

The Impact of Act 170 on LLCs, LLPs, LPs and GPs

Management
Transferees
Duties

MANAGEMENT STRUCTURES OF LLCs GENERALLY

- LLCs are either member managed or manager managed
 - This is the same as prior law
- However, there are several notable differences from the prior law:

NOTABLE DIFFERENCES

- Company defaults to member managed unless the *operating agreement* expressly provides that the company will be manager managed (§8847(a))
 - Previously if a manager managed company was desired, such must have been noted in the *certificate of organization*
 - But; we will talk later about the agency authority of managers and the role of the certificate of organization

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NOTABLE DIFFERENCES

- Statute now lists *default rules* for member managed companies (§8847(b) and for manager managed companies (§8847(c))
- Default rules, in this case, govern management of the LLC where the operating agreement is silent on an issue.
- Default rules sometimes cite other laws or rules that apply, but otherwise may always be amended by the operating agreement (§8815(a)(2))

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**DEFAULT RULES FOR MEMBER MANAGED LLCs
(§8847(B))**

- (1) Except as expressly provided in this title, the management and conduct of the company are vested in the members.
- (2) Each member has equal rights in the management and conduct of the company's activities and affairs.
- (3) A difference arising among members as to a matter in the ordinary course of the activities and affairs of the company may be decided by a majority of the members.

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**DEFAULT RULES FOR MEMBER MANAGED
LLCS (§8847(B)) (CONTINUED)**

- (4) Except as provided under section 325 (relating to approval by limited liability company) 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 may be undertaken only with the affirmative vote or consent of all members.
- (5) Except as provided in section 8822(d) (relating to amendment or restatement of certificate or organization), the certificate of organization may be amended only with the affirmative vote or consent of all members.
- (6) The operating agreement may be amended only with the affirmative vote or consent of all members

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DEFAULT RULES FOR MANAGER MANAGED LLCS (§8847(C))

- (1) 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.
- (2) Each manager has equal rights in the management and conduct of the company's activities and affairs.
- (3) The affirmative vote or consent of all members is required:
 - (i) except as provided under section 325 with respect to a transaction under Chapter 3, to undertake any act outside the ordinary course of the company's activities and affairs;
 - (ii) except as provided under section 8822(d), to amend the certificate of organization; or
 - (iii) to amend the operating agreement.

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DEFAULT RULES FOR MANAGER MANAGED LLCS (§8847(C)) (CONTINUED)

- (4) 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.
- (5) A person need not be a member to be a manager, except that the dissociation of a member that is also a manager removes the person as a manager. If a person that is both a manager and a member ceases to be a manager, that cessation does not by itself dissociate the person as a member.
- (6) A person's ceasing to be a manager does not discharge any debt, obligation or other liability to the limited liability company or members which the person incurred while a manager

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AGENCY AUTHORITY

- Agency authority in an LLC changes significantly under the new law:
 - A member will not be an agent of an LLC solely by reason of being a member regardless of whether the LLC is member-managed or not (§8831(a))
 - A manager will not possess statutory apparent authority, unless the **certificate of organization** states that the LLC is manager-managed (§8831(b))

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TRANSFERS/TRANSFeree

Section References

- §8412 (General Partnerships)
- §8612 (Limited Partnerships)
- §8812 (Limited Liability Companies)

Definitions:

“Transferable interest.” The right, as initially owned by a person in the person’s capacity as a member, to receive distributions from a limited liability company, whether or not the person remains a member or continues to own any part of the right. The term applies to any fraction of the interest, by whomever owned.

“Transferee.” A person to which all or part of a transferable interest has been transferred, whether or not the transferor is a member. The term includes a person that owns a transferable interest under section 8863(a)(3) (relating to effect of dissociation).

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TRANSFERS/TRANSFEREE

§ 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.

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TRANSFERS/TRANSFEREES

- 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 rule, a member's attempted transfer of governance rights to another member under the default rule of Section 8851
 - (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.

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TRANSFERS/TRANSFEREES

- Example: LCN Company, LLC is a member-managed limited liability company with three members, Laura, Charles, and Nora. The operating agreement does not displace Chapter 88 default rule on the allocation of governance rights among members. Thus, each member has 1/3 of those rights. Laura transfers her entire ownership interest to Charles. The transfer does not increase Charles's governance rights but does eliminate Laura's. After the transfer, Laura has no governance rights (regardless of whether Charles and Nora agree to expel Laura under 15 Pa. C.S. § 8861(5)(ii)). As a result, Charles and Nora each have ½ of the governance rights. [See §8851, Committee Comment]

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TRANSFERS/TRANSFEE

§ 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 (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.

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TRANSFERS/TRANSFEREE

§8852 (con't)

(d) Certificate of interest. – A transferable interest may be evidenced by a certificate of the interest issued by the limited liability company in record form and, subject to this section, the transferable interest represented by the certificate may be transferred by a transfer of the certificate.

(e) Recognition of transferee's rights. – A limited liability company need not give effect to a transferee's rights under this section until the company knows or has notice of the transfer.

(f) Transfer restrictions. – A transfer of a transferable interest in violation of a restriction on transfer contained in the operating agreement is ineffective if the intended transferee has knowledge or notice of the restriction at the time of transfer.

(g) Rights retained by transferor. – Except as provided in section 8861(5)(ii) (relating to dissociation by a vote of the other members), if a member transfers a transferable interest, the transferor retains the rights of a member other than the transferable interest transferred and retains all the duties and obligations of a member.

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DUTIES

- ➔ Separate sections provide rules on the duties of:
 - » members in a member-managed LLC (§ 8849.1)
 - » managers in a manager-managed LLC (§ 8849.2)

- ➔ The duties in the two sections are largely the same, but the sections are tailored to the specific situations of members and managers.

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General Rule

Members

- **§ 8849.1(a) General rule.** - A **member** of a **member-managed** limited liability company owes to the company and, * * * the other members the duties of loyalty and care stated under subsections (b) and (c).

Managers

- **§ 8849.2(a) General rule.** - A **manager** of a **manager-managed** limited liability company owes to the company and, * * * the members the duties of loyalty and care stated under subsections (b) and (c).

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MEMBER DUTIES IN A MANAGER MANAGED LLC

- Section 8849.1(i) provides that “a **member** does not have any duty to a **manager-managed** limited liability company or to any other member of the company solely by reason of being or acting as a member.

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BASIC DUTIES

- ➔ **Duty of loyalty.** (§§ 8849.1(b), 8849.2(b))
- ➔ **Duty of care.** (§§ 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.** (§§ 8849.1(d), 8849.2(d))
 - » Is different from the corporate law concept of good faith which is an aspect of the duty of loyalty, as articulated in *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).
 - » 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.”

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ASPECTS OF THE DUTY OF LOYALTY

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.

These duties apply both during the life of the company and also during winding up.

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NEW: DUTIES VARIABLE

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

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VARYING DUTIES

- ➔ Duties **other than care and loyalty** may be altered or eliminated by the operating agreement, if not manifestly unreasonable.
- ➔ The operating agreement may alter the duty of **care**, if not manifestly unreasonable.
- ➔ 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.

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VARYING DUTIES

Aspects of the Duty of Loyalty

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.

These duties apply both during the life of the company and also during winding up.

- The operating agreement may **identify types of activities** that do not violate the duty of loyalty.
- The operating agreement may alter, but **not eliminate**, the aspects of the duty of loyalty stated in 1, 2, and 4.
- The operating agreement may freely alter, and may **eliminate entirely**, the aspects of the duty of loyalty stated in 3 and 5.

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STATUTORY DISCUSSION

- A properly drafted operating agreement may substantially alter and even eliminate fiduciary duties, subject to two important limitations:
 - » First, arrangements subject to this subsection **may not** be “manifestly unreasonable” as that concept is delineated in subsection 8815(e).
 - » Second, the operating agreement **may not** transform the relationship among the members, managers, and the limited liability company into an entirely arm’s length arrangement. For example, displacement of fiduciary duties is effective only to the extent that the displacement is stated clearly and with particularity. See, e.g., Paige Capital Management, LLC v. Lerner Master Fund, LLC, Civ. A. No. 5502–CS, 2011 WL 3505355 at *31 (Del.Ch. Aug. 8, 2011) (even under a statute that permits complete waiver of fiduciary duty, such waivers must be set forth clearly”).

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STATUTORY DISCUSSION

Determination of manifest unreasonableness. – Section 8815(e) provides that the **court** shall decide as a matter of law whether a term of an operating agreement is manifestly unreasonable under subsection (d)(3). The court:

(1) makes its determination as of the time the challenged term became part of the operating agreement and by considering only circumstances existing at that time; and

(2) may invalidate the term only if, in light of the purposes, activities and affairs of the limited liability company, it is readily apparent that:

- (i) the objective of the term is unreasonable; or
- (ii) the term is an unreasonable means to achieve the term's objective.