

# The New LLC Law in Pennsylvania



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# Background

- The new LLC law is part of Act 170, which became effective in early 2017. Act 170 was a sweeping revision to a significant portion of Title 15.
- Major aspects of Act 170:
  - Expanded liability shield for LLPs and LLLPs.
  - Revision of the laws on partnerships and LLCs.
    - ✦ Uniform Partnership Act (1997, 2013)
    - ✦ Uniform Limited Partnership Act (2001, 2013)
    - ✦ Uniform Limited Liability Company Act (2006, 2013)
  - Benefit LLCs.
  - Nonprofit limited partnerships and LLCs.
  - New provisions on derivative suits involving all types of unincorporated entities.

## Background (cont.)

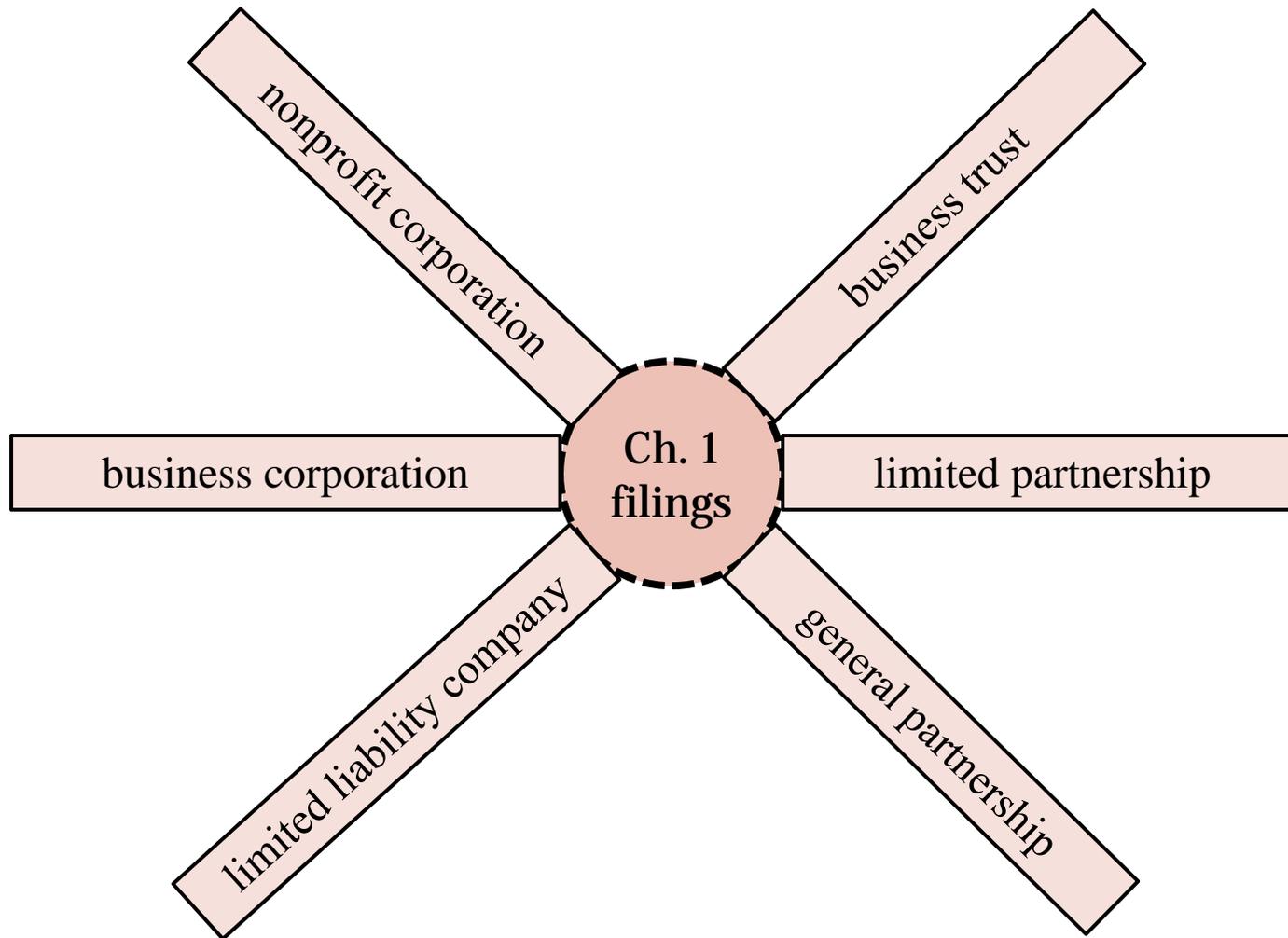
- Act 170 became effective on February 21, 2017 for newly formed unincorporated entities and on April 1, 2017 for all general partnerships, limited partnerships, and limited liability companies.
- The Committee Comments act as legislative history for Act 170 and can be an invaluable tool for interpreting Act 170.
- Act 170 was part of the third portion of an overarching overhaul of Title 15 which began with the enactment of the general provisions (the “Hub”) in 2014, followed by the Entity Transactions Law, effective July 1, 2015,

# Background (cont.)

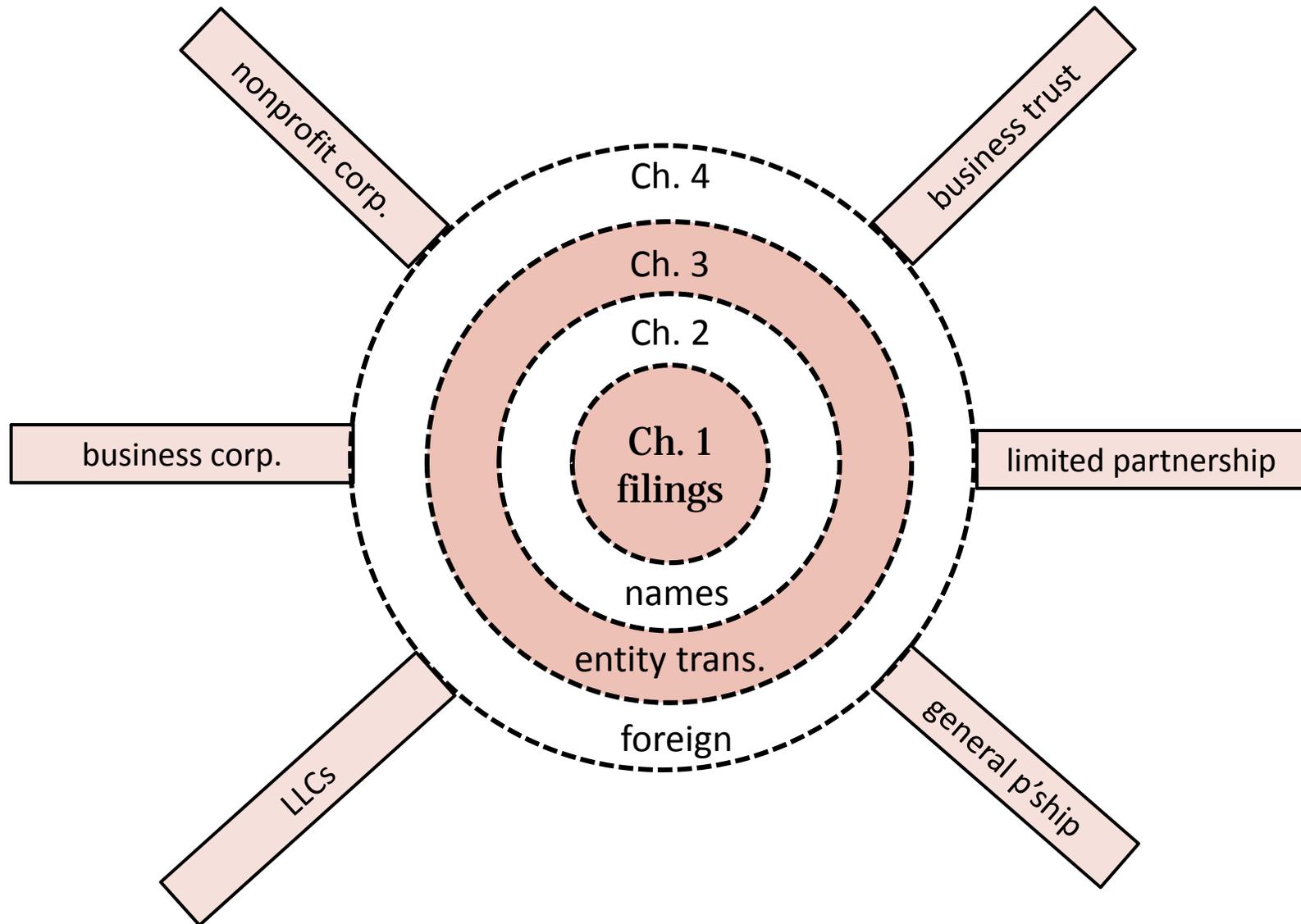
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- **Today's presentation:**
  - Structure of Title 15
  - Major impacts of the new LLC law for health law practitioners:
    - ✦ Governance
    - ✦ LLC Organizational Documents
    - ✦ Duties of LLC Members and Managers
    - ✦ Membership Interests

# Structure of Title 15 Prior to the Entity Transactions Law and Act 170



# Structure of Title 15 After Entity Transactions Law and Act 170



# GOVERNANCE



- Like prior law, LLCs are either member-managed or manager-managed.
- However, there are several notable differences from the prior law:

# GOVERNANCE

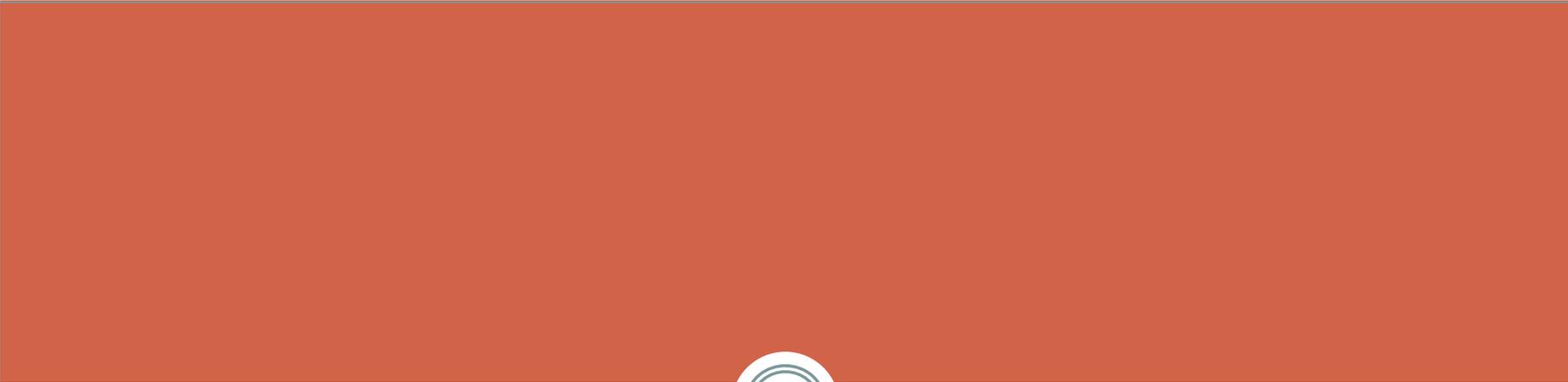
- Default rule is member-managed unless the ***operating agreement*** expressly provides that the company will be manager managed (§8847(a)).
- Statute now lists default rules for member-managed companies (§8847(b)) and for manager managed companies (§8847(c)).
- Default rules govern the management of the LLC where the operating agreement is silent on an issue.

# Default Rules for Member-Managed LLCs

- Each member has **equal** rights in the management and conduct of the company's activities and affairs (the *per capita* rule).
- A difference arising among members as to a matter in the ordinary course of the activities and affairs of the company **will** be decided by a majority of the members.
- Except for the majority-vote rule with respect to a transaction under Chapter 3 (relating to entity transactions), an act outside the ordinary course of the activities and affairs of the company requires the affirmative vote or consent of all members.
- Except as provided in section 8822(d) (correcting an inaccuracy in a certificate of organization), amendment of the certificate of organization requires the affirmative vote or consent of *all* members.
- Any amendment to the operating agreement requires the affirmative vote or consent of *all* members.

# Default Rules for Manager-Managed LLCs

- Except as expressly provided in this title, any matter relating to the activities and affairs of the company is decided exclusively by the manager, or, if there is more than one manager, by a majority of the managers.
- Each manager has **equal** rights in the management and conduct of the company's activities and affairs.
- Notwithstanding the foregoing, the affirmative vote or consent of **all members** is required:
  - except as provided under section 325 with respect to a transaction under Chapter 3 (META), to undertake any act outside the ordinary course of the company's activities and affairs;
  - Except as provided under section 8822(d), to amend the certificate of organization; or
  - To amend the operating agreement.
- A manager may be chosen at any time by the affirmative vote or consent of a majority of the members and remains a manager until a successor has been chosen, unless the manager at an earlier time resigns, is removed or dies, or, in the case of a manager that is not an individual, terminates. A manager may be removed at any time by the affirmative vote or consent of a majority of the members without notice or cause.



# **ORGANIZATIONAL DOCUMENTS**



# ORGANIZATIONAL DOCUMENTS

- **LLCs are Creatures of Statute and Contract**
  - As has always been the case, a certificate of organization must be filed with the Department of State in order to create an LLC.
  - Once formed, subject to the limitations set forth in Sections 8815(c) and (d), the members of an LLC retain the freedom of contract to design the governance and operation of the LLC through the operating agreement.

# CERTIFICATE OF ORGANIZATION

- Under the new LLC law, it is no longer *necessary* for the certificate of organization to disclose:
  - whether the LLC is member-managed or manager-managed;
  - whether membership interests are to be certificated or uncertificated.

# CERTIFICATE OF ORGANIZATION (old)

STATE OF CALIFORNIA DEPARTMENT OF REVENUE - TAX SERVICES DIVISION

DSCB:15-8913-2

4. ~~Strike out if inapplicable form~~  
~~A member's interest in the company is to be evidenced by a certificate of membership interest.~~

5. ~~Strike out if inapplicable:~~  
Management of the company is vested in a manager or managers.

6. The specified effective date, if any is: Upon Filing  
month date year hour, if any

7. ~~Strike out if inapplicable: The company is a restricted professional company organized to render the following~~  
~~restricted professional service(s):~~

8. For additional provisions of the certificate, if any, attach an 8 1/2 x 11 sheet.

IN TESTIMONY WHEREOF, the organizer(s) has (have)  
signed this Certificate of Organization this  
29<sup>th</sup> day of Sept., 2015

  
\_\_\_\_\_  
Signature

  
\_\_\_\_\_  
Signature

\_\_\_\_\_  
Signature

# CERTIFICATE OF ORGANIZATION

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- Department of State form available at <http://www.dos.pa.gov/BusinessCharities/Business/RegistrationForms/Pages/default.aspx>
- **If you prefer to draft your own, a model for the new certificate of organization is included in your materials**
- The form does *not* require the organizer to indicate how the LLC is managed or whether membership interests are certificated

# OPERATING AGREEMENT

- Section 8812 defines the term “Operating Agreement” as:
  - “The agreement, whether or not referred to as an operating agreement and whether oral, implied, in *record form* or in any combination thereof, of all of the members of a limited liability company, including a sole member, concerning matters described in Section 8815(a) (relating to contents of operating agreement). The term includes the agreement as amended or restated.”

# OPERATING AGREEMENT

- To the extent the operating agreement does not provide for a matter described in Section 8815(a), Chapter 88 will govern.
- While a default rule is helpful – *be careful*:
  - For example:
    - ✦ If the operating agreement is silent on the standard for member approval, Section 8847(b)(2) provides that matters before the members will be decided by reference to the number of members.
    - ✦ If the operating agreement is silent in the topic of distribution, Section 8844(a) generally provides that distributions by an LLC before dissolution shall be in equal portions among members ***and persons dissociated as members***.

# OPERATING AGREEMENT

- **Section 8815(c) lists 20 aspects of Chapter 88 and Title 15 that cannot be varied or may be varied subject to a stated limitation.**
- **Examples:**
  - vary the rule on governing law
  - eliminate the duty of loyalty
  - eliminate the duty of care
  - vary the contractual obligation of good faith and fair dealing

# OPERATING AGREEMENT

- An operating agreement may specify that its amendment requires the written approval of a person not a party to an operating agreement or the satisfaction of a condition.
- If a provision of the certificate of organization conflicts with a provision of the operating agreement, the certificate of organization prevails.

# OPERATING AGREEMENT

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- Useful drafting aids:
  - **LLC Formation Worksheet (included in your materials)**
  - Pennsylvania LLC Documents, Third Edition (PBI)

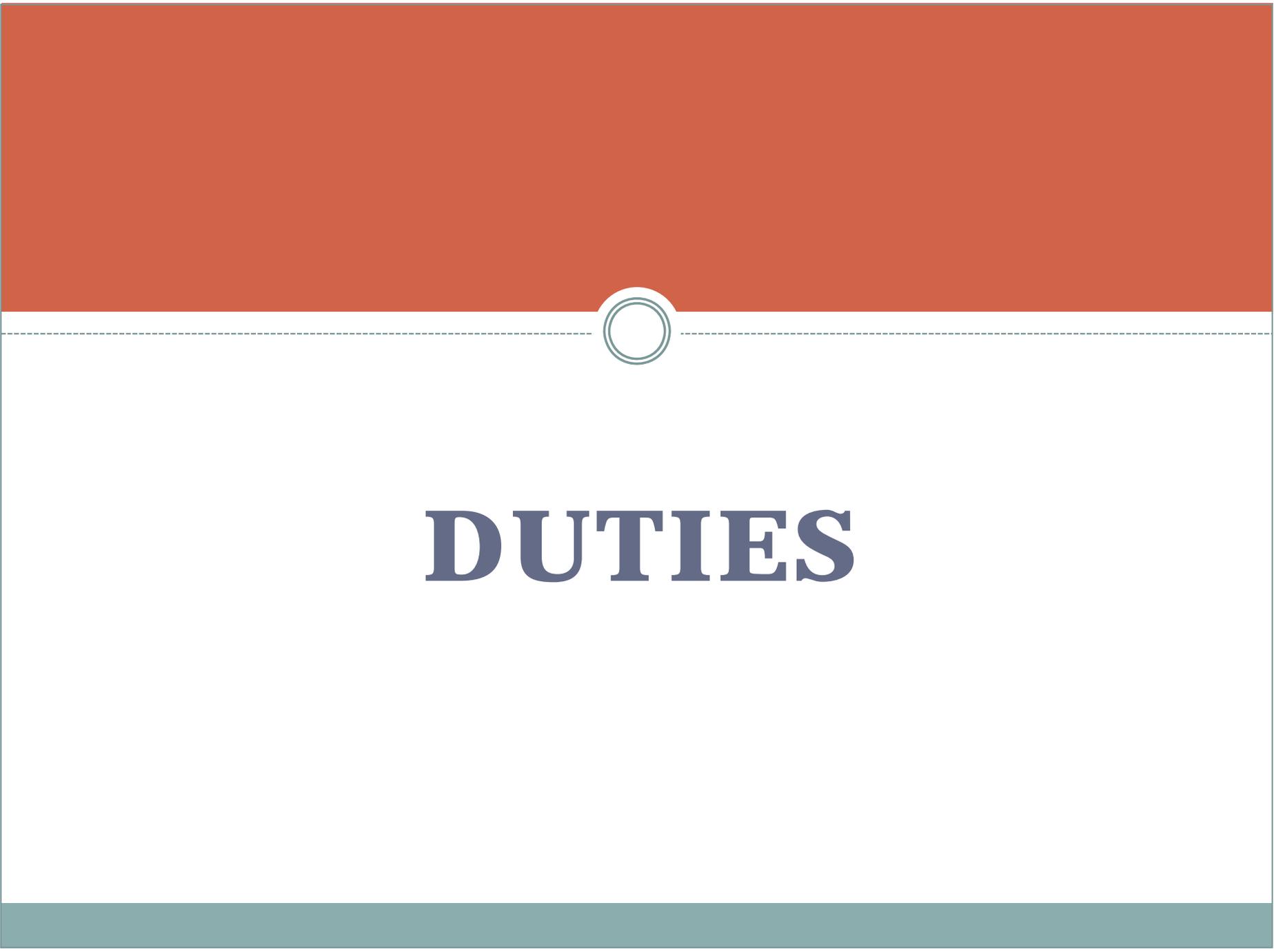
# CERTIFICATE OF AUTHORITY



- A new tool (**sample is included in your materials**)
- An LLC may file a certificate of authority under Section 8832 that pertains to:
  - a position in the LLC; or
  - a specific person.
- The certificate may state the authority of a person holding the position or of the specific person to:
  - transfer real property held in the name of the LLC; or
  - enter into other transactions involving the LLC.

## CERTIFICATE OF AUTHORITY (cont.)

- An effective certificate protects a third party, unless that party has knowledge to the contrary.
- A copy of a certificate may be recorded in the land records.
- A person named in a filed certificate of authority may file a **certificate of denial** which acts as an amendment of the certificate and may be recorded in the land records.



# **DUTIES**

# DUTIES

- Separate subsections provide rules for the duties of:
  - members in a member-managed LLC  
(Section 8849.1)
  - managers in a manager-managed LLC  
(Section 8849.2)
- The duties in the two subsections are largely the same, but the sections are tailored to the specific situations of members and managers.

## DUTIES (cont.)

- **Fiduciary duty of loyalty.** (Sections 8849.1(b), 8849.2(b))
- **Duty of care.** (Sections 8849.1(c), 8849.2(c))
  - The duty is “to refrain from engaging in gross negligence, recklessness, willful misconduct or knowing violation of law.”
- **Contractual obligation of good faith and fair dealing.** (Sections 8849.1(d), 8849.2(d))
  - Comment: “[T]he contractual obligation ... is not a fiduciary duty, does not command altruism or self-abnegation, and does not prevent a partner from acting in the partner’s own self-interest ... [T]he purpose ... is to protect the arrangement the partners have chosen for themselves, not to restructure the arrangement under the guise of safeguarding it.”

## DUTIES (cont.)

- In a major change from prior law, the duties of members in a member-managed LLC and managers in a manager-managed LLC are ***subject to variation*** by agreement of the members.
- Look to operating agreement.

## DUTIES (cont.)

- The operating agreement may alter the **duty of care**, if not manifestly unreasonable. (§8815(d)(3)(iv))
- The operating agreement may not vary the contractual obligation of **good faith and fair dealing**, **but** may prescribe the standards by which it is measured, if not manifestly unreasonable. (§8815(d)(ii))

## DUTIES (cont.)

### DUTY OF LOYALTY

#### 5 Core Aspects

1. Do not **conduct the company's activities** for personal gain.
2. Do not **use company property** for personal gain
3. Do not appropriate a **company opportunity**.
4. Do not engage in **self-dealing**.
5. Refrain from **competing** with the company.

## DUTIES (cont.)

### Treatment of Duty of Loyalty in the Operating Agreement

- **Operating Agreement:**
  - may not eliminate the duty of loyalty but may alter certain aspects of the duty;
  - may specify the method by which an act or transaction that would violate the duty may be approved or ratified; and
  - may identify types or categories of activities which do not violate the duty.



# **MEMBERSHIP INTERESTS**

# Transfers/Transferee

- Fundamental characteristic of limited liability company law is the “pick your partner” principle.
- A member’s rights in a limited liability company are bifurcated into economic rights (the transferable interest) and governance rights (including management rights, consent rights, rights to information, and rights to seek judicial intervention).
- Transfer of transferable interest is governed by §§ 8851 – 8854.
- Remember: LLCs are creatures of statute and contract – **a very helpful form of agreement regarding restrictions on and terms of transfer is included in your materials**

## Transfers/Transferee

### **Section 8851. Nature of transferable interest.**

- (a) Personal property. – A transferable interest is personal property.
- (b) Only right that may be transferred. – A person may not transfer to a person not a member any rights in a limited liability company other than a transferable interest.

## Transfers/Transferee

- The Section 8851 default rule may be changed by way of the operating agreement, or via consent of the members.
- Absent a change to the default governance rule for member-managed companies (per capita governance rights), a member's purported transfer of governance rights to another member:
  - (a) does not increase the transferee's governance rights;
  - (b) eliminates the transferor's governance rights; and
  - (c) changes the denominator but not the numerator in calculating governance rights.

# Transfers/Transferee

## **Section 8852. Transfer of transferable interest.**

- (a) General rule. – Subject to section 8853(f) (relating to charging order), a transfer, in whole or in part, of a transferable interest:
- (1) is permissible;
  - (2) does not by itself cause the dissociation of the transferor as a member or a dissolution and winding up of the limited liability company's activities and affairs; and
  - (3) subject to section 8854 (relating to power of personal representative of deceased member), **does *not* entitle the transferee to: (i) participate in the management or conduct of the company's activities and affairs; or (ii) except as provided in subsection 8852(c), have access to records or other information concerning the company's activities and affairs.**
- (b) Right to distributions. – **A transferee has the right to receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled.**
- (c) Right to account on dissolution. – In a dissolution and winding up of a limited liability company, a transferee is entitled to an account of the company's transactions only from the date of dissolution.

# Charging Orders

**Section 8853(a) provides that upon application by a judgment creditor of a member or a transferee, a court may enter a charging order against the transferable interest of the judgment debtor for the unsatisfied amount of the judgment.**

# Charging Orders

- It is the sole method by which a judgment creditor of a member or transferee (other than a single-member entity) can extract any value from the member's or transferee's interest in a limited liability company.
- Originally designed to preserve the “pick your partner” rule, prohibits creditor from taking the ownership interest and stepping into shoes of the judgment debtor (as a member of the LLC).
- The charging order remedy was intended to protect the judgment debtor's co-owners – NOT the judgment debtor.

# Charging Orders

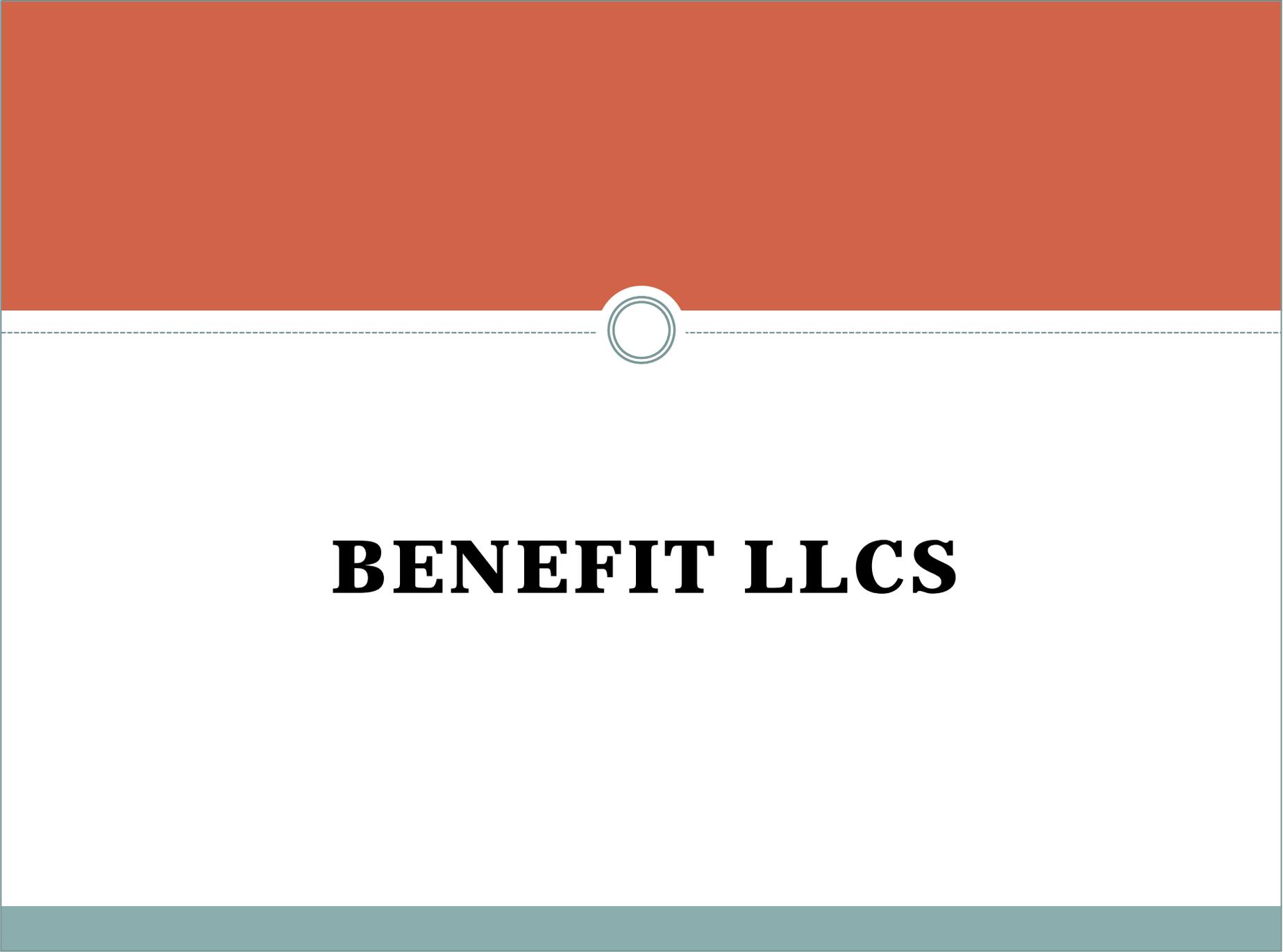
- **§ 8853(b) – Available relief.** – To the extent necessary to effectuate the collection of distributions pursuant to a charging order in effect under subsection (a), the court may:
  - (1) appoint a receiver of the distributions subject to the charging order, with the power to make all inquiries the judgment debtor might have made; and
  - (2) make all other orders necessary to give effect to the charging order.
- **§ 8853(c) – Foreclosure.** – Upon a showing that distributions under a charging order will not pay the judgment debt within a reasonable time, the court may foreclose the lien and order the sale of the transferable interest. Except as provided in subsection (f), the purchaser at the foreclosure sale only obtains the transferable interest, does not thereby become a member, and is subject to section 8852 (re: transfer of transferable interest).

## Charging Orders

- If foreclosure is against the sole member of an LLC, then § 8853(f) provides that:
  - (1) the court shall confirm the sale;
  - (2) the purchaser at the sale obtains the member's entire interest, not just the member's transferable interest;
  - (3) the purchaser becomes a member (with attendant governance rights); and
  - (4) the person whose interest was subject to the foreclosed charging order is dissociated as a member.

# Charging Orders

- § 8853 (h) – Exclusive Remedy. – This section provides the exclusive remedy by which a person seeking to enforce a judgment against a member or transferee may, in the capacity of judgment creditor, satisfy the judgment from the judgment debtor’s transferable interest.
- The charging order remedy does not:
  - override UCC Article 9
  - override a voidable transaction law
  - prevent a “reverse pierce” where appropriate
  - permit the holder to force distributions – it receives them as, if and when the company makes them.



# **BENEFIT LLCs**

# Benefit Companies

- **New Subchapter I (Sections 8891-8898) provides for the organization of benefit companies, the LLC analog of benefit corporations.**
- **Like benefit corporations, benefit companies have three distinguishing characteristics:**
  - a purpose that includes having a material positive impact on society and the environment;
  - a duty of the governors to consider the interests of non-owner stakeholders; and
  - an obligation to report on the accomplishment of the expanded purpose of the company.