

# PROPOSED REVISIONS TO THE UTAH LLC ACT

## 2010 SPRING CONVENITION OF THE UTAH STATE BAR

March 19, 2010

### Introduction

Utah's Revised Limited Liability Company Act (the "Revised Utah Act") has recently been targeted by professionals and legislators as ripe for an overhaul. Momentum has been building to make wholesale changes to the Utah Act, and recently two viable alternatives have been proposed. During the 2010 legislative session, the Revised Uniform Limited Liability Company Act (the "Revised Uniform Act") was proposed in committee (SB0065 – "Unincorporated Business Entity Uniform Acts"), but was defeated prior to committee debate. Legislators are also discussing the possibilities of the ABA's Revised Prototype Limited Liability Company Act (the "Revised Prototype Act"). Based on discussions with state leaders it is likely that the Utah Act will either be modified or be replaced in its entirety with one, or a combination, of these acts in the near future.

### OUTLINE

- I. POLICIES – What policies should be incorporated into Utah's LLC Act?
  - A. Business Friendly
    1. What does this mean?
      - a. Ease of formation
      - b. On-going compliance obligations
      - c. Favor toward entity, equity owners and management as opposed to other third parties (e.g., creditors and other persons doing business with entity)
      - d. Freedom of contract
  - B. Uniformity among States
    1. Is uniformity necessary?
      - a. Likely confusion
      - b. Impediment to inter-state commerce
    2. Is uniformity likely to be achieved?
      - a. States not likely to conform to a uniform statute

- i. Delaware, California, New York, and Texas
- 3. Is there a benefit to being uniform?
  - a. Benefit of similar architecture
- 4. Is there a benefit to not being uniform?

## II. UTAH REVISED LIMITED LIABILITY COMPANY ACT

- A. First Utah LLC Act was enacted in 1991
- B. Revised Utah Act was enacted in 2001
  - 1. Modified several times
  - 2. On the national stage, the Revised Utah Act is not viewed favorably (this view is shared by several Utah practitioners)
    - a. Not “Business Friendly”
      - i. Invites forum shopping
      - ii. Article in the *Utah Bar Journal* (Sep/Oct 2009) – “Utah LLCs vs. Other State LLCs: When Should Attorneys Consider Forming LLCs Outside Utah?”
    - b. “Frankenstein Statute”
  - 3. Perceived Defects
    - a. Overall structure – the Frankenstein Effect
    - b. No allowance of oral operating agreements
    - c. Inadequate asset protection
    - d. Subordination of creditor-member claims
    - e. Subordination of creditor claims for costs and expenses of winding-up
    - f. Undue extension of statutory apparent authority
    - g. Inflexible in delegation of authority
    - h. Confusing use of the term “capital account”

- i. 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
- j. Conflicting requirements to terminate a series (*see* §48-2c-613(3)(c) – compare with original Delaware provision (§18-215(k)(3))
- k. No perpetual term allowed
- l. 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))

### III. REVISED UNIFORM LIMITED LIABILITY COMPANY ACT

- A. National Conference of Commissioners on Uniform State Laws (“NCCUSL”)
- B. The first “Uniform Limited Liability Company Act” proposed in 1995
- C. The Revised Uniform Act was proposed in December of 2006
- D. Adopted by only two States: (1) Iowa, and (2) Idaho
- E. Distinctive features:
  - 1. Architecture is based on the Revised Uniform Partnership Act (“RUPA”)
  - 2. Shelf Registration – permits filing LLC charter without any LLC members
  - 3. Definition of rules regarding Operating Agreements
    - a. Permits oral operating agreements
    - b. Reverses hierarchy of governing documents – operating agreement is supreme not certificate of formation (i.e., articles or organization)
  - 4. Transferee Rights
    - a. Person who ceases to be a member – has no “pay out” right
    - b. No right to become member, has no governance rights, and virtually no information rights
    - c. Members may alter operating agreement and affect the transferee’s rights without the consent of the transferees
    - d. Transferee has no right to seek dissolution – locked in

5. Fiduciary Duties
  - a. “Un-Cabining”
  - b. Duty of Loyalty
    - i. Self Interest
    - ii. Good Faith and Fair Dealing
  - c. Duty of Care – replaces “gross negligence” with “ordinary care” subject to business judgment rule
  - d. Limitations on ability to waiver and modify duties
6. Eliminates statutory apparent authority by position (*e.g.*, manager of manager-managed LLC has power to bind; member of member-managed LLC has power to bind)
7. No default provision of allocation of profits and losses
8. Charging order is NOT the exclusive remedy – foreclosure available
9. Judicial dissolution for oppression
10. No Series LLCs
11. Professional LLCs not included

F. Concerns raised by Senator Valentine

IV. REVISED PROTOTYPE LIMITED LIABILITY COMPANY ACT

- A. The ABA’s Committee on LLCs, Partnerships and Unicorporated Entities (“LPUE”) published the first “Prototype Limited Liability Company Act” in November 1992
- B. LPUE released the Revised Prototype Act in January 2009 – is intended to be an “evergreen” project and will be updated regularly to reflect changes in tax law, developments in case law, changes in the law applicable to unincorporated business entities, etc.
- C. Distinctive features:
  1. Follows approximate architecture of Revised Uniform Act which is in turn based on the RUPA
  2. Permits oral operating agreements

3. Item including in certificate of formation (other than those required) do not constitute constructive notice of any fact
4. Eliminates statutory apparent authority by position
5. Removes management provisions – leaves management structure, authority and duties entirely up to the operating agreement
6. Charging order is exclusive remedy
7. Judicial dissolution for oppression
8. No default provision for allocation of profits and losses

#### V. DELAWARE LIMITED LIABILITY COMPANY ACT

- A. Viewed as “Business Friendly”
- B. The Delaware “Advantage”
  1. Helpful and business friendly Secretary of State
  2. Experienced Court of Chancery
  3. Quick legislative resolutions following unfavorable court rulings
  4. Large body of case law – greater predictability
  5. The “9/11” Rule – Emergency Filings (2 day extension)
- C. Forum of choice for many sophisticated investors (*e.g.*, Venture Funds)
- D. Distinctive features:
  1. Broad flexibility – freedom of contract (§18-1101(b))
  2. Fiduciary duties may be eliminated
  3. Series LLCs
  4. Charging Order – exclusive remedy
  5. Contains a default provision for the allocation of profits and losses (§18-503) that in certain circumstances will conflict with the Internal Revenue Code and Treasury Regulations

#### VI. AREAS OF COMPARISON

- A. Oral Operating Agreements

1. What constitutes as an operating agreement/limited liability company agreement
  2. Default Statute vs. business deal
  3. What provisions (if any) must be in writing
  4. Statutes of Fraud
    - a. Real Property
    - b. Obligations not susceptible to performance within 1 year (*see Olsen v. Halvorsen*, Del. Ch., 2008, 2008 Del. Ch. LEXIS 156 (Oct. 22, 2008))
  5. Examples under the Utah Act
- B. Management Structures and Statutory Apparent Authority
  - C. Charging Orders
  - D. Profit Allocation Provisions
  - E. Default Distribution Provisions
  - F. Fiduciary Duties
    1. Standard of Care
    2. Ability to modify, waive and eliminate

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