

Calif.'s New LLC Act Needs Clarification

Law360, New York (August 26, 2013, 12:23 PM ET) -- On Sept. 21, 2012, S.B. 323, the California Revised Uniform Limited Liability Company Act (known as the RULLCA), was signed into law by Gov. Jerry Brown and is scheduled to take effect on Jan. 1, 2014.

The RULLCA entirely replaces the Beverly-Killea Limited Liability Company Act and revises certain rules for formation and operation of limited liability companies in the state of California. There is a possibility, however, that the RULLCA will be modified prior to Jan. 1, 2014, and thus the law governing LLCs may still be subject to change and clarification prior to its effective date.

As it reads today, and if not clarified before its effective date, the RULLCA may cause confusion upon application. The RULLCA states in Section 17713.04(a) that, except as otherwise provided in the law, the RULLCA will apply not only to all domestic LLCs existing on or after Jan. 1, 2014, but also to all foreign LLCs registered with the secretary of state, both prior to Jan. 1, 2014, and on or after Jan. 1, 2014.

At the same time, Section 17708.01(a) provides that the law of the state or other jurisdiction under which a foreign LLC is formed governs “(1) [t]he organization of the limited liability company, its internal affairs and the authority of its members and managers; [and] (2) [t]he liability of a member as member and a manager as manager for the debts, obligations or other liabilities of the limited liability company.”

Thus a foreign LLC registered in California is subject to the RULLCA, unless a carveout exists, such as the one provided in Section 17708.01(a) noted above. Without further clarification, however, it is not clear which aspects of a foreign LLC would remain subject to the laws of the state or other jurisdiction under which a foreign LLC is formed and which would be subject to the RULLCA.

For example, Section 17708.01(a) provides that the law of the state under which a foreign LLC is formed governs the “internal affairs” of such foreign LLC. Confusion and arguments are almost certain to arise regarding what constitutes an “internal affair” of a foreign LLC. For example this could include, or not, contributions to capital, indemnification, dissolution of the LLC or admission to membership in the LLC, to name just a few.

Section 17713.04(b) states that the RULLCA applies only to contracts entered into on or after Jan. 1, 2014, and to all actions taken by the managers or members of an LLC on or after that date. Prior law continues to apply to contracts entered into and actions taken before Jan. 1, 2014.

An operating agreement is a contract. An operating agreement entered into before Jan. 1, 2014, as a contract, would seem to be unaffected by the RULLCA under Section 17713.04(b). But Section 17713.04(a) says the RULLCA applies to all LLCs existing on and after Jan. 1, 2014.

This raises the question of whether subsection (b) supersedes subsection (a) and whether a minor amendment to an operating agreement, which was in existence prior to Jan. 1, 2014, would cause the operating agreement (contract) to be subject to the RULLCA after Jan. 1, 2014.

In addition, while under prior law, unless otherwise stated in the articles of organization or written operating agreement, only certain limited actions such as an amendment to the articles of organization or operating agreement required the unanimous vote of all members, the RULLCA requires the consent of all members in a manager-managed LLC to do any of the following:

- sell, lease, exchange or otherwise dispose of all, or substantially all, of the limited liability company's property, with or without the goodwill, outside the ordinary course of the limited liability company's activities,
- approve a merger or conversion under the RULLCA,
- undertake any other act outside the ordinary course of the limited liability company's activities, or
- amend the operating agreement.

This change pertaining to manager-managed LLCs is sure to cause confusion for members and managers trying to determine when consent of all members of a manager-managed LLC is required under the RULLCA and when it is not.

Members and managers of an existing manager-managed LLC should review their operating agreement to ensure that managerial powers exercised in such LLC may continue under the RULLCA, or if an amendment to the operating agreement is necessary.

Furthermore, the RULLCA makes clear that for manager-managed LLCs, the fiduciary duties of loyalty and care apply to managers, but not to members, and addresses the extent to which the LLC operating agreement may define or alter aspects of fiduciary duty.

While Section 17701.10(c)(4) provides that an operating agreement cannot eliminate the duty of loyalty, duty of care, or any other fiduciary duties, Section 17701.10(e) provides that the fiduciary duties of a manager to the LLC and to the members of the LLC may be modified in a written operating agreement with the informed consent of the members.

The extent to which such fiduciary duties may be modified may, without further clarification, create a challenge once the RULLCA goes into effect. For example, although Section 17701.10(c)(14) provides that the duty of loyalty cannot be eliminated by an operating agreement, an operating agreement may identify types or categories of activities that do not violate the duty of loyalty if not “manifestly unreasonable.”

Similarly, Section 17701.10(c)(15) provides that an operating agreement cannot “unreasonably” reduce the duty of care. What is meant by the qualifying terms “manifestly unreasonable” and “unreasonably” in these sections can significantly alter the extent to which fiduciary duties may be able to be modified by the operating agreement.

Unfortunately, this is likely going to be an evolving concept pronounced by appellate court decisions rather than as a clearly articulated statute that provides uniform guidance. Note that the Delaware Limited Liability Company Act makes it clear that fiduciary duties may be expanded, restricted or even eliminated by provisions in the limited liability company agreement, provided that the implied contractual covenant of good faith and fair dealing cannot be eliminated.

These are just a few examples of potential challenges that may arise upon the application of the RULLCA. Although it is possible that some questions may still be answered by modifications to the RULLCA prior to its effective date on Jan. 1, 2014, both existing and new LLCs as well foreign LLCs registered in California should be familiar with the new law and review their agreements and other documents to ensure compliance with its provisions.

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