

THURSDAY, MARCH 19, 2015

The New California Limited Liability Company Law

The California Revised Uniform Limited Liability Company Act (RULLCA) took effect in 2014, resulting in several significant changes to the former Beverly-Killea Limited Liability Company Act (Beverly-Killea). The RULLCA replaces and clarifies Beverly-Killea. The legislature's intent in establishing this new law was to bring California laws governing LLCs in line with the laws of other states, making it easier for multi-state LLCs to operate across state borders.

The RULLCA applies to all California limited liability companies and foreign limited liability companies registered in the State of California, even if they were formed prior 2014. This means that even if your LLC was formed before the RULLCA became effective, you may be affected by its provisions. In particular, your operating agreement and articles of organization may require revision to avoid the implications of the RULLCA's new default rules.

The following list summarizes several noteworthy changes made by the RULLCA. We encourage you to review these changes carefully because they may apply to you and will affect how your LLC operates.

Noteworthy Changes:

Manager Managed LLCs. Under the RULLCA, LLCs are member managed by default. In order to create a manager managed LLC, both the articles of organization and the operating agreement must expressly elect to be manager managed by stating that the entity is "manager managed," "managed by managers," "vested in managers," or similar.

Unanimous Consent Required. Unless modified by the operating agreement, the unanimous consent of all members is required to:

- sell, lease, exchange, or otherwise dispose of all or substantially all of a limited liability company's property outside the ordinary course of the LLC's activities;
- approve of a merger or conversion;
- undertake any other act outside the ordinary course of business; or
- amend the operating agreement.

Note: this is only a default rule and may be modified by a written operating agreement. If your operating agreement is silent on this issue, the new default rules will apply and you may need to amend the operating agreement to avoid voting conflicts between members and managers.

Indemnification. The RULLCA requires an LLC to indemnify its managers (if the LLC is manager managed) or members (if the LLC is member managed) for debts, obligations, or other liabilities incurred by the manager or member on behalf of the LLC. Indemnification is not required if the manager or member breached a fiduciary duty while incurring the debt, obligation or other liability. Under the old rules, LLCs were permitted but not required to provide such indemnification.

Reimbursement. The RULLCA requires an LLC to reimburse its managers (if the LLC is manager managed) or members (if the LLC is member managed) for expenses incurred by the manager or member while acting on behalf of the LLC. Reimbursement is not required if the manager or member breached a fiduciary duty while incurring the expense. Under the old rules, LLCs were permitted, but not required to reimburse.

Fiduciary Duties. Beverly-Killea provided that a manager owes the same fiduciary duties to the LLC and its members as a partner owes to a partnership and its partners. The RULLCA explicitly enumerates these

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fiduciary duties. Under the RULLCA, the fiduciary duties owed by a managing manager or a managing member are as follows:

- the duty of loyalty, which includes the duty to account and hold in trust for the LLC any property or benefit of the LLC; to refrain from dealing with the LLC as or on behalf of a party having an adverse interest to the LLC; and to refrain from competing with the LLC;
- the duty of care, which is the duty to refrain from grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law in the conduct or winding down of LLC business; and
- the duty of good faith and fair dealing.

Note: the operating agreement may modify the duty of loyalty and the duty of care, but these duties may not be eliminated or unreasonably reduced. Likewise, the operating agreement may modify the standard for measuring good faith and fair dealing, as long as the modification is not manifestly unreasonable.

Dissociation of Members. Under the RULLCA, certain events trigger the automatic dissociation of a member. These events are:

- death
- appointment of a guardian or conservator for a member of a member managed LLC;
- a judicial order that a member of a member managed LLC is incapable of performing such member's duties;
- in the case of a member that is a trust, the distribution of the trust's interest in the LLC; and
- the member of a member managed LLC becomes a debtor in bankruptcy.

Note: the dissociation of a manager automatically removes the manager from his or her management role in the LLC. A dissociated member's interest in the LLC is solely as a transferee; s/he loses any management rights and retains only economic rights, and his or her fiduciary duties end upon dissociation. The operating agreement may modify the types of events that trigger dissociation and removal.

New Members. A new member is subject to the terms of the operating agreement, even if the new member does not sign it or otherwise consent to it. This rule is a default rule, and the LLC may modify it by expressly providing otherwise in the operating agreement.

This alert is a summary of the changes in California law applicable to LLCs and does not include every change effected by the Revised Uniform Limited Liability Company Act. We encourage you to review your existing operating agreements and articles of organization, and to make appropriate changes to reflect the intentions of your members and managers.

About Smith LLP

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