



## **WHY YOUR STATE SHOULD ADOPT THE UNIFORM LIMITED LIABILITY COMPANY ACT (ULLCA) (2006) (LAST AMENDED 2013)**

Limited liability companies (LLCs) are a relatively new form of unincorporated business organization that provide corporate-style limited liability to its owners. LLCs began to be widely used in the late 1980s after upholding LLC taxation as partnerships (Revenue Ruling 88-76). Every state has enacted some sort of LLC legislation; and LLC filings in almost all states far outnumber the number of new corporate filings on an annual basis. The existing state LLC statutes, however, are far from uniform; many have been amended on a patchwork basis and have not kept up with the LLC cases and other legal developments.

The Uniform Law Commission (ULC) promulgated the original Uniform Limited Liability Company Act in 1994 and amended it in 1996 to take into account the then newly adopted federal tax "check-the-box" regulations. ULLCA (1996), like most existing state LLC statutes, is classified as a "first generation" statute. In 2006 the Act was revised extensively. ULLCA (2006) also known as the Revised Uniform Limited Liability Company Act, is a comprehensive, fully integrated "second generation" LLC statute that takes into account the best elements of the "first generation" LLC statutes and two decades of legal developments in the field. The 2011 and 2013 amendments, enacted as part of the Harmonization of Business Entity Acts project, updated and harmonized the language in the provisions that are the same as provisions in the other uniform unincorporated entity acts, and made additional harmonization changes. The list below describes some of the more significant changes and innovations in ULLCA (2006), as amended:

- **The operating agreement.** The operating agreement, rather than the certificate of organization, determines whether an LLC is member-managed or manager-managed. The act also makes it clear that the operating agreement is binding on the LLC even in the case of a single member LLC and even if the LLC has taken no formal action to adopt the operating agreement.
- **LLCs may engage in any lawful purpose.** An LLC is not restricted to for-profit business activities. It can have "any lawful purpose, regardless of whether for profit." This expands the availability of LLCs to activities that are not traditional businesses, such as ownership of a family vacation home and, subject to other federal and state laws, allow an organization whose activities might be classified as non-profit to select an LLC as its form of entity.
- **Internal affairs default rules.** The act contains a basic set of internal affairs default rules governing the relationship of members and managers of an LLC between themselves and each other, most of which can be varied by the operating agreement. For example, if the operating agreement is silent on the type of management structure, an LLC is member-managed by default. There are also default rules for decisions by members and managers and for other matters.

- **Flexible management structure.** It is possible to have any type of management structure the LLC members want, including a corporate-style board of directors and officers. The management structure is set forth in the operating agreement.
- **Duties of managers and members.** The act specifies the fiduciary duty of loyalty and the duty of care for managers and clarifies the contractual status of the duty of good faith and fair dealing. These and other duties may be restricted or eliminated "if not manifestly unreasonable." The operating agreement may limit or eliminate liability of a manager to the LLC or other members for monetary damages except for breaches of the duty of loyalty, liability for improper distributions, or conduct involving bad faith, willful or intentional conduct, or knowing violation of law, limitations that are similar to those found in state corporation statutes.
- **Agency authority.** The authority of members and managers to bind an LLC is determined by agency law and not by status as a member of a member-managed LLC or a manager of manager-managed LLC, as is the case under most existing LLC statutes. Statements of authority may be filed in the office of the Secretary of State (or the equivalent state office for filing entities) and in the case of real estate, in the office where real estate records are kept to provide notice that only certain members or managers have authority to conduct business on behalf of the LLC.
- **Charging orders.** The act clarifies and simplifies the rules governing charging orders, the exclusive remedy for a creditor of a member to obtain a member's financial rights to distributions from the LLC. The act also provides the rules for foreclosing on a charging order and makes it absolutely clear that, except in the case of a single member LLC, a purchaser of a foreclosed interest only obtains the financial rights to distributions to the member and does not become a member of the LLC by virtue of the foreclosure or have any rights to participate or interfere with the management of the LLC or to demand inspection of the LLC's documents or records.
- **Distributions.** The act specifies the circumstances under which distributions from an LLC can and cannot be made and contains provisions for recovery of improper distributions. The act also makes it clear that payment for reasonable compensation and for retirement plans or other benefits programs are not distributions.
- **A remedy for oppressive conduct.** Reflecting case law developments around the country, the act permits a member to seek a court order "dissolving the company 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 applicant."
- **Direct and derivative claims, special litigation committees.** Under the act, 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 has merit and is for the good of the company.

- **Reorganization transactions.** The act has comprehensive provisions authorizing LLCs to merge, have interest exchanges or convert into another type of entity and also authorizes other types of entities to merge, have interest exchanges with and convert into an LLC. In addition, the act authorizes an LLC to domesticate in another state and also authorizes a foreign LLC to domesticate in the enacting state.

This act represents a significant advancement in LLC law. Some of the benefits of enacting the uniform act include reduced compliance costs, streamlined administration (which reduces costs to states) and consistency across jurisdictions.

ULLCA (2006) (Last Amended in 2013) is Article 5 of the Uniform Business Organizations Code.

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