

UTAH'S NEW LLC ACT: THE GOOD, THE BAD AND THE UGLY¹

Introduction

After years of building momentum and failed attempts, Utah's Revised Limited Liability Company Act (the "Revised Utah Act" or the "Current Act") was replaced in its entirety by a modified version of the Revised Uniform Limited Liability Company Act (the "Revised Uniform Act") (SB131 – "Unincorporated Business Entity Uniform Acts") in the 2011 General Session of the Utah Legislature. Adoption of the Revised Uniform Act is a significant deviation from the current Utah Act and represents a fundamental shift in the Utah limited liability company landscape. SB131 also included wholesale replacements to Utah's Partnership and Limited Partnership Acts. It is anticipated that before the Uniform Partnership Acts included in SB131 become effective they will be replaced by new Uniform Partnership Acts to be introduced by NUCUSL in the coming months. As such, further discussion on the Uniform Partnership Acts will be presented in future meetings.

Over the past several years Senator Lyle Hillyard introduced the Revised Uniform Act, but on each instance it was defeated at various legislative stages. During the summer of 2010, Senator John Valentine worked with Senator Hillyard to address several of the lingering concerns; and in a slightly modified Revised Uniform Act was introduced with the backing of several powerful Utah lawmakers and an almost insurmountable momentum.

After reviewing the modifications to the Revised Uniform Act, practitioners still had serious concerns about the merits of the lofty goal of "uniformity" and about several of the substantive provisions of the Revised Uniform Act. In early 2011, an ad hoc committee was formed to study SB 131 and understand its merits. The committee attended the initial Senate Committee hearing for SB131 and requested that Senator Hillyard provide a forum in which the Business Section could provide further input. Over the course of several weeks we worked with the National Commissioners on Uniform State Laws ("NCUSL") and reporters of the Revised Uniform Act making significant modifications to the Revised Uniform Act. The result was Substituted SB131; the bill adopted by the Utah Legislature and signed into law by Utah's governor (the "New Act"). For purposes of this outline, the Revised Uniform Limited Liability Company Act as adopted by NUCUSL is referred to herein as the "RULLCA".

The goal of this presentation is to provide a summary of the New Act and highlight key differences with the Current Act. The shift is so significant that we recommend that all business practitioners read SB131.

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SUMMARY OF UTAH'S NEW LLC ACT (SB 131)

I. CURRENT ACT

A. *Not Viewed Favorably (on National Stage)*

1. Not “Business Friendly” – invites forum shopping
2. “Frankenstein Statute”

B. *Perceived Defects*

1. Overall structure – the “Frankenstein” effect
2. No allowance for oral operating agreements
3. Inadequate asset protection
4. Subordination of creditor-member claims
5. Subordination of creditor claims for costs and expenses of winding-up
6. Undue extension of statutory apparent authority
7. Inflexible in delegation of authority
8. Confusing use of the term “capital account”
9. Contains a default provision for the allocation of profits and losses (§48-2c-906) that in certain circumstances will conflict with the Internal Revenue Code and Treasury Regulations
10. Conflicting requirements to terminate a series (see §48-2c-613(3)(c) – compare with original Delaware provision (§18-215(k)(3))
11. No perpetual term allowed
12. Conversion of domestic LLC into a foreign entity – statute is silent as to what is to be filed in Utah (see §48-2c-1406(4))

II. NEW ACT

A. *Policies Reasons for Adoption*

1. More Business Friendly
 - a. Ease of formation

- b. Freedom of contract
- c. Greater predictability

2. Uniformity

- a. While, it is unlikely that the RULLCA will gain majority acceptance among the various states due to the revenue incentives of maintaining a unique LLC statute, wide acceptance is anticipated.
- b. The following States have adopted the RULLCA (most with minor modifications):
 - i. District of Columbia
 - ii. Idaho
 - iii. Iowa
 - iv. Nebraska
 - v. Utah
 - vi. Wyoming
- c. The following States have a version of the RULLCA pending in their Legislatures:
 - i. California
 - ii. Indiana
 - iii. Kansas
 - iv. Minnesota
 - v. New Jersey

3. Best Overall Structure

- a. New Act has a clean intuitive flow and structure compared to state LLC statutes based on the ULLCA or the ABA Prototype Act.
- b. New Act rectifies some of the perceived defects with the Current Act

B. *Administrative Matters*

1. Effective Date
 - a. Newly formed LLCs – July 1, 2012
 - b. Existing/All LLCs – January 1, 2014
 - c. Existing LLC Opt-in – Existing LLCs may opt-in to the New Act at any time after July 1, 2012 and before January 1, 2014.
2. Articles/Certificate
 - a. Existing Articles of Organization are automatically treated as qualifying under New Law as Certificate of Organization (*i.e.*, no need to amend or replace existing Articles – unless specific reason).
 - b. “Certificate” vs. “Articles” – Reflects creation and existence, but no terms relating to the operation of the LLC (*i.e.*, no member/manager information)
3. Perpetual Duration
 - a. Default – perpetual unless the Certificate of Organization states otherwise.
 - b. Existing LLC Articles with “99-year” term will need to be replaced.
4. Annual Report
 - a. Current Act requires information regarding members/managers
 - b. New Act – less information is required
5. Statement/Articles of Dissolution
 - a. Current Act requires filing of Articles of Dissolution with Division
 - b. Under the New Act, an LLC “may” file a statement of dissolution with the Division. Non-member third-parties are deemed to have constructive notice of such a filing 90 days after filing.
6. Statements of Authority
 - a. New Act – no statutory apparent authority by position

- b. Filed with the Division and identifies specific position or person with authority or limitations on authority

7. Necessary/Recommended Amendments to Existing Documents

- a. LLCs formed on or after July 1, 2012
 - i. Certificate of Organization
 - ii. Operating Agreement
 - iii. Certificates of Authority (if applicable)
- b. Existing LLCs
 - i. Replace current Articles with Certificate
 - ii. Amend and restate Operating Agreements to draft around new defaults (especially fiduciary duties)
 - iii. Certificates of Authority (if applicable)

C. *Important Features*

1. Certificate of Organization

- a. Less information required
- b. Only evidence that the LLC has been formed
- c. No constructive notice

2. Operating Agreements

- a. Oral Operating Agreements permitted – default statute doesn't override business deal if OA not in writing
 - i. OA can be oral, in a record, implied, or any combination
 - ii. UT evidentiary standard – “preponderance of the evidence”
- b. Reverses hierarchy of governing documents – Operating Agreement is supreme not Certificate of Organization
 - i. OA prevails as to members, dissociated members, transferees and managers.
 - ii. Certificate prevails as to other persons to the extent they reasonably rely on it.

3. Management
 - a. Preserves “member-managed” and “manager-managed” structure
 - i. Default is “member-managed” unless OA expressly provides for “manager-managed”
 - ii. No statutory apparent authority by position (*i.e.*, member in a member-managed LLC or a manager in a manager-managed LLC isn’t automatically an agent)
 - iii. Traditional agency law applicable
 - b. Delegation of authority doesn’t have to be in writing or filed with the Division
 - c. Certificate of Authority – can be filed to state or limit authority

4. Fiduciary Duties

- a. “Un-Cabining” – no statutory limit to applicable fiduciary duties.
- b. Specified Fiduciary Duties
 - i. Duty of Loyalty
 - (a) Account to LLC for property, profit and benefit derived in conduct or winding up of LLC, from use of LLC property or from appropriation of LLC opportunity.
 - (b) Refrain from dealing with LLC with interests adverse to LLC.
 - (c) Refrain from competing with LLC.
 - ii. Duty of Care
 - (a) RULLCA – Ordinary negligence subject to “business judgment rule”
 - (b) New Act – retains “gross negligence” standard and delineates standard
 - iii. Good Faith and Fair Dealing – in discharge of duties
- c. Limitations on ability to waiver and modify duties

- i. Operating Agreement may alter or eliminate the duties of loyalty, care and any other fiduciary duty provided that such modification is not “unconscionable or against public policy”.
 - ii. Determination of unconscionability is made at the time of modification.
 - d. Cannot waive intentional misconduct or knowing violation of law
 - e. Members in manager-managed LLC have no fiduciary duties solely by reason of being a member (may conflict with duty not to oppress)
- 5. Profits and Losses
 - a. New Act is silent as to how profits and losses (which are relevant only for taxes) are to be allocated
 - b. Profit and loss allocation would be governed by LLC Agreement or if silent by federal income tax law
- 6. Distributions
 - a. Prior to Dissolution (Defaults)
 - i. Current Act – “in proportion to capital account balances”
 - ii. New Act – “equal share”
 - b. Liquidating Distributions (Defaults)
 - i. Current Act
 - (a) Penalizes creditor-members and creditors of winding up expenses
 - (b) “in accordance with the member’s final capital account balances”
 - ii. New Act
 - (a) No penalty to creditor-members
 - (b) First, return capital, and thereafter in equal share
- 7. Charging Orders – not significantly different from Current Act
- 8. Judicial Dissolution for Oppression

- a. RULLCA
 - i. Right to dissolve LLC on the grounds that the managers or those members in control of the company have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the member.
 - ii. Gives court authority to grant other remedies.
 - b. New Act
 - i. Incorporates Current Act's right to dissolve for oppression as well as the right to purchase oppressed members interest in lieu of dissolution.
 - ii. No other court remedies.
9. Conversions
- a. Current Act – is silent as to what must be filed in Utah to convert a domestic LLC into a foreign entity.
 - b. New Act – contains comprehensive provisions authorizing LLCs to merge or convert into another type of entity and also authorizes other types of entities to merge and convert into an LLC and authorizes an LLC to domesticate in another state and also authorizes a foreign LLC to domesticate in the enacting state.
10. Series LLCs
- a. Current Act – incorporates almost verbatim series LLC provisions from the Delaware LLC Act
 - b. RULLCA – no series LLCs
 - c. New Act – provides for series LLCs with significantly greatly clarification and guidance.
11. Professional LLCs – included in New Act
12. L3Cs – included in New Act
13. Direct and Derivative Claims, Special Litigation Committees
- a. Current Act – provides an express derivative right for members on behalf of the LLC. The LLC can have the proceeding stayed by conducting an investigation of the allegations for a maximum of 30 days or completion of the investigation

- b. New Act – provides that a member can bring a direct action for injuries to that member and can bring a derivative action to enforce a claim of an LLC. If a derivative action is filed, the LLC may form a special litigation committee to investigate the asserted claims. This stays the litigation while the committee does its investigation. The objective of the investigation is to determine if the litigation is for the good of the company. Court can determine length of stay.

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