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A Summary of the New Minnesota Revised Uniform Limited Liability Company Act

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Introduction

On April 11, 2014, Minnesota's governor signed the state's new limited liability company act (the "New LLC Act"). With the passage of the New LLC Act, Minnesota joined numerous other states, including Florida, New Jersey, and Utah, in adopting a version of the Revised Uniform Limited Liability Company Act ("RULLCA"). Consistent with the legislative processes of several other states, Minnesota did not adopt the RULLCA in its entirety, but adopted many of the critical concepts from the model law, and retained other concepts from the current Minnesota Limited Liability Company Act (the "Current LLC Act"). This article summarizes some of the key concepts incorporated in the New LLC Act, and briefly compares those concepts, where a comparison may be made, relative to the relevant provision(s) of the Current LLC Act.

Effective Dates

The Minnesota Legislature adopted staggered effective dates for the New LLC Act. The new law will apply to all LLCs formed on and after August 1, 2015 (the "Initial Effective Date"). The statute will also apply to LLCs formed prior to that date, if they elect to be subject to the New LLC Act after the Initial Effective Date. Opting to be subject to the New LLC Act after the Initial Effective Date will be accomplished through the process the members identify in the LLC's operating agreement or bylaws. See Section 322C.1204, Subdivision 1. However, effective January 1, 2018, the Current LLC Act will be repealed, and on and after that date the New LLC Act will apply to all LLCs organized under Minnesota law (the "Final Effective Date"), regardless of their formation dates.

The periods before and after the Initial Effective Date, and after the Final Effective Date, raise potentially challenging drafting and counseling issues for Minnesota

practitioners. To begin with, practitioners who represent LLCs formed in Minnesota prior to the Initial Effective Date must be prepared to draft organizational and other documents that will comply with the Current LLC Act, and which will be consistent with the provisions of the New LLC Act on and after the Final Effective Date. For example, for an LLC formed under the Current LLC Act prior to August 1, 2015, practitioners must be prepared to draft constituent documents to support not only compliance with the existing law prior to that date, but which will comply with (or which can be easily revised to comply with) the New LLC Act on and after the Final Effective Date (assuming that the LLC does not elect to be governed by the New LLC Act prior to that date). More specifically, practitioners representing LLCs formed prior to August 1, 2015, must be prepared to craft organizational documents (and any transactional documents to which the entity is a party) to take into account a future decision by the LLC's owners or governors to elect to be governed by the New LLC Act prior to the Final Effective Date.

Some Key Concepts

Governing Documents

The Current LLC Act expressly provides for a set of corporation-like governing documents, including articles and bylaws. It is not uncommon for a Minnesota LLC's articles to include substantive provisions allocating the owners' rights and responsibilities, and the form and processes by which the entity will be governed. But the owners' rights and responsibilities, and the substance and terms of any governance structure, may also be articulated in the entity's bylaws, or in a combination of the articles, bylaws, and a "member control agreement." See Section 322B.37, Subdivision 1 (a member control agreement "may relate to, without limitation, the management of the limited liability company's business").

The New LLC Act, in contrast, presupposes that the articles will include the minimal terms necessary to form the entity, and that the articles will not serve as a governance document. Instead, the New LLC Act simplifies the LLC structure by allowing the

members to develop a single contract – the “operating agreement” – through which they will allocate rights and responsibilities among themselves, and construct the entity’s governance processes. Section 322C.0110 of that legislation states that the operating agreement governs:

- Relations among the members as members and between the members and the LLC;
- The rights and duties of a person “in the capacity of a member or governor;”
- The activities of the company and the conduct of those activities; and
- The “means and conditions” for amending the operating agreement.

Importantly, Subdivision 2 of the same section includes a default provision which states that any “matter” not addressed in the operating agreement will be governed by the New LLC Act. In other words, the New LLC Act shifts the responsibility to the parties to identify and articulate the topics to be covered in the operating agreement, or risk that the relevant provisions of the New LLC Act will limit the parties’ rights and duties.

Governance: Default Concept

Under the Current LLC Act, the “business and affairs” of an LLC are to be managed by a board of governors, subject, in the first instance, to the vote of the members to take an action that could otherwise be taken by the board, and, in the second instance, to the terms of the member control agreement. See Section 322B.606, Subdivision 1. In keeping with the corporation-like approach to LLC governance under the Current LLC Act, that statute also includes numerous provisions that govern the process for electing the board of governors, including with respect to the exercise and calculation of cumulative voting rights (Section 322B.63); the length of the terms to be served by governors (Section 322B.616); and compensation arrangements to which members of the board of governors are subject (Section 322B.623). Further,

Subdivision 2 of Section 322B.606 expressly provides that members may unanimously determine to take any action that the board of governors would be permitted to take under the Current LLC Act. Cf., Minnesota Statutes, Section 302A.201, Subdivision 2 (the shareholders of a Minnesota corporation may take any action that the board is required or permitted to take).

The New LLC Act introduces substantively different concepts which clarify the governance structure of the LLC, and which make that governance structure less like that of a corporation. As a threshold matter, Section 322C.0407 of the New LLC Act provides, as a default, that an LLC formed under the statute will be managed by its member or members in the absence of an express provision in the operating agreement that the entity will be managed by one or more managers or by a board of governors. Subdivision 3 of this section defines the term “manager” as the person who “is responsible, along or in concert with others, for performing the management functions” identified in the statute. If the entity is to be managed by its manager, then “any matter relating to the activities of the company” will be “decided exclusively by the manager.”

Note, however, as referenced above, that the New LLC Act retains the Current LLC Act concept of a board of governors. Subdivision 4 of Section 322C.0407 of the New LLC Act states that a board of governors, if elected by a majority of the members, will be authorized to manage “the activities and affairs” of the LLC. And although the New LLC Act does not include all of the prescriptive provisions under the Current LLC Act relating to the election and functioning of the board of governors (e.g., the provisions relating to terms of office, cumulative voting, and compensation of governors), it has retained from that statute many of the corporation-like procedures by which a board of governors’ meeting would be called and conducted. See Section 322C.0407, Subdivision 4 (“Board-managed company rules”).

Exculpation / Fiduciary Duties

There are important similarities and differences respecting exculpation and the

treatment of fiduciary duties under the Current LLC Act and the New LLC Act. With respect to the former, under both statutes, for example, an LLC's governing documents (e.g., articles and bylaws under the Current LLC Act, and the operating agreement under the New LLC Act) generally cannot provide for the exculpation of a manager, member or director for breach of the duty of loyalty; hence each of the acts provides that a breach of the duty of loyalty by such a person is non-exculpable. See Section 322B.663, Subdivision 4 (respecting a governor) and Section 322C.0110, Subdivision 3.

But there are also subtle, and important, differences between the statutes in relation to the exculpability of certain types of misconduct. Under the Current LLC Act, only governors may be exculpated under the LLC's formation and organizational documents; the New LLC Act, in contrast, allows for the exculpation of members, managers, and governors. The New LLC Act also provides a mechanism by which the members may ratify or authorize an act that "would otherwise violate the duty of loyalty." Section 322C.0111, Subdivision 5. In addition, the New LLC Act allows the members to identify in the operating agreement certain types of "activities that do not violate the duty of loyalty." Section 322C.0110, Subdivision 4(2). Further, Section 322B.663, Subdivision 4(2), of the Current LLC Act provides that "intentional misconduct" is not exculpable, while Section 322C.0110, Subdivision 7(4), of the New LLC Act states that "intentional infliction of harm" to or "on" the LLC or a member is not exculpable. And Section 322B.663, Subdivision 4(2), of the Current LLC Act states that a "knowing violation" of law is non-exculpable, and Section 322C.663, Subdivision 7(5), of the New LLC Act provides that an "intentional violation of criminal law" is not exculpable.

Finally, the New LLC Act adopts a modified "un-cabined" approach to the treatment of fiduciary duties. That statute allows the members to modify in the operating agreement any fiduciary duty (other than the duty of loyalty), "including eliminating particular aspects of that duty" where it is not "manifestly unreasonable" to do so. 322C.0110, Subdivision 4(4). The Current

LLC Act contains no such provision.

"Shelf LLC"

Section 322C.0105 of the New LLC Act provides for a "shelf LLC" – an entity that does yet have a member, but which is nonetheless recognized under the statute as a separate juridical person for purposes of admitting members and filing and amending documents required of LLCs formed under Minnesota law. See, e.g., Section 322C.0202 (relating to the filing of an amendment to the certificate relating to the articles); Section 322C.0208 (relating to the filing of the entity's annual report); and Section 322C.0702 (relating to the filing of a certification of termination). The Current LLC Act does not recognize the concept of a "shelf LLC."

Automatic Agency

Section 322C.0301 of the New LLC Act provides that "a member is not an agent" of the LLC only on the basis that the person is a member. In other words, the New LLC Act requires the entity to take an action to vest a member with the authority to act as an agent on its behalf, for that person to be considered and treated as an agent of the LLC. This concept was not incorporated in the Current LLC Act. Instead, the existing statute includes standard provisions on the authority of the LLC to elect or appoint agents, identify their duties, and "fix their compensation" (Section 322B.20, Subdivision 18); the limited liability of agents for the debts and liabilities of the entity solely because of their status as agents of the LLC (Section 322B.303, Subdivision 2); and the authority of the LLC to enter into contracts with agents (Section 322B.683).

Charging orders

Section 322C.503 of the New LLC Act recognizes the concept of a charging order that may be obtained by a judgment creditor of a member (or by the transferee of a member). Subdivision 1 of that section makes clear that the charging order is a lien on the judgment debtor's (i.e., a member's) "transferable interest," and that the LLC is required to "pay over to the person to which the charging order was issued any distribution that would otherwise be paid to

the judgment debtor.” The Current LLC Act does not reference charging orders, or include any specific provision clarifying an LLC’s obligations with respect to a lawfully obtained charging order issued against a member of the LLC.

Conclusion

As referenced above, when advising clients prior to the Initial Effective Date, Minnesota practitioners should carefully consider the application of the New LLC Act after the Initial Effective Date, and what revisions, if any, to the entity’s formation and organizational documents will be necessary now and in the future to achieve their client’s objectives. In particular, practitioners should bear in mind three considerations. First, practitioners (including those representing a client buying or investing in a Minnesota LLC) should carefully prepare organizational and transaction documentation to comply both with the Current LLC Act, and with the provisions of the New LLC Act after August 1, 2015, if so elected, and in any case after January 1, 2018. This means, for example, including appropriate provisions in the “member control agreement” (rather than in the articles) that allow for amending organizational and transaction documentation to adopt provisions under the New LLC Act that would be beneficial to the client, and without causing a re-allocation of rights and duties (or a re-negotiation of the documents) in conflict with the client’s objectives. Second, because of the differences in statutory defaults under the Current LLC Act and the New LLC Act, practitioners should carefully draft organizational documentation to reduce the risk of relying on statutory defaults available under the Current LLC Act that do not exist under, or which are contrary to, those under the New LLC Act. Finally, practitioners who are retained by entities formed prior to the Initial Effective Date, but which seek to elect to be subject to the New LLC Act after that date, should carefully review their client’s individual facts and circumstances, and all relevant documentation, to determine the scope and nature of any advisable revisions to (and potentially any significant re-drafting of) governing and transactional documentation.