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# The New Limited Liability Company Law in California

## *Will the LLC structure still work for you?*

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In January 2014, the existing limited liability company act in California (the Beverly-Killea Limited Liability Company Act) will be repealed and superseded by the California Revised Uniform Limited Liability Company Act, popularly known as RULLCA. RULLCA was signed into law by Governor Jerry Brown on September 21, 2012, and is the focus of an increasing amount of scrutiny as managers, members, advisors and lenders to California LLCs attempt to understand and cope with the forthcoming changes, and in some cases, unpleasant surprises it presents.

**Applicability**

RULLCA applies to existing LLCs and LLCs formed under the laws of California after January 1, 2014, and, for purposes of foreign registration and liability of certain debts and obligations, foreign LLCs registered in California prior to or after such date. However, RULLCA provides that the prior law will govern certain actions of existing LLCs, including votes or consents taken by an existing LLC's members or managers prior to January 1, 2014 (even if a certificate or document is required to be filed with the state relating to such vote or consent but is not filed prior to such date), and any transactions and contracts entered into by the existing LLC prior to January 1, 2014. While RULLCA further provides that it gives a maximum effect to the principles of freedom of contract and to the enforceability of operating agreements – and thus, as demonstrated above, should not retroactively alter exiting contracts with third parties – it will nonetheless alter provisions of an existing operating agreement. Managers, members and advisors to California LLCs must consider two things in preparation for the new Act: first, whether the California LLC structure is the best option to serve an entity's purposes moving forward and, second, what revisions, if any, must be made to an existing LLCs operating agreement prior to RULLCA taking effect.

**Significant Changes for Manager-Managed LLCs**

LLCs are the preferable organizational structure for many California real estate investors, small businesses and entities with holding companies. Generally, such LLCs are managed by one or more managers – and not the members – to reduce legal and business operating obstacles. While RULLCA authorizes manager-managed LLCs, it requires that a company's articles of organization *and* operating agreement expressly establish management by a manager or managers. If an existing LLC is relying on such a statement solely in its articles of organization, its operating agreement must be revised to provide that the company is manager-managed, or else it will be subject to RULLCA's default rule and become a member-managed entity.

Under RULLCA, manager-managed LLCs are subject to material changes concerning the operation of the company. Specifically, RULLCA provides certain rules for manager-managed LLCs, including a requirement that the consent of *all* members of a LLC is required to do any of the following:

- ✦ Sell, lease, exchange or otherwise dispose of all, or substantially all, of the LLC's property, with or without the goodwill, outside of the ordinary course of the LLC's activities;
- ✦ Approve a merger or conversion under RULLCA;
- ✦ Undertake any other act outside the ordinary course of the LLC's activities; or
- ✦ Amend the operating agreement.

RULLCA provides that these provisions may *only* be varied by a written operating agreement. Thus, prior to January 2014, managers of a California LLC – particularly those with several members – should review and amend any operating agreement to ensure that it expressly identifies when the consent of all members is required and when it is not, including specifically addressing those matters which would otherwise be subject to the revised RULLCA rules. Companies and their advisors may also want to consider whether the agreement adequately defines the matters that are within the ordinary course of the LLC's activities. For new transactions, real estate investors, lenders and their counsel should also consider the implications of an LLC agreement's failure to specify that only the consent of the manager is required in connection with a sale of the LLC's property. This could include real estate sales, whether by the LLC itself or as a part of the exercise of a lender's rights and remedies (including receivership sales). Some title companies may not insure such sales unless the 60-day appeals period has expired (with respect to a receivership sale) or the consent of all of the members of the LLC is obtained, which may prove difficult if the property value has significantly deteriorated and the investors have lost their investments.

Additionally, the Beverly-Killea Limited Liability Company Act provides that only the vote of a majority of the members is required to amend the provisions of the articles of organization or operating agreement. Many existing LLC agreements may be silent regarding the consent necessary to amend the agreement, relying on the default provisions of the existing law instead. Such agreements should be modified to specifically address amendment consent requirements. Otherwise, unanimous consent will be required. Managers that take no action prior to the act becoming operative in January are likely to suffer transaction delays.

**Substantive Changes For All Existing LLCs**

There are a number of other conceptual changes under RULLCA that affect both manager-managed and member-managed LLCs alike. Some of the more prominent changes include the following:

✦ ***Conflicts:*** One function of RULLCA is to give a company's operating agreement priority over its articles of organization in the event of conflicting provisions. The only exception is for third parties reasonably relying on the articles. Any existing LLC that has been relying on a statement in its articles (e.g., that an LLC is manager-managed) must amend its operating agreement prior to January 2014 to eliminate the conflicting provision, or be subject to the change.

✦ ***Fiduciary Duties***: RULLCA's focus on fiduciary duties has been a much discussed topic of the new Act. RULLCA expands the concept of governing fiduciary duties to explicitly include the duty of loyalty, the duty of care and "any other fiduciary duty." While RULLCA prohibits an operating agreement from "unreasonably reducing the duty of care," it will allow companies to modify (but not eliminate) the duty of loyalty as it applies to a manager. However, any such modification must be clearly stated in a company's operating agreement with the informed consent of the members. RULLCA emphasizes the heightened knowledge required in such situations, and notes that informed consent by a member differs from a member who is deemed to statutorily assent to the operating agreement

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**About Troutman Sanders**

Troutman Sanders in an international law firm with more than 600 lawyers and 15 offices throughout the North American and Asia. Its attorneys have participated in major real estate transactions in California and around the globe and vigorously negotiate and advocate on behalf of its clients within the real estate industry. The firm represents an array of clients, including lenders, developers, operators, buyers, sellers, lessors, lessees and real estate-focused private equity funds. It provides advice on virtually every aspect of real estate transactions including the acquiring, financing, leasing, managing, owning and operating of real estate. The firm's attorneys are also experienced in the structuring, negotiating and implementation of real estate financing transactions, including complex loan syndications, single-lender facilities, loan origination, distressed debt work, capital formation and bankruptcy.
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## REAL ESTATE TRENDS TO WATCH

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a vocal contingent of urban planners are advocating doing away with minimum parking requirements imposed by cities on all types of development. These planners argue that minimum parking requirements serve as a barrier to affordable housing (since the extra land needed for housing cars is expensive) and as a barrier to walkable neighborhoods (since walking through a parking lot does not quite feel like a stroll along the Champs-Elysées). West Hollywood, Washington, Seattle, St. Paul, New York, Portland and Ithaca are cities experimenting with on-site parking requirements to see if such actions will pave the way to utopia. Closer to home, Tustin recently adopted an innovative parking ordinance that allows all or a portion of a project's required parking obligation in the Old Town Cultural Resources district to be met through the payment of an annual $60 fee. As a result, businesses and new developments can make use of the city's public parking infrastructure to meet their private on-site parking demand.

**4. CEQA Reform, Toothfairies, and Other Pleasant Thoughts**

Anyone involved in real estate development, or who knows someone in real estate development, has heard the very specific tone of voice used when uttering that hated four-letter word: *CEQA*. It's a combination of hatred and resignation – but mostly hatred. As they know, CEQA compliance can be expensive, time-consuming, and laden with risk, and it's affecting more and more projects. Recently, an Environmental Impact Report (the most elaborate environmental review document available under CEQA) was required in connection with a new single-family home in Newport Beach. Not a sprawling subdivision affecting endangered species or a new smelting plant – *one home*. Add CEQA litigation to the mix, and the negatives multiply. Lately, CEQA litigation has become less about protecting the environment, and more about thwarting economic competition. For instance, late last year, the City of Redondo Beach brought a CEQA action against the City of Torrance in an effort to halt Nordstrom's relocation from Redondo Beach's South Bay Galleria to Torrance's Del Amo Fashion Center. Because of these and other examples of abuse, even Jerry Brown hates CEQA.

What to do about this broken system? Enter CEQA reform: the long-awaited and much-heralded remedy to CEQA's ills. The overall CEQA reform concept had the wind at its back headed into the current legislative session in Sacramento, even if its details were uncertain given all of CEQA's problems. The governor is a vocal proponent, and the cause found a strong advocate in then Senator Michael Rubio (D–Shafter). However, the prospect for CEQA reform in 2013 has noticeably dimmed in recent months with the resignation of Senator Rubio from the Senate in February and the gathering force of antireform advocates. These opponents of reform include environmentalists, labor unions and others who have learned how to harness CEQA to their advantage. Although Senate President Pro Tem Darrell Steinberg took the CEQA reform baton from Senator Rubio and more than two dozen CEQA bills have been introduced in Sacramento, it is now widely believed that meaningful CEQA reform is unlikely this year. Ironically, of all the pending bills, the one with the most momentum at the time of this writing is championed by environmental groups and would actually expand CEQA's scope.



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when such party becomes a member of an LLC. Any existing LLC that opts to modify the fiduciary standards imposed by RULLCA should consider what actions are necessary to obtain the appropriate consent from its members.

✦ ***Indemnification***: RULLCA's default rules provide for mandatory indemnification of any member in a member-managed LLC and any manager of a manager-managed LLC who complies with the duties set forth in the Act. However, RULLCA provides that an operating agreement may alter or eliminate such indemnification and may limit or eliminate completely a member or manager's liability to the LLC and other members for money damages, except with respect to: breaches of the duty of loyalty; receipt by such party of a financial benefit to which such party was not entitled; liability for excess distributions; intentional inflictions of harm (on a person or the LLC); or intentional violations of criminal law. An existing LLC should consider the benefits and liabilities of the proposed RULLCA indemnification policies and, to the extent possible, amend its operating agreement to address any concerns.

✦ ***Overriding RULLCA Provisions***: As noted above, RULLCA contemplates giving the maximum effect to the enforceability of operating agreements. However, the new Act identifies certain provisions from which an LLC cannot "opt-out" in its operating agreement. Thus, mangers, members and their advisors may need to contemplate whether a California LLC still satisfies the needs of the entity under the new law.

**Prepare for January 2014**

Prior to RULLCA taking effect, LLC managers, members and advisors should review RULLCA in connection with a company's existing operating agreement and articles. A focus should be given to any potential 2013 year-end transaction that might carry over into 2014 and be subject to the additional or varying requirements of RULLCA. Please call Troutman Sanders if you would like additional information on RULLCA or assistance with review and modification of your existing LLC agreements.