A Review of the Revised Uniform Limited Liability Company Act: The Good, The Bad, and Your Operating Agreement

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I. INTRODUCTION

"You get liability! You get liability! Everyone is getting liability!" That thought has been running through the minds of several estate and business planning attorneys since states have started adopting the Uniform Law Commission's 2006 Revised Uniform Limited Liability Company Act (RULLCA). Since 2008, nineteen states and the District of Columbia have enacted versions of the Act and South Carolina recently introduced legislation that would enact the act in early 2019.[1]

RULLCA is the act passed by the Uniform Law Commission in 2006 that is intended to promote a uniform law governing limited liability companies (LLCs) among the states and territories in the union, as well as the District of Columbia. LLCs are a relatively new business entity, which may provide some insight as to why states have been slow to enact RULLCA. Wyoming was the first state to recognize LLCs in 1997 and it was not until 1996 that all fifty states had legislation recognizing LLCs as a business entity.[2] However, this does not mean that there was any uniformity among states with respect to the way that LLCs were governed.

The first uniform act released by the Uniform Law Commission was the Uniform Limited Liability Act (ULLCA) of 1995, which was amended in 1996. ULLCA was not widely accepted in the United States as only five states and one territory enacted it.[3] Thus, many states continued to have their Limited Liability Company (LLC) laws, which resulted in a less uniform law than we have today.

The fact that fewer than half of the states in the union have enacted RULLCA since the ULC passed it over ten years ago might be because they are trying to figure out the business entity for themselves. Regardless, LLCs are an entity that practitioners work with frequently, and understanding the advantages and disadvantages of the entity, specifically under the provisions of RULLCA is important for any practitioner in this area of law.

As states adopt RULLCA, practitioners are faced with the impacts that the Act has on LLC law. For LLCs in states that have not adopted the previous Uniform Limited Liability Company Act (ULLCA) of 1995, RULLCA brings significant changes that may affect a member's fiduciary duties and their related liability depending on the law of their state. LLCs in states that adopted the prior ULLCA also need to be aware of the changes that RULLCA brings, but in this latter situation, they may benefit from the freedom and discretion that RULLCA now provides in their LLC operating agreements. Specifically, if they initially adopted the fiduciary duty provisions of ULLCA, they now benefit from the RULLCA provisions that enable them to make certain modifications to fiduciary duties in their operation agreements.

LLC law has tried to walk the line between partnerships and corporations. Initially LLCs were thought of more like partnerships, but as the law advances, there is some indication that LLCs might begin to look more like corporations with respect to governing law. LLCs have become increasingly popular because of the contractual freedoms that members and managers can enjoy with respect to their LLC operating agreements. While corporations have to abide by certain requirements, such as corporate formalities and annual meetings, an LLC is largely only required to do what its operating agreement requires of it. An LLC is able to enjoy contractual freedom that a corporation does not, all while receiving the benefits of limited liability applicable to corporations. In an attempt to address the shift toward a more corporate form, the drafters passed

the 2013 Harmonization Amendments, which were intended to harmonize certain aspects of the law applicable to both corporations and LLCs.

LLCs have retained characteristics of partnerships as they are often taxed as partnerships. Unlike a corporation, in which taxes are due on both profits and on distributions to shareholders, LLCs enjoy passthrough taxation similar to partnerships as only the distributions that it makes are taxed. However, as previously mentioned, unlike the liability that partnerships are subject to, an LLC, as its name implies, has limited liability. Because of these favorable offerings, an LLC has become increasingly popular as a corporate form. With this increasing popularity comes a continued struggle to balance the freedom to contract with corporate requirements.

In several states, LLC law has traditionally been more like a "chill" parent who is ready to drop their child off to college and only provides guidance when their young-adult child asks for it. Practitioners in such states may view RULLCA as the helicopter-parent who imposes a curfew on their college-aged child and requires them to meet certain duties and responsibilities. While there are several positive aspects of RULLCA, such as providing LLCs with the benefit of corporation-type liability with partnership-type tax treatment, some practitioners are concerned that the Act's provisions related to creditor rights and fiduciary duties may expose LLCs, their managers, and their members to unwanted liability.

This paper identifies and evaluates some of the more significant changes brought by RULLCA in both the 2006 Act and the related 2013 Amendments and suggests ways in which practitioners and LLCs can work with the Act when forming LLCs. While this paper is an attempt to address significant changes, revised provisions pertaining to merger, conversion, and domestication are not addressed. Part II provides some background with respect to RULLCA,

discussing the need for an updated Act and some of the more significant provisions. It details added or revised sections, including those related to charging orders, fiduciary duties, limitations with respect to an operating agreement, agency law, and indemnification provisions. Part III provides my analysis of the RULLCA provisions, focusing on the fiduciary duty provisions of the Act, and what RULLCA means for LLCs. Part IV summarizes my conclusions with respect to the effect that RULLCA has on LLCs. This paper will reference and analyze both the 2006 RULLCA, as well as the 2013 Harmonization Amendments.

II. BACKGROUND

Although RULLCA is intended to provide a uniform law among the states, that result is dependent upon states in fact enacting RULLCA, which may require them to significantly revise the LLC laws of their state. This section will begin with a summary of the problems under ULLCA that RULLCA was intended to address, and an overview of some of RULLCA's solutions. In addition, this section provides some examples of LLC law in states where RULLCA was not enacted, and then discuss the changes that RULLCA made to LLC law.

A. RULLCA as an Answer to ULLCA

RULLCA brings with it several changes. Prior to the Act, ULLCA was viewed more as a gap filler, providing guidance and clarification for LLCs when they may have overlooked a technicality when forming the LLC. The 1995 Uniform Act was essentially the first step in balancing partnership and corporation law as it pertains to LLCs. As LLCs increased in popularity, the law governing them would evolve. While the drafters sought to maintain the flexibility that made LLCs so popular, they also needed to address the reality that LLCs were often looking more

like corporations.[4] As such, some of the provisions in ULLCA that reflected a partnership were not as appropriate considering the nature of LLCs.

RULLCA also provides expansive default provisions pertaining to member duties and sets forth certain modifications that an operating agreement is prohibited from making. In addition, the Act gives an LLC the ability to modify and eliminate some of its provisions in the LLC's operating agreement to the extent permitted by law. As LLCs increase in popularity, RULLCA reflects the need for governing provisions that enhance uniformity and clarity among LLCs. To this end, RULLCA adds certain provisions which bring LLC law more in line with the law applicable to corporations.

This Section explores some of the ways that RULLCA addressed evolving LLC law and the issues left unresolved by ULLCA, as well as other additions brought by the Act. It also examines provisions such as the business judgment rule which were included in the 2006 RULLCA, but not in the 2013 Harmonization Amendments. Finally, this Section discusses the fiduciary duties and agency law provisions included in RULLCA.

1. Charging Orders

Section 503 of the 2013 RULLCA Amendments adds a provision that appears to limit the protections of a sole member of an LLC with respect to a charging order. A charging order is often used by judgment creditors to obtain the judgment by accessing the judgment debtor's interest in a company.[5] This does not mean that the judgment creditor will be paid immediately, but it does provide the judgment creditor with some security. Generally, with respect to a partnership, a charging order will only give the judgment creditor rights to the judgement debtor partner's

distributions and a right to foreclose on the debtor's transferable interest.[6] This is often limited to the partner's share alone.[7]

The exclusiveness of a charging order to enforce a judgment creditor's rights generally aligns with partnership law as a means to protect Partner A if Partner B's creditors obtain a charging order from the court to enforce their interest. Notably, partnerships cannot continue to exist with only one member. LLCs, on the other hand, can have a sole member. When viewed in this context, the benefit of protecting another member of the company does not make much sense for sole members of an LLC.

The drafters of RULLCA addressed this issue in Section 503(f) of the 2013 Amendments to RULLCA, which provides that, in the case of a sole member of an LLC, "if a court orders foreclosure of a charging order lien against the sole member," the purchaser, who may or may not be the creditor, obtains the member's entire interest, thus becoming member, and the judgment debtor member is disassociated as a member.[8] Unlike partnerships, where the judgment creditor is really only entitled to the judgment debtor's *transferable* interest. The 2013 Amendments provide the judgment creditor the ability to obtain the judgment debtor's *entire* interest. Section 503(f) reflects the idea that individuals should not be able to use an LLC as a means of asset protection by creating single-member LLC and avoiding creditors.[9]

2. The Business Judgment Rule

One aspect of RULLCA's shift toward corporate law is the inclusion of the business judgment rule in the 2006 Revised Act.[10] The business judgment rule has traditionally been used by directors as a defense when they face lawsuits alleging that they violated their duty of care to the corporation. The rule essentially states that decisions by directors, or managers and members

in the case of an LLC, will be upheld as long as they are made: (1) in good faith; (2) with the care that a reasonably prudent person would use; and (3) with the reasonable belief that the director is acting in the best interests of the corporation.[11]

Generally, the only ways that a plaintiff can overcome the business judgment rule is if the plaintiff proves that the director acted in gross negligence or bad faith, or that the director had a conflict of interest with respect to the his decision or act.[12] Although the 2013 amendments to the Act do not include the business judgment rule, several states that have adopted a version of RULLCA have kept the rule in their respective state-enactments.[13]

The business judgment rule has long been used in corporate law.[14] It is worth examining the rule as it relates to LLCs as more states enact it as statutory law. Limited liability companies in states that have enacted the rule in their LLC Acts will be subject to the rule unless their operating agreements provide otherwise, which means that it will likely be more difficult to bring a lawsuit against the manager or managing member, depending on the type of LLC, as they will have the business judgment rule as a defense. In states that have not made this shift toward corporate law, and where it has not been adopted by common law, then the LLC manager or managing member will not have the protection provided by the Rule with respect to their decisions. Importantly, the Rule can likely be stricken from or added to an LLC's operating agreement because it is often associated with the duty of care, which RULLCA provides can be modified as long as such modification is not manifestly unreasonable.[15]

3. Fiduciary Duties

The ways in which some states have enacted RULLCA are causing some practitioners to call the Act the "Liability Company Act" instead of the "Limited Liability Company Act."[16] Under

the Act, as enacted in several states, members of a member-managed LLC are subject to the fiduciary duties of care and loyalty unless the operating agreement provides otherwise. While at first glance it looks like the Act imposes liability like Oprah gives away cars, a deeper look suggests that RULLCA provides more flexibility to LLCs than ULLCA once did with respect to fiduciary duties.

Under RULLCA, an operating agreement may modify or eliminate the duty of care and the duty of loyalty to the extent permitted by the law and under the Act.[17] Namely, the operating agreement cannot modify or eliminate the duty of good faith and fair dealing and it may not authorize a knowing violation of the law.[18] However, if you have an LLC in a state that has not already adopted a version of ULLCA, then it is possible that such fiduciary duties are a completely new concept. For these reasons, this section addresses the fiduciary duty provisions of RULLCA.

The 2006 RULLCA expands the default duties applicable to a manager of a manager-managed LLC and member of a member-managed LLC by not limiting the fiduciary duties to those expressly set forth in section 409 as ULLCA previously did.[19] Although the 2006 Act, as well as the 2013 Amendments, do not expressly add many more duties, by removing the language that limited the fiduciary duties imposed on members of member-managed LLC to those set forth in the Act, it suggests that such members could be subject to duties that are not yet known and not set forth in RULLCA.

An additional concern for LLCs in states that have not yet adopted RULLCA, or have recently adopted the Act, is that their respective state law may not have imposed any fiduciary duties on managers of manager-managed LLCs or members of member-managed LLCs as RULLCA does. For example, Arizona recently adopted RULLCA, which includes several of the

fiduciary duties included in Section 409 of RULLCA.[20] However, consistent with Arizona's "wild west" approach, Arizona's previous LLC Act, which will be repealed September 1, 2019, did not expressly impose fiduciary duties on managers or members of LLCs.[21] The new default provisions that subject certain individuals to fiduciary duties, understandably come across as expanding their exposure to liability. Part III of this paper discusses suggestions when drafting operating agreements that might limit the application of such fiduciary duties.

4. Actions Brought by Members – Direct Actions & Special Litigation Committee

Another means by which RULLCA brings LLC law more in accordance with corporate law is by expressly permitting direct actions. While the 1995 Act provided for derivative actions, it was silent with respect to direct actions. Generally, when a member brings a direct action it is because of an injury that they personal suffered, an injury that is independent of one suffered by the company. The inclusion of direct actions in the 2006 Act is significant as it permits members to bring actions against the LLC to enforce the member's rights or interest.

Unlike a derivative action, where the member is enforcing the company's interest and the remedy is for the company itself, in a direct action the member seeks a remedy for the *member*. As the comments to Section 801 explain, a member does not have a direct claim against a manager or another member solely because such other person breached a duty set forth in the operating agreement.[22] Similarly, when a member breaches a duty in the operating agreement, it does not necessarily create a cause of action for other members.[23] In order to have standing to bring a direct action, a member in her own right "must be able to show a harm that occurs independently of the harm caused or threatened to be caused to the limited liability company."[24]

Importantly, Section 105 prohibits an operating agreement from unreasonably restricting a member's right to bring an action under Article Eight, which includes direct actions.[25] However, this does not mean that an operating agreement cannot impose any restrictions. The operating agreement can reasonably modify the standing rule, by either expanding it or restricting it. For example, a reasonable restriction could be one that requires the member to plead and prove an actual or threatened injury that is independent from an injury that is suffered by the company. An LLC could include this heightened standard in its operating agreement to prevent unnecessary claims and needless litigation. The drafters did not intend to allow members to frivolously bring direct actions, but they noticed that such actions were also needed for certain situations. They stuck a balance by permitting the actions, while also providing the LLC flexibility in its operating agreement to determine when a member has standing to bring a direct action.

Another way that a member can bring an action against the LLC comes in the form of a derivative lawsuit. As LLCs continue to increase in popularity, the drafters perhaps foresaw an increase in potential lawsuits initiated by members. Such a belief would support RULLCA's addition of a Special Litigation Committee in the 2006 Act. Under RULLCA, a special litigation committee is appointed by the LLC when the LLC is named as a party or is made a party in derivative proceeding.[26] Therefore, when a member brings a derivative action, alleging that the managers or managing members have essentially wronged the company, the LLC may appoint a special litigation committee. The specific provisions of the special litigation committee are set forth in Section 905 of the 2006 RULLCA and in Section 805 of the 2013 Amendments.

Once the special litigation committee is appointed, the court will generally stay discovery with respect to the derivate action in order for the committee to perform an investigation to determine whether or not the action is in the best interests of the LLC. On a basic level, if the court

finds that the committee was disinterested and independent, and acted with reasonable care, then the court will enforce the committee's determination. If the court does not come to that conclusion, then it will allow the action to continue.

In states that have adopted this provision of RULLCA, it means that unless the LLC's operating agreement provides otherwise, a special litigation committee will always be an available option. It could prove more costly with respect to both time and money. However, it might also prevent needless or frivolous derivative actions from proceeding. This seems to strike a balance by providing LLCs with the option to take a step towards corporate law and utilize a special litigation committee to resolve derivative actions, while also not making the special litigation committee mandatory. Importantly, RULLCA prohibits an LLC from modifying the terms of the special litigation committee.[27] However, if an LLC does not want a special litigation committee as an option at all, then it can expressly state in its operating agreement that it will not have one.[28]

5. Member's Rights to Records & Information

Another significant revision in RULLCA is Section 410 pertaining to a member's right to records and information. While the section itself is not new to RULLCA, the 2006 Act contained significant additional provisions and distinctions with respect to manager-managed LLCs and member-managed LLCs, as well as restrictions and limitations that the LLC can impose on certain requests for records.

In a member-managed LLC, to the extent that such information is *material* "to the member's rights and duties under the operating agreement or [the Act]," a member may, on reasonable notice, "inspect and copy during regular business hours, at a reasonable location specified by the company, any record maintained by the company regarding the company's

activities, affairs, financial condition, and other circumstances."[29] The Act further sets forth the conditions and records that the company is responsible for providing, which is essentially the same as under ULLCA.[30] The only addition in RULLCA is that the duty to furnish information applies to "each member to the extent the member knows of any of the information" requested and required to be furnished.[31]

Many of the additions with respect to a member's right to information pertains to the rules for manager-managed LLCs, as set forth in Section 410(b). Under this section, only managers have the duty to furnish the information requested under the Act.[32] Importantly, more requirements are placed on members of manager-managed LLCs if they want to obtain records and information. The request for information must first be just and reasonable and the member is required to meet the requirements set forth in 410(b)(2). Namely, the member must (i) seek "the information for a purpose reasonably related to the member's interest as a member;" (ii)the member must make "a demand in a record received by the company, describing with reasonable particularity the information sought and the purpose for seeking the information;" and (iii) the information sought must be directly connected to the member's purpose.[33] The first requirement, that the information be reasonably related to the member's interest as a member, is the result of a modification in the 2013 Amendment to RULLCA. The 2006 Act required the information to be related to a *material* purpose. The modified standard in the 2013 Amendments is somewhat more lenient.

On the management side of the manager-managed LLC, the company has ten days after receiving the demand for records to inform the member that they will either provide the requested records or that the request was denied and state the reasons for denying the request.[34] An additional limitation in RULLCA is that the rights to information set forth in Section 410 do not extent to a transferee.

If an LLC wanted to restrict a member's right to records and information, Section 105 provides that such a restriction must not be unreasonable.[35] Expressly approved modifications include reasonable restrictions on the availability and use of information that a member obtains and defining appropriate remedies, such as liquidated damages, for "a breach of any reasonable restriction on use."[36]

B. Agency & Indemnification and Advancements

The revised Act passed in 2006, as well as 2013 amendments, provided updated provisions related to both agency law and indemnification. This section examines the agency provisions as revised in the 2006 RULLCA, as well as the added indemnification provisions included in the 2013 Harmonization Amendments to RULLCA.

1. Agency

There is good news for members of LLCs who do not want to automatically take on the role of an agent of the LLC under traditional agency law, as the 2006 Act does not base one's status as "agent" solely up one's status as "member". This is a shift from the 1995 ULLCA that preceded RULLCA, which provided that:

> [e]ach member is an agent of the company for purpose of its business, and an act of a member . . . binds the company, unless the member had no authority to act for the company in the particular matter and the person with whom the member was dealing knew or had notice that the member lacked authority.[37]

Under the 1995 Act, as long as a member was "carrying on in the ordinary course the company's business or business of the kind carried on by the company," the member was considered an agent of the company.[38] RULLCA modifies the Uniform Act's default agency provisions in Section 301 of the Act, which provides that "[a] member is not an agent of a limited

liability company solely by reason of being a member."[39] However, Section 301 does not mean that LLCs are immune from liability that results from a member's conduct.

While RULLCA rejects *statutory apparent authority*, the common law of agency likely still applies. As the comments to Section 301 explain, statutory apparent authority makes sense for partnerships, where a third party can more easily determine whether or not the partner with whom they are dealing has the authority to bind the partnership based up her status as a general or limited partner.[40] RULLCA departs from statutory apparent authority largely because, unlike partnerships, it is often difficult for a third party to know who has the authority to bind an LLC. An LLC does not designate general and limited partners. Instead, there are a variety of management structures used by LLCs such that a third party cannot easily determine whether an LLC is member-managed or manager-managed, which in turn would assist them in determining who has the statutory authority to bind the LLC. Based upon this consideration, the Act does not base authority to bind an LLC upon one's status as a member. Instead, it brings LLC law more in line with the common law of agency.

Although Section 301(a) of RULLCA rejects statutory apparent authority, subsection (b) makes clear that a person's status as a member does not limit another law from applying that would otherwise impose liability because of the person's conduct as a member. Section 301(b) states that "[a] person's status as a member does not prevent or restrict law other than this [act] from imposing liability on a limited liability company because of the person's conduct."[41] As the comment to Section 301(b) explains, a member could still be liable because of their status as a member in other contexts, such as under the doctrine of *respondeat superior*.[42]

For example, if the circumstances are such that the member is acting as a "servant" of the LLC and while doing so the member commits a tort, assuming the requirements of *respondeat superior* are met, then the LLC could be held liable for the member's conduct. As the comment to subsection (b) explains, "[a] person's status as a member does not weigh against [this] or other relevant theories of law."[43]

Importantly, unlike the other RULLCA provisions that the Act prevents you from modifying in the operating agreement, the Act does not prevent LLCs from using their respective operating agreements to modify the governing agency provisions in Section 301. Thus, in drafting an LLC operating agreement, an LLC can include provisions that set forth the members or managers that have the agency authority to bind the company.

2. Indemnification and Advancements

If a manager of a manager-managed LLC or a member of a member-managed LLC did in fact act as an agent on behalf of the company, and acted within their respective capacity, then they may be entitled to indemnification or advanced expenses in connection with any claim brought against them in such capacity.

While indemnification has been included since the 1995 Act, the 2013 Amendments expressly expand who can benefit from indemnification. The 2013 Amendments now require an LLC to indemnify and hold harmless "a person with respect to any claim or demand against the person and any debt, obligation, or other liability incurred by the person by reason of the person's *former or present* capacity as a member of manager…" as long as such claim is not due to the person's breach of other sections in the Act pertaining to distributions, management, and standards of conduct.[44]

The 2013 Amendments expressly expand the class of individuals entitled to indemnity by including *former* members and managers as well. Importantly, indemnification for such individuals is mandatory under this default provision unless otherwise addressed in the operating agreement. Thus, if an LLC does not want this benefit to apply to the respective members, it must state so in its operating agreement.

In addition, the Act provides LLCs with the option to advance reasonable expenses to a person if such expenses were incurred "in connection with a claim or demand against the person by reason of the person's former or present capacity as a member or manager, if the person promises to repay the company if the person ultimately is determined not to be entitled to be indemnified."[45] Prior to the 2013 Amendments, an individual was not entitled to any advancement for such expenses. Because this advancement provision is discretionary, it does not mandate such advancements for LLCs if it is not otherwise addressed in the operating agreement.

Because RULLCA does not prohibit an LLC from modifying the provisions pertaining to indemnification, reimbursement, and advancement in its operating agreement, an LLC can modify or eliminate them to accord with their practices. Because of the mandatory nature of the indemnification provision, this must be addressed in the operating agreement if an LLC does not want it to apply as written.

C. Operating Agreement Limitations under RULLCA

For the most part, RULLCA retains the freedom of contract element that has helped make LLCs increasingly popular since the beginning of their existence. However, with the Act's addition of certain duties that an LLC might want to eliminate or restrict in an operating agreement, it is important to be aware of some of the modifications that an operating agreement is prohibited from

making. An LLC is still able to modify several provisions of RULLCA in its operating agreement, but a review of the prohibited modifications is worth mention. Specifically, Section 105(c) of RULLCA, as amended in 2013, provides fourteen modifications that an operating agreement is prohibited from making. While some of these restrictions were included in the 1995 Act, several of them were not.

Among the operating agreement limitations included in RULLCA that were not included in the 1995 Act, are: an operating agreement may not vary the LLC's capacity to sue and be sued in its own name, restrict the rights and duties of a person in the person's capacity as manager, vary the applicable governing law or power of the court, or restrict a member's right to maintain a derivative or direct action under the Act.[46] In addition, an operating agreement may not modify the provisions of the special litigation committee. However, an LLC may provide in its operating agreement that the LLC will not have a special litigation committee.[47]

The additional, but perhaps less significant, operating agreement provisions that RULLCA restricts an LLC from modifying in its operating agreement are also worth noting. An operating agreement may not: "vary any requirement, procedure, or other provision of [the Act] pertaining to: (A) registered agents; or (B) the [Secretary of State], including provisions pertaining to records authorized to be delivered to the [Secretary of State] for filing . . . ."[48] Section 105 of RULLCA also prohibits an operating agreement form varying the "required contents of a plan of merger under Section 1022(a), plan of interest exchange under Section 1032(a), plan of conversion under Section 1042(a), or plan of domestication under Section 1052(a)."[49] Similarly, an operating agreement may not vary a member's right to approve of a merger, interest exchange, conversion, or domestication.[50] A complete list of modifications that an operating agreement is prohibited from

making is located in Section 110(c) of the 2006 RULLCA and Section 105(c) of RULLCA, as amended in 2013.

III. ANALYSIS

Based upon the foregoing RULLCA provisions, this section discusses the ways that practitioners have dealt with drafting operating agreements in light of RULLCA and provides suggestions for how operating agreements can be drafted to modify or eliminate some of the Act's provisions. Because less than half of states have adopted RULLCA, and states that have enacted the Act have modified some of its provisions, it is important to confirm the extent to which a certain state permits an operating agreement to modify or eliminate the provisions in the governing law. This section analyzes the ways in which an operating agreement can modify the fiduciary provisions imposed by RULLCA. As other provisions have been discussed throughout this paper as they relate to the operating agreement's ability to modify them, they will not be included in this analysis section.

A. Operating Agreement – Fiduciary Duties

In states that have enacted or are enacting RULLCA and have never adopted a previous form of the Act, it is important to consider the default duties that RULLCA imposes and how they will affect the operation of an LLC. For example, as previously noted, prior to adopting its version of RULLCA in 2018, Arizona LLC law did not impose fiduciary duties on members of an LLC. Again, perhaps this is part of the reason that some have referred to the Act as the "Liability Company Act."[51] Although the fiduciary duties cannot be eliminated, they can be limited by appropriately structuring your LLC and including appropriate provisions in your operating agreement. Two of the ways that LLCs under the Act can limit the applicable fiduciary duties

under RULLCA is to: (1) convert a member-managed LLC to a manager-managed LLC; and (2) Amend your LLC operating agreement to modify the fiduciary duties imposed by the Act.[52]

1. Convert to a Manager-Managed LLC

Because certain fiduciary duties under the Act only apply to members of member-managed LLCs, and not members of manager-managed LLCs, a member-managed LLC could convert to a manager-managed LLC to limit the number of individuals subject to the fiduciary standards. This limits the applicability of both the duty of care and the duty of loyalty. Importantly, this does not limit the member's obligation to exercise his rights "consistently with the contractual obligation of good faith and fair dealing," which can never be modified by the operating agreement.[53] However, even if the LLC is manager-managed, the manager will still be subject to fiduciary duties under the Act. These duties can be modified to the extent permitted by the Act. Section 105 expressly sets forth certain duties that can not be modified by the Act. Generally, modifications are permitted as long as the contractual obligation of good faith and fair dealing is not modified or eliminated.[54]

2. Amend the Operating Agreement to Modify Fiduciary Duties

The second method available to limit the application of fiduciary duties under RULLCA is to limit the duties in the operating agreement to the extent permitted by the Act. Section 105(d)(3) of RULLCA permits an operating agreement to alter or eliminate the duty of care and aspects of the duty of loyalty as long as such modification is not manifestly unreasonable and certain requirements are still met. For example, although the operating agreement may alter the duty of care, it may not authorize any conduct involving "bad faith, willful or intentional misconduct, or knowing violation of the law."[55] In addition, an LLC may have the option to specify what

constitutes a breach of a duty, as RULLCA expressly provides that the operating agreement may also identify certain types of activities that do not constitute a breach of the duty of loyalty.

Although RULLCA imposes fiduciary duties, which may cause concern in states that have not yet been subject to the Act, it also provides for substantial modifications to such duties. Knowing the permitted modifications under the Act can help limit the fiduciary duties members applicable to members and managers of an LLC.

IV. CONCLUSION

The Revised Uniform Limited Liability Company Act has managed to strike a balance between the more formal aspects of corporate law and the considerable flexibility that LLCs have traditionally offered. The Act reflects the unique considerations with respect to LLCs. It contains revised charging order provisions because the drafters wanted to ensure that the entity was not used solely for asset protection. The Act imposes fiduciary duties that are consistent with corporate governance, but also allows for significant modifications to such duties. RULLCA's modified agency provisions reflect the ways in which LLCs have evolved that make them more distinguishable from partnerships.

As LLCs continue to develop and evolve, keeping up-to-date with respect to the evolving law can help companies draft their operating agreements to accord with their own practice and avoid some of the Act's undesired default provisions, at least to the extent permitted by the Act. In states that have not yet adopted a form of RULLCA, knowing the Act's default provisions is perhaps even more important so you can address them before you are exposed to them.

[1] According to the Uniform Law Commission's website, the states that have adopted the Revised Uniform Limited Liability Company Act are Idaho (2008), Iowa (2008), Wyoming (2010), Nebraska (2010), Utah (2011), District of Columbia (2011), California (2012), New Jersey (2012), Florida (2013), South Dakota (2013), Minnesota (2014), Washington (2015), Idaho (2015), Vermont (2015), North Dakota (2015), Connecticut (2016), Illinois (2016), Pennsylvania (2017), and Arizona (2018). South Carolina introduced SB 265 in early 2019 which would enact the Revised Uniform Limited Liability Company Act.
[2] Susan Pace Hamhill, *The Story of LLCs: Combining the Best Features of a Flawed Business Tax Structure*, *in* BUSINESS TAX STORIES 295, 297 (Steven A. Blank & Kirk J. Starks eds., 2005).
[3] The states that enacted versions of ULLCA are Illinois (1997), South Dakota (1998), Alabama (1998), Montana (1999), and Hawaii (1999). In addition, the US Virgin Islands enacted ULLCA in 1998.
[4] *See* Prefatory Note to the REVISED UNIF. LTD. LIAB. CO. ACT (UNIF. LAW COMM'N 2006)
[5] *Charging Orders – Overview*, LEXISNEXIS, https://www.lexisnexis.com/ap/pg/hkdisputeresolution/document/410922/5CV2-VXP1-DYRV-G412-00000-00/Charging_orders___overview (last visited May 3, 2019).
[6] May Lu, *Charging Orders: Their Effects on Different Business Interests Part Two: Partnerships and Limited Partnerships*, TIFFANY & BOSCOE P.A. (Mar. 16, 2017), https://www.tblaw.com/charging-orders-effects-different-business-interests-part-twopartnerships-limited-partnerships/
[7] *Id.*
[8] REVISED UNIF. LTD. LIAB. CO. ACT §503(f) (UNIF. LAW COMM'N 2013)
[9] REVISED UNIF. LTD. LIAB. CO. ACT §503 cmt. At 129 (UNIF. LAW COMM'N 2013)
[10] REVISED UNIF. LTD. LIAB. CO. ACT §409(c) (UNIF. LAW COMM'N 2006)
[11] *Business Judgment Rule*, CORNELL L. SCH., https://www.law.cornell.edu/wex/business_judgment_rule (last visited May 3, 2019)
[12] *Id.*
[13] REVISED UNIF. LTD. LIAB. CO. ACT §409(c) (UNIF. LAW COMM'N 2013). Among some of the states that have retained the business judgment rule are Idaho, Wyoming, and Minnesota. *See* ID Code § 30-6-409 (2016); WY Stat § 17-29-409 (2015); Minn. Code § 322C.0409
[14] Smith v. Van Gorkom is one of the notable cases detailing the business judgment rule, which was decided in 1985. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).
[15] REVISED UNIF. LTD. LIAB. CO. ACT §105(d)(3)(C) (UNIF. LAW COMM'N 2013).
[16] *See* Richard Keyt, *Arizona Limited Liability Company Law 2019*, KEYTLAW.COM, https://www.keytlaw.com/azllclaw/ (last visited May 3, 2019).
[17] REVISED UNIF. LTD. LIAB. CO. ACT §105(d)(3) (UNIF. LAW COMM'N 2013).
[18] *Id.*
[19] REVISED UNIF. LTD. LIAB. CO. ACT §409(a) (UNIF. LAW COMM'N 2006). The language originally included in Section 409(a) of the 1995 Act stating the duties imposed by subsections (b) and (c) were "[t]he only fiduciary duties" a member owes to a member-managed company was stricken in the 2006 Act.
[20] *See* ARIZ. REV. STAT. §29-3409 (2019).
[21] *See* ARIZ. REV. STAT. §§ 29-601–858 (2008).
[22] REVISED UNIF. LTD. LIAB. CO. ACT §801 cmt. at 157–58 (UNIF. LAW COMM'N 2013).
[23] *Id.*
[24] *Id.*
[25] REVISED UNIF. LTD. LIAB. CO. ACT §105(c)(11) (UNIF. LAW COMM'N 2013).
[26] REVISED UNIF. LTD. LIAB. CO. ACT §805 (UNIF. LAW COMM'N 2013).
[27] REVISED UNIF. LTD. LIAB. CO. ACT §105(c)(12) (UNIF. LAW COMM'N 2013).
[28] *Id.*
[29] REVISED UNIF. LTD. LIAB. CO. ACT §410(a)(1) (UNIF. LAW COMM'N 2013).
[30] *Compare* UNIF. LTD. LIAB. CO. ACT §410 (UNIF. LAW COMM'N 1995), *with* REVISED UNIF. LTD. LIAB. CO. ACT §410 (UNIF. LAW COMM'N 2006).
[31] REVISED UNIF. LTD. LIAB. CO. ACT §410(a)(3) (UNIF. LAW COMM'N 2013).
[32] REVISED UNIF. LTD. LIAB. CO. ACT §410(b) (UNIF. LAW COMM'N 2013).
[33] REVISED UNIF. LTD. LIAB. CO. ACT §410(b)(2) (UNIF. LAW COMM'N 2013).
[34] REVISED UNIF. LTD. LIAB. CO. ACT §410(b)(3) (UNIF. LAW COMM'N 2013).
[35] REVISED UNIF. LTD. LIAB. CO. ACT §105(c)(8) (UNIF. LAW COMM'N 2013).
[36] *Id.*

[37] UNIF. LTD. LIAB. CO. ACT §301 (UNIF. LAW COMM'N 1995).
[38] *Id.*
[39] REVISED UNIF. LTD. LIAB. CO. ACT §301(a) (UNIF. LAW COMM'N 2013).
[40] REVISED UNIF. LTD. LIAB. CO. ACT §301 cmt. at 74–75 (UNIF. LAW COMM'N 2013).
[41] REVISED UNIF. LTD. LIAB. CO. ACT §301(b) (UNIF. LAW COMM'N 2013).
[42] REVISED UNIF. LTD. LIAB. CO. ACT §301 cmt. at 75–76 (UNIF. LAW COMM'N 2013).
[43] *Id.*
[44] REVISED UNIF. LTD. LIAB. CO. ACT §408(b) (UNIF. LAW COMM'N 2013).
[45] REVISED UNIF. LTD. LIAB. CO. ACT §408(c) (UNIF. LAW COMM'N 2013).
[46] REVISED UNIF. LTD. LIAB. CO. ACT §105(c) (UNIF. LAW COMM'N 2013).
[47] *Id.*
[48] REVISED UNIF. LTD. LIAB. CO. ACT §105(c)(3) (UNIF. LAW COMM'N 2013).
[49] REVISED UNIF. LTD. LIAB. CO. ACT §105(c)(14) (UNIF. LAW COMM'N 2013).
[50] REVISED UNIF. LTD. LIAB. CO. ACT §105(c)(13) (UNIF. LAW COMM'N 2013).
[51] *See* Richard Keyt, *Arizona Limited Liability Company Law 2019*, KEYTLAW.COM, https://www.keytlaw.com/azllclaw/ (last visited May 3, 2019).
[52] Richard Keyt, *Manager of an Arizona Manger Managed LLC Says "Toto, We're Not in Kansas Anymore",* KEYTLAW.COM (May 17, 2018), https://www.keytlaw.com/azllclaw/2018/05/toto/.
[53] REVISED UNIF. LTD. LIAB. CO. ACT §409(i)(3) (UNIF. LAW COMM'N 2013). Section 409(i)(3) states that the duty in Subsection (d) is applicable to both members and managers.
[54] *See* REVISED UNIF. LTD. LIAB. CO. ACT §105 (UNIF. LAW COMM'N 2013).
[55] REVISED UNIF. LTD. LIAB. CO. ACT §105(d)(3)(C) (UNIF. LAW COMM'N 2013).