



What Every California LLC Needs To Know About California's New Revised Uniform Limited Liability Company Act

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New changes to California's limited liability company law affect many of the rules governing operation of limited liability companies ("LLCs"). These changes include the default provisions that automatically apply when the operating agreement is silent. All California LLCs should review their articles of organization and operating agreements in light of the new law to ensure the documents still provide what they intended.

On January 1, 2014 (the "Effective Date"), the Beverly-Killea Limited Liability Company Act (the law in California governing LLCs prior to the Effective Date) (the "Prior Act") was repealed and replaced by the Revised Uniform Limited Liability Company Act ("RULLCA"). Existing LLCs and those formed after the Effective Date are subject to the RULLCA. The RULLCA imposes significant changes in the way California LLCs are to be governed and inserts default provisions in LLC operating agreements if certain matters are not specifically addressed. The RULLCA provisions highlighted below are some of the more substantive changes made to the Prior Act and are changes that those who do business through LLCs should be keenly aware of. This is not an exhaustive list, however, and each LLC should review the new law in its entirety to verify its impact on their operations.

Member Voting Rights. The Prior Act provided that to the extent that the articles of organization or a written operating agreement of an LLC did not address the members' voting rights on particular matters, certain default rules would apply. For example, the Prior Act required a vote of the majority in interest of the members in order to approve a merger or dissolution of the LLC. Section 17704.07(c) of the RULLCA has now revised the default rules and states that a *unanimous* consent of all of the members is necessary in order to take certain actions such as the (a) sale, lease, exchange, or disposition of all, or substantially all, of the LLC's property outside the ordinary course of the LLC's activities; (b) approval of a merger or conversion

of the LLC; and (c) undertaking of any other act outside the ordinary course of the LLC's activities. The RULLCA does allow for a written operating agreement to change these default rules. If however, the operating agreement does not provide for a different voting standard for these matters, a situation could arise where a single minority member could prevent the LLC from taking the actions mentioned above. In the case of a single purpose LLC holding real property, for example, a decision to sell the property could be stalled or prevented by any member of the LLC who does not wish to approve the sale. This result could prove disastrous in case of an internal conflict between the members.

Formation of an LLC. The Prior Act defined an operating agreement as a written or oral agreement between all of the members of the LLC. Section 17701.02(g) of the RULLCA has now expanded the definition to refer to any agreement of all of the members of the LLC "whether oral, in a record, *implied*, or in any combination thereof," (emphasis added). In order to avoid a situation where an agreement would be "implied" between the parties, it is now more important than ever to document in writing the parties' agreement regarding the operation of the LLC. In addition, Section 17701.11(b) of the RULLCA provides that "a person that becomes a member of a limited liability company is deemed to assent to the operating agreement." Thus, a member can now be subject to an implied operating agreement or a written one that he/she does not even sign.

Management of an LLC. The default rule in the Prior Act was that an LLC was member-managed unless the articles of organization indicated otherwise. Section 17704.07(a) of the RULLCA now provides that an LLC is member-managed unless the articles of organization *and the operating agreement* provide otherwise. Therefore, in the event that both the articles and operating agreement fail to indicate that the LLC is manager-managed, the default rules would apply and the LLC will be deemed to be member-managed. Existing LLCs that have elected managers to make day to day decisions on behalf of the LLC should ensure that both their articles and operating agreement provide for a manager-managed company. If the articles and operating agreement do not both provide that the company is to be manager-managed, the day-to-day decision making authority of the company may be vested in its members where that is clearly not the intent.

Indemnification of Members and Managers. The Prior Act provided that the articles of organization or the written operating agreement *may* provide for indemnification of any person acting on behalf of the LLC. The RULLCA now requires the LLC to provide indemnification to selected individuals. Section 17704.08(a) of the RULLCA requires that the LLC reimburse and indemnify a member of a member-managed LLC or the manager for any debt, obligation or other liability incurred by them on behalf of the LLC as long as they complied with their fiduciary duties. RULLCA provides that these indemnification requirements may only be varied by a *written* operating agreement. LLCs should confirm that their written operating agreement covers indemnification as they intend.

Fiduciary Duties to the LLC. The RULLCA specifically provides that the manager or member(s) in control of the LLC owe a "duty of loyalty" and a "duty of care" to the non-controlling members. In addition, all LLC members owe a "duty of good faith and fair dealing" to one another. These fiduciary duties may be modified (but not eliminated) by a *written* operating agreement, subject to a number of defined limitations including being subject to a "not manifestly unreasonable" standard. Therefore, parties desiring to modify fiduciary duties should clearly define those duties and specifically authorize certain activities that may otherwise be viewed as a breach of fiduciary duties, for example engaging in competitive activities. Most important, the RULLCA provides that any variation of fiduciary duties must be approved "with the informed consent of the members." Unlike the Prior Act, which failed to elaborate on the definition of "informed consent", the RULLCA specifically provides that mere assent to the operating agreement shall not constitute informed

consent. While the RULLCA does not specifically define "informed consent", at a minimum each member must be made fully aware of the provision before he or she becomes a party to the operating agreement. As opposed to certain other default rules implemented by the RULLCA, the prohibition against eliminating fiduciary duties cannot be modified by the operating agreement.

The new rules under the RULLCA affect all LLCs in California, whether formed before or after the Effective Date. It is therefore important for existing LLCs to carefully review their operating agreements against the RULLCA and, where needed to reflect the intent of the parties and to continue smooth operations, amend them accordingly. Nossaman Corporate and Real Estate Practice Groups are familiar with the new RULLCA and can assist with operating agreement reviews and amendments to help LLCs avoid costly incidents, potential internal conflict and unintended consequences.