Business Law POV

California's New Uniform Limited Liability Company Act

By Hannah Sweiss

EFFECTIVE JANUARY 1, 2014, CALIFORNIA'S Beverly-Killea Limited Liability Company Act (Beverly-Killea Act) was repealed and replaced by the California Revised Uniform Limited Liability Company Act (RULLCA). RULLCA is codified in Corporations Code Sections 17701.01-17713.13. Under RULLCA, much of California's LLC law remains the same. However, several substantive changes in the law will impact California LLCs.

What do these substantive changes mean for your LLC clients? Below is an overview of the noteworthy changes to California's LLC law and distinctions between the Beverly-Killea Act and RULLCA, as well as tips on contracting around some RULLCA default provisions that clients may prefer to avoid.

Management Structure

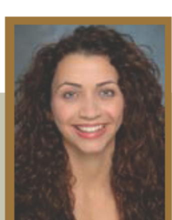
RULLCA retains the manager-managed and member-managed structures, but changes the governing document determining the management structure. Under the Beverly-Killea Act, the articles of organization determined whether an LLC was member-managed or manager-managed. Under RULLCA, the articles of organization no longer determine if the LLC is manager-managed or member-managed. Under the new law, this is governed by the operating agreement. If an LLC operating agreement is silent on the management structure, then pursuant to Section 17704.07(a) the default rule is that the LLC is member-managed.

Practice Tip: Review the articles of organization and operating agreement to determine if the management structure is consistent and clear in both documents. If the operating agreement is silent on management structure, consider modifying it to clarify the management structure.

Management Authority

RULLCA delineates more robust default rules pertaining to members' consent rights. The Beverly-Killea Act had only a handful of default rules on consent of members. Most operating agreements drafted prior to enactment of RULLCA likely set limitations on management authority by requiring a majority or supermajority vote by members.

RULLCA has more default rules establishing actions that require consent of all members. For example, RULLCA requires consent of all members for acts outside the ordinary course of business activities and to amend the operating agreement.



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Practice Tip: The default rules requiring consent of all members may be troublesome. Just one dissenting member could prevent action that the majority or supermajority want. Under the new LLC law, acts that are (or will be) outside the ordinary course of business are not specified. Without clarification, the broad language "outside the ordinary course" may lead to disputes between members and managers or in some instances, give a minority member veto power. To limit the ability of a small number of members to hold up important action, consider whether to have the operating agreement disclaim additional voting rights for members and clarify the scope and limitations on voting rights of members.

Fiduciary Duties

RULLCA delineates the extent to which the operating agreement can define, alter or even eliminate aspects of fiduciary duties. Previously, the Beverly- Killea Act had only a general reference to fiduciary duties. Now, under RULLCA, the fiduciary duties of loyalty, care, and any other fiduciary duty of members and managers are specified. Under RULLCA, members may modify (but cannot eliminate) fiduciary duties, so long as the modifications are not manifestly unreasonable. To contractually modify fiduciary duties, RULLCA requires informed consent by all members. Merely acknowledging and signing the operating agreement will not suffice as informed consent.

Practice Tip: RULLCA language likely sought to provide clarity, but the language may actually be troublesome, because it is not clear what modifications cross the "manifestly unreasonable" threshold. Parties seeking to modify fiduciary duties of members or managers should define those duties to limit ambiguity as to what constitutes a breach and prevent running afoul of the manifestly unreasonable standard.

Dissociation

RULLCA specifies when a member is dissociated from an LLC. Under the Beverly-Killea Act, events of dissociation of a member were not specified. The new LLC law specifies events of dissociation and effects of dissociation of a member in Section 17706.01.

Practice Tip: If parties do not want any of the default events to result in dissociation, then the operating agreement should specify events of dissociation. Similarly, the effects of dissociation should also be clarified in the operating agreement.

RULLCA makes significant substantive changes to California's LLC law that will impact existing as well as newly formed California LLCs. To avoid being subjected to possibly unwanted default provisions of the new LLC law, legal counsel should consult with clients, review their operating agreements and make revisions where necessary.