

Corporate & Business Alert: Minnesota Adopts New Limited Liability Company Act

July 24, 2014

On April 8, 2014, Governor Dayton signed into law the Minnesota Revised Uniform Limited Liability Company Act - new Chapter 322C of the Minnesota Statutes (the "**New Act**"). The New Act will become effective on August 1, 2015, for all LLCs formed on or after that date. LLCs in existence on July 31, 2015, will remain governed by the present Minnesota LLC Act, Chapter 322B ("**Chapter 322B**"), but may elect after that date to be governed by the New Act. Any Chapter 322B LLCs that have not elected to be governed by the New Act will automatically become subject to the New Act on January 1, 2018.

Significant aspects of the New Act, compared to Chapter 322B, include the following:

- **Change Toward Partnership Model**

Chapter 322B, was in many respects cloned from the Minnesota Business Corporation Act. Its default rules establish a corporate structure, with members, a board of governors, and managers that are analogous to shareholders, a board of directors, and officers. The New Act defaults to member management (more like a partnership), but permits manager management and board management. The latter is to permit existing LLCs to continue with their current structures.

- **Governing Documents; Expanded Definition of Operating Agreement**

Chapter 322B contemplates that an LLC will have a member control agreement and bylaws, which are sometimes separate documents and sometimes combined. The member control agreement - analogous to a partnership agreement - must be in writing and must be executed by all persons who, at the time of execution, are members or have executed contribution agreements with the LLC.

The New Act takes a broader approach. It contemplates an "operating agreement" serving as the governing document, addressing the (1) relations among the members as members and between the members and the LLC; (2) the rights and duties of persons acting in the capacity of manager or governor; (3) the activities of the LLC and the conduct of those activities; and (4) the means and conditions for amending the operating agreement. ("Operating agreement" is terminology more frequently used in other states.) Under the New Act the operating agreement is initially entered into by all the members of the LLC (including a sole member), but is not limited to written agreements, as it also includes oral agreements, agreements implied by conduct, and any combination of these forms. This should be a benefit to less formal LLCs where articles are filed but no formal agreement is ever entered into. The reasons for having a written agreement and spelling out

such matters as to how the agreement may be amended remain just as strong as they were under Chapter 322B.

- **Management/Governance Structures**

The default structure under Chapter 322B contemplates a Board of Governors, similar to a Board of Directors in the case of the corporation. The default structure under the New Act is member management, although the act also permits manager management and board management. These provisions will allow any prior LLC to operate with its management structure pretty much as it did prior to becoming a 322C LLC. Under the current statute, there must be at least one natural person exercising the positions of chief manager (i.e., CEO) and treasurer. The New Act has no such requirement. The managers in a manager-managed LLC may be either individuals or entities. In a Board-managed LLC, however, board members must be individuals as under Chapter 322B.

- **Voting Rights**

The New Act changes the presumption on voting rights. In the absence of an agreement, voting rights under the New Act will be on a per capita basis (each member has one vote), whereas Chapter 322B allocates voting rights in accordance with the value of capital contributions. The New Act is more in line with partnership default rules.

- **Authority to Bind LLC**

Chapter 322B does not specifically address the agency of members, but it does require that an LLC have one or more natural persons exercising the functions of the offices, of chief manager, and treasurer. Subject to the LLC's MCA, Chapter 322B specifically delegates the power to actively manage the LLC and sign documents to the Chief Manager. The New Act provides that a member is not an agent of an LLC solely by reason of being a member, i.e., there is no apparent statutory authority. Agency issues and the authority to bind an LLC will be governed by the operating agreement and agency law. The New Act does not require the appointment or designation of any particular manager or office, but does contain default rules similar to those contained in Chapter 322B governing the status of persons a board may designate as chief manager", "president," "chief executive officer," "CEO," or as "treasurer," "chief financial officer," "CFO," or, in each case, other titles of similar import.

- **Statements of Authority**

The New Act permits an LLC to file statements of authority similar to those that may be filed under the Uniform Partnership Act of 1994, Chapter 323A. These affect only the power of a person to bind an LLC to persons that are not members. The New Act contains rules for filing these statements with the Secretary of State, limiting authority conferred under such a statement, revoking the statement, giving effect to authority to transfer real estate, etc., as well as filing Statements of Denial (of authority). Chapter 322B contains no similar provisions.

- **Duties of Members, Managers, and Board Members**

Under Chapter 322B governors are to discharge their duties in good faith, in a manner the governor

reasonably believes to be in the best interests of the LLC (the duty of loyalty), and with the care an ordinarily prudent person in a like position would exercise under similar circumstances (the duty of care), i.e., the business judgment rule. These duties are not waivable, although subject to significant restrictions, to a governor's personal liability to the LLC or its members for monetary damages for certain breaches of fiduciary duty. The members are subject to these duties to the extent that they act in place of the Board.

As with the Chapter 322B, the New Act imposes on members, managers, and governors fiduciary duties of loyalty and care, and spells out what these duties entail absent permitted modification in the operating agreement. The New Act does permit an LLC, through its operating agreement, to restrict or eliminate certain aspects of the duty of loyalty and to identify specific types or categories of activities that do not violate that duty, so long as these modifications are not manifestly unreasonable. The duty of care also can be altered so long as the operating agreement does not authorize intentional misconduct or knowing violation of law. Other fiduciary duties that may apply may be altered and particular aspects of such duties may be eliminated.

■ **Indemnification and Exculpation**

Under Chapter 322B, so long as the LLC's Articles of Organization or a member control agreement does not otherwise contain a prohibition or limitation applicable equally to all persons or to all persons within a given class, and subject to certain conditions, including that the person being indemnified has acted in good faith and received no improper personal benefit, an LLC is required to indemnify governors, managers, members, and other persons made or threatened to be made a party to a proceeding by reason of the person's official capacity (prior or present) against judgments, penalties, or fines. The New Act essentially carries over these provisions.

Under Chapter 322B, an LLC, through its Articles or a member control agreement, may eliminate or limit the personal liability for monetary damages to the LLC or its members of a governor (or a member acting in place of a governor) for breach of fiduciary duty as a governor except for: (1) breaches of the duty of loyalty to the LLC or its members; (2) acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law; (3) illegal or improper distributions; (4) any transaction from which the governor derived an improper personal benefit; or (5) any act or omission occurring before the date when the provision in the articles of organization or a member control agreement eliminating or limiting liability becomes effective.

The New Act similarly permits an LLC, through its operating agreement, to eliminate or limit a member's, manager's, or governor's liability to the LLC and members for money damages, except for: (1) breach of the duty of loyalty; (2) a financial benefit received by the member or manager to which the member or manager is not entitled; (3) making improper distributions; (4) intentional infliction of harm on the company or a member; or (5) intentional violation of criminal law.

- **Rights to Distributions and Allocations of Profits and Losses**

Under Chapter 322B, unless a written member control agreement provides otherwise, profits and losses and distributions are allocated in proportion to the capital contributions. The New Act does not specifically allocate profits and losses, but allocates distributions prior to dissolution on a per capita basis (each member has an equal share). Upon liquidation, distributions are allocated to the members first to reflect previously unreturned contributions and then on a per capita basis. Under the New Act, the allocation of profits and losses is considered a conceptual matter to be dealt with in the agreement or under applicable tax law. In either case, and under either law, it is important to address these matters in an agreement among the members.

- **Rights to Transfer Ownership**

Unless restricted by a written member control agreement, Chapter 322B permits a member to transfer financial rights without the consent of any other member and to transfer governance rights to anyone who is already a member. Any other transfer is permitted and effective only if all members other than the transferor unanimously approve. The New Act's rules are much the same, bifurcating membership interests into economic rights (referred to as a "transferable interest") and governance rights. Unless restricted by an operating agreement, a member may transfer some or all of the "transferable interest," but may transfer other rights (e.g., voting, management, information rights) only with the consent of all other members.

- **Oppression Remedies/Judicial Dissolution and Intervention**

Chapter 322B has very extensive provisions regarding judicial intervention, equitable remedies, and judicial dissolution (sections 322B.833 and 322B.836). These closely track those contained in the Minnesota Business Corporation Act, and have very detailed provisions regarding how and when a court may become involved in disputes among members, what considerations it may take into account, and how it may go about imposing equitable remedies, including involuntary dissolution or forced buy-outs.

The New Act more closely tracks the uniform act, permitting a court to order dissolution or some remedy shy of dissolution (including a forced buy-out) if: (1) the conduct of all or substantially all of the LLC's activities is unlawful; (2) it is not reasonably practicable to carry on the LLC's activities in conformity with the articles of organization and the operating agreement; or (3) the managers, governors, or those members in control of the LLC: (i) have acted, are acting, or will act in a manner that is illegal or fraudulent; or (ii) have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant.

Minnesota's version of the New Act contains a definition of "oppressive conduct" that is intended to guide courts in resolving these disputes in a manner that is consistent with the deal the LLC members struck for themselves. It protects expectations of members that are reasonable in light of the reasonable expectations of the other members, that are material to the member's decision to become a member of the LLC or, for a substantial time, to continue membership, are known to other members (or that the other members had reason to know) and are not contrary to the operating agreement as applied consistently with the

contractual obligation of good faith and fair dealing. The statute states explicitly that conduct is not "oppressive" solely because there is reason of a good faith disagreement as to the content, interpretation, or application of the LLC's operating agreement.

- **Shelf LLCs**

Chapter 322B permits an LLC to exist with some authority prior to the admission of members. The organizer(s) may name the first board of governors and the organizer(s) (or first board, if named) take actions to transact business or as may be necessary or appropriate to complete the organization of the LLC, including, without limitation, amending the articles, electing governors, adopting bylaws, electing managers, adopting banking resolutions, authorizing or ratifying the purchase, lease, or other acquisition of suitable space, furniture, furnishings, supplies, and materials approving an LLC seal, adopting a fiscal year for the LLC, contracting to receive and accept contributions, and making any appropriate tax elections.

This authority is further limited under the New Act. Until an LLC has or has had at least one member, the LLC lacks the capacity to do any act or carry on any activity except: (1) delivering to the secretary of state for filing a statement of change, an amendment to the certificate, a statement of correction, an annual report, and a statement of termination; (2) admitting a member; and (3) dissolving. When the LLC later has at least one member, it may ratify acts or activities that occurred when the LLC lacked capacity under these shelf LLC provision.

- **Series LLCs**

Neither the New Act nor Chapter 322B provide for "series LLCs."