111] Families can use a LLC or LP as the main investment vehicle for multiple trusts by centralizing investments in the LLC or LP and allocating units or interests to each trust.[112]

In a bit of a twist on traditional planning options, South Dakota trust law now clearly authorizes a business to form and fund a South Dakota domestic asset protection trust ("DAPT"), which is also referred to as a self-settled trust.[113] Advisors are accustomed to thinking in terms of having individuals or people form and benefit from a trust. With a 2015 amendment to South Dakota's trust law, a business entity is now expressly authorized to form a DAPT to shelter assets from creditors of the business.[114] The business DAPT is just one more option available to protect the golden goose.

2. Life Insurance

The SMLLC is a popular choice to own a private placement life insurance policy ("PPLI"). PPLI is a highly specialized form of life insurance privately issued to qualified individuals. PPLI can be used to minimize income tax liability or may be owned in a South Dakota trust and used for wealth replacement or wealth enhancement purposes. Insurance premiums typically exceed a lump sum of $1 million. All states impose a premium tax on life insurance premiums in excess of $100,000. The advantage associated with owning a PPLI in a South Dakota SMLLC with a South Dakota-based manager (which is typically a South Dakota-based trust company) is to qualify for South Dakota's lowest-in-the-nation premium tax of eight basis points, or .08%.[115] In comparison, most states impose a premium tax in the range of 1.75%

[111] Al W. King, III., *Drafting Modern Trusts*, TRUST & ESTATES, Dec. 1, 2015, at 20.
[112] *Id.*
[113] *See* other articles in this Symposium edition that discussing DAPTs in more detail.
[114] S.D.C.L.§ 55-16-1 (2012) (citing to S.D.C.L. § 55-4-1(2) (2012) which includes partnership, LLC and corporation among the class of grantors to form a DAPT).
[115] S.D.C.L. § 10-44-2 (2012 & Supp. 2015). All states impose the premium tax. Al W. King & Pierce McDowell, *Powerful Private Placement Life Insurance Strategies With Trusts*, TRUSTS & ESTATES, April 2016, at 42-47. Alaska

to 3.5%.[116] By ensuring a South Dakota entity is the owner of the policy, significant savings can be realized on the amount of premium taxes due to the state imposing the tax.[117]

Conventional forms of life insurance can be owned in a South Dakota LLC or LP instead of using an irrevocable life insurance trust ("ILIT").[118] This strategy involves having the LLC purchase life insurance with cash contributed by the insured to the LLC.[119] The insured's family members obtain their LLC membership interest through outright gifts, which do not involve withdrawal notices ("Crummey Notices") that are associated with the typical ILIT arrangement.[120] The life insurance LLC provides more flexibility than an ILIT. If circumstances change, the LLC's operating agreement can be amended or the entity dissolved. Using the life insurance LLC may be better suited to create liquidity to fund buy-out agreements between family members and provide capital to non-business heirs. However, if the family desired to use life insurance to perpetuate or enhance wealth in successive generations, owning the life insurance in a South Dakota dynasty trust or perpetuities trust is a better option.

3. Real Property

Families seeking a method to retain ownership of a unique home or vacation property can use a South Dakota LLC or LP to own the home or vacation property. The entity can be an effective mechanism to allow family members to share the use of the property, protect the home from outside risks by the dual layer of the entity, and a trust that owns the units or interests of the

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charges 10 basis points. *Id.* New Hampshire charges 125 basis points. *Id.* Nevada charges 350 basis points. *Id.* Wyoming charges 75 basis points. *Id.* Note: as of May 2016, Delaware changed its statute to cap its premium tax at $3,000, which means that South Dakota is now tied with Delaware for the lowest in the nation premium tax up to $2,500,000 in premium payments, which equates to the $3,000 in premium tax on $2,500,000 in premium. *See* DEL. CODE ANN. tit. 18 § 702(c)(3) (West 2016).

[116] Examples of states with the abovementioned premium tax. *See generally* King & McDowell, *supra* note 115.

[117] *See generally* Richard Kagan & Jon Gallo, *A Short, Practical Private Placement Life Insurance Primer: Or Why Estate Planners Need to Understand Things Like Facultative Reinsurance*, 37 ACTEC L.J. 165 (2011).

[118] Goetzinger, *supra* note 36, at 255-56.

[119] *Id.*

[120] *Id.*

entity. When used in combination with an installment note sale to an intentionally defective grantor trust, the capital gains tax and transfer tax can be minimized in transferring the property to the next generation. This structure can substitute for a qualified personal residence trust.

LLCs and LPs are, additionally, powerful choices to assist farm and ranch families achieve their business succession goals and objectives. The formation of an entity to own the family's agriculture real property is a standard planning technique in farm and ranch country. A significant planning consideration, however, involves statutory restrictions on the ownership of South Dakota agricultural real property by a LLC. The restrictions on ownership of South Dakota land capable of being farmed are codified in S.D.C.L. Chapter. 47-9A, which is cited as the Family Farm Act of 1974 ("FFA"). The FFA was originally adopted by the legislature in 1974 as South Dakota's response to threats to the family farm presented by conglomerates engaging in farm activity.[121] To protect family farms, the legislature imposed far-reaching restrictions on corporate ownership of land capable of being farmed.[122]

The FFA casts a wide net in defining what South Dakota real estate is subject to the restrictions of the FFA. South Dakota Codified Laws section 47-9A-3 states:

> Except as provided herein, no foreign or domestic corporation may engage in farming; nor may any foreign or domestic corporation, directly or indirectly, own, acquire, or otherwise obtain an interest, whether legal, beneficial or otherwise, in any title to real estate used for farming *or capable of being used for farming* in this state.[123]

Note that out-of-state agricultural land owned by a South Dakota entity is not affected by the FFA.

South Dakota Codified Laws section 47-9A-2(2) defines the term corporation for purposes of the FFA as "both corporations under the South Dakota Business Corporations Act

[121] S.D.C.L. § 47-9A-1 (2012).
[122] *See id.*
[123] S.D.C.L. § 47-9A-3 (2012) (emphasis added).

and limited liability companies under the South Dakota Limited Liability Company Act."[124] It is important to note a LP and a LLP are not included in the definition of a prohibited entity that must qualify as a family farm corporation under the FFA. In other words, a LP or a LLP can own South Dakota agriculture land without concern about compliance with the FFA. Thus, if compliance with the FFA is problematic, a LP (registered as a LLLP) will satisfy the same planning objectives as a LLC.

For purposes of the FFA, S.D.C.L. section 47-9A-2(4) defines "Farming" as:

> the cultivation of land for the production of agricultural crops; livestock or livestock products; poultry or poultry products; milk or dairy products; or fruit or other horticultural products. It shall not include the production of timber or forest products; nor shall it include a contract whereby a processor or distributor of farm products or supplies or provides spraying, harvesting or other farm services.[125]

Take note of the several exceptions to the application of the FFA forbidding corporate or LLC ownership of agricultural land. These exceptions are codified in S.D.C.L. sections 47-9A-3 to 47-9A-13.[126]

South Dakota Codified Laws sections 47-9A-14 and 47-9A-15 set forth the requirements to be considered a qualified or authorized Family Farm Corporation ("FFC"). The requirements of a FFC are satisfied if any corporation founded for the purpose of farming *and* the ownership of agricultural land in which the majority of the voting stock is held by members of a family, an estate of a family member, or a trust that benefits members of the family, *and* at least one of whose stockholders is a person who is residing on or actively operating the farm or who has resided on or has actively operated the farm, *and* none of whose stockholders are corporations. Transfers of shares to persons who are/have been family members are qualified as a family

[124] S.D.C.L. § 47-9A-2(2) (2012).
[125] *Id*.
[126] S.D.C.L. §§ 47-9A-3 to -13 (2012).

member under this chapter. South Dakota Codified Laws. sections 47-9A-16 through 47-9A-20 set forth the annual reporting requirements of a FFC.

South Dakota Codified Laws sections 47-9A- 21 and 47-9A-22 set forth the rules to enforce the FFA and what happens if a corporation or LLC is found to be in violation of the FFA. Note that in addition to the Attorney General's authority to bring an action to enforce the FFA, there is also a private right of action to enforce the FFA. The author is unaware of any action by either the Attorney General or a private citizen to enforce the FFA.

The lack of any known enforcement action of the FFA begs the question, "So what's the big deal if a corporation or LLC that owns land capable of being farmed is not a qualified or authorized FFC?" The failure to comply with the FFA can result in disregarding the entity as a corporation or LLC and the limited liability protections inherent with the choice of entity. If two or more individuals are in the ownership group, the entity may default to classification as a general partnership–and invite the application of partnership tax law as well as the fundamental rule of joint and several liability among the partners. Thus, the very reason a client selected a limited liability entity can be destroyed if they do not comply with the FFA.

The limited liability protection your client thought they had may evaporate if the entity is not a qualified FFC. The tax status your client thought they had may be jettisoned. The legal opinions given to lenders, buyers, sellers, the title company, and others about the entity being valid, effective, and in good standing under South Dakota law may be inaccurate. Representations on the insurance application about the entity may be inaccurate and nullify coverage. Discounts taken on the value of shares or units may be disallowed.

It is also necessary to distinguish the FFA from the history of Amendment E to the South Dakota State Constitution. Amendment E was enacted in 1998.[127] The constitutionality of Amendment E was challenged in federal court and declared unconstitutional in 2003.[128] The nullification of Amendment E restored the FFA as the law governing ownership of agriculture land by corporations and LLCs.[129]

4. Mineral Rights

Severed mineral rights from agricultural real property can be owned in a South Dakota LLC or LP and then transferred to a trust that allows the entire family to share in the mineral rights activity. Mineral rights are not subject to the FFA. The surface rights associated with agricultural real property can be designated for use by the on-ranch heirs. A mineral rights entity allows parents to treat non-ranch heirs fairly while not interrupting the on-ranch heir's agricultural operation. Allowing all family members the prospect of sharing in the rewards of a windfall from mineral activities is one technique to achieve the fair versus equal balance among on-ranch and off-ranch heirs. The severed mineral rights can be transferred to a separate entity with its own rules and regulations regarding governance and transfer restrictions.

Several other factors motivate segregation of the mineral rights from the surface rights. Unifying mineral rights in a separate entity avoids exponential fractionalization of the mineral rights as they pass from one generation to the next. Bargaining power, streamlined management, and economies of scale are achieved by unifying mineral rights under the umbrella of a single entity. Mining activities are directed through one entity, not multiple fractionalized owners. The entity enters into the working interest agreement, royalty agreement, or whatever agreement

[127] S.D. CONST. art XVII, § 21, *abrogated by* S.D. Farm Bureau, Inc. v Hazeltine, 340 F.3d 583 (8th Cir. 2003).
[128] *See generally S.D. Farm Bureau*, 340 F.3d 583 (finding corporate farming initiatives unconstitutional).
[129] Beware, the printed volume of the State Constitution (formerly the "red books") still contains Amendment E, though the pocket parts show its repeal. The continued presence of Amendment E in the Code has created confusion among practitioners.

relates to the mineral rights. Segregating surface rights from mineral rights, each owned by a separate entity, provides another layer of asset protection to the members and assets of the respective entitles.

5. Special Purpose Entities

Switching gears to address the office of a fiduciary, a South Dakota LLC is the preferred choice for operating as a trust company or a special purpose entity that serves in the capacity of a trust advisor or trust protector. The vast majority of state chartered public and private trust companies are formed as a South Dakota LLC. The rules that govern the formation of a South Dakota chartered trust company are located in S.D.C.L. Chapter 51A-6A. A planning option for ultra-high net worth families is to form a private trust company that can serve as the trustee on the trusts formed by the family members. South Dakota's statutory framework distinguishes between a public trust company and a private trust company. A public trust company engages in trust company business with the general public.[130] A private trust company does not engage in trust business with the general public or hold itself out as a trust company for hire.[131] Instead a private trust company serves only one family or group of families.[132] It is believed that South Dakota leads the nation in the total number of state chartered, non-depository trust companies with eighty-four.[133] South Dakota averages adding four such trust companies to the South Dakota economy annually.[134]

A private trust company enjoys less regulation under South Dakota law by being exempted from several statutory requirements that apply to a public trust company.[135] The

[130] S.D.C.L. § 51A-6A-1(12A) (2012 & Supp. 2015).
[131] S.D. ADMIN. R. 20:07:22:03 (2010).
[132] *Id.*
[133] *H.B. 1039, Hearing Before the H. State Affairs Comm.*, 2016 Leg., 91st Leg. Assemb., Reg. Sess. (S.D. 2016) (statements by Bret Afdahl, Dir. Div. of Banking).
[134] *Id.*
[135] S.D.C.L. § 51A-6A-66(3) (2012 & Supp. 2015).

private trust company is a powerful tool for families who seek privacy and control over their own affairs at the trust company level.

The family has another powerful choice to keep certain trust administration functions in-house with the option of forming a South Dakota special purpose entity ("SPE"). The SPE is not a trust company, and is not regulated as a trust company.[136] The SPE is an entity established for the exclusive purpose of acting as a trust protector, investment trust advisor, or distribution trust advisor, as defined by S.D.C.L. section 55-1B-1, or any combination of such purposes.[137] South Dakota was the first state to statutorily recognize SPEs and remains only one of two states to do so.

SPEs are typically formed as manager-managed South Dakota LLCs. The role of trust advisor and trust protector represent the cornerstone of South Dakota's directed trust statutes (addressed in other articles to this edition). A SPE is a desirable choice for families who seek additional protection from liability for those making the decisions delegated to a trust advisor and trust protector. When families design trusts that last in perpetuity, unique issues associated with appointing individuals who do not enjoy a perpetual existence to serve as advisors and protectors arise. To address continuity in the position of trust advisor and trust protector, a SPE can be formed and appointed to serve in those positions under the trust instrument. A SPE can have a perpetual existence and include provisions in its governing documents addressing management succession that will roll with the generations. Thus, both halves of the dynamic duo can last in perpetuity.

III. CONCLUSION

[136] *See id.* § 51A-6A-66(1).
[137] *Id.* § 51A-6A-66.

The search for effective planning techniques to achieve the objectives of protecting family assets and family members from predators, creditors, in-laws and outlaws has led families and their advisors to South Dakota and its dynamic statutory duo. The challenges presented by the complications of life are both timeless and ever evolving taking new forms of risk and disruption on multiple fronts. In response, South Dakota has crafted an attractive statutory framework featuring innovative solutions to the risks presented by a constantly changing family, tax and economic environment. Due to the attentiveness of the TTF and the Business Law Committee of the South Dakota State Bar, prudent and balanced statutory innovation tracks changing circumstances virtually in real time. Living up to one of it's many state mottos from a planning perspective, South Dakota is truly the Land of Infinite Variety.