

Washington's New Limited Liability Company Act – What to Know

Washington's new Limited Liability Company Act became effective on January 1, 2016. The new Act introduces several changes to the previous laws that LLC managers and members should be aware of as we begin 2016. This update provides a short summary of some of those changes and potential action items that our clients may wish to consider.

- **Limited liability company agreements may be oral or implied.**

While previously most LLC agreements had to be in writing to be enforceable, the new Act recognizes oral and implied LLC agreements and amendments to existing LLC agreements. For example, imagine that Alan and Barbara form an LLC without a written LLC agreement, with Alan holding 60% of the membership interests and Barbara 40%. Over the phone, Alan and Barbara agree that they will not act for the LLC unless both of them have agreed on the course of action. Under the new Act, that agreement to require unanimous approval of action could be recognized as an LLC agreement. We anticipate that this change may create new ambiguity and confusion in LLC agreements and amendments.

➔ Action Item: We recommend that each of our clients have a written LLC agreement, explicitly stating that it supersedes all prior communications relating to the LLC and its governance, and explicitly stating that it may only be amended by a written amendment.

- **A written limited liability company agreement may alter or eliminate dissenters' rights.**

The previous Act granted members of an LLC with dissenters' rights, pursuant to which members of an LLC could dissent from a transaction involving the merger of the LLC into another legal entity and receive the fair market value of their membership interests. These dissenters' rights could not be altered or abridged by an LLC agreement. The new Act allows a written LLC agreement to alter or eliminate the default statutory dissenters' rights. This change is likely beneficial for majority members who want freedom to enter into a merger without undertaking a potentially costly fight with dissenting members. If an LLC agreement eliminates dissenters' rights, however, minority members of the LLC will have little power to influence a potential merger or seek recourse if they dissent from such a merger.

➔ Action Item: We recommend that our clients consider whether a provision altering or eliminating dissenters' rights should be added to their LLC agreements. This question should be analyzed on a case-by-case basis, and if you are uncertain whether such a provision is right for your LLC, please do not hesitate to contact us.

- **The new Act allows a limited liability company to be managed by a board of managers.**

The previous Act did not explicitly allow a manager-managed LLC to be managed by a board of managers that acted as a collective body in the way that a corporation's board of directors

acts. Accordingly, under the previous Act, each member of a board of managers was deemed to hold full authority to act on behalf of the LLC, but the managers could contractually limit such power by agreeing to act only as a collective board in the LLC agreement. Bringing Washington law in line with the current practice of many LLCs, the new Act expressly allows the manager of an LLC to be a board that must act as a collective body. If an LLC chooses to be managed by a board of managers, no single member of the board will have statutory authority to act individually on behalf of the LLC. We also note that, under the new Act, authority to manage an LLC is by default given to its members.

- ➔ Action Item: Many of our clients will, practically speaking, be unaffected by this change. If an LLC has previously used a board structure, however, it may be beneficial to review the LLC agreement to determine whether the management provisions are sufficient to grant management authority to the board acting as a collective body and do not inadvertently vest management authority in any single board member.
- **Although managing members and managers now explicitly owe the limited liability company the duties of loyalty and care, those duties are narrowly defined and do not include duties among members except for the obligations of good faith and fair dealing, and to avoid knowing violations of the law, wrongful distributions, and intentional misconduct.**

Although the previous Act was silent with respect to the fiduciary duties of LLC members and managers, Washington courts had held that the managing members of a member-managed LLC or managers of a manager-managed LLC owe duties to the LLC and its members similar to those duties owed by partners in a partnership. The new Act explicitly states that managing members and managers owe the duties of loyalty and care to their LLCs. We caution, however, that these statutorily imposed duties are narrower than would typically apply to partners in a partnership or to directors and officers of a corporation. Under the new Act, the “duty of loyalty” includes only the following:

(a) To account to the LLC and hold as trustee for it any property, profit, or benefit derived by such manager or member in the conduct and winding up of the LLC’s activities or derived from a use by such manager or member of LLC property, including appropriation of an LLC opportunity;

(b) To refrain from dealing with the LLC as or on behalf of a party having an interest adverse to the LLC; and

(c) To refrain from competing with the LLC in the conduct or winding up of the LLC’s activities.

The new Act states that a violation of the duty of loyalty does not occur “simply because the manager’s or member’s conduct furthers the manager’s or member’s own interest.” Noticeably absent in the Act’s definition of “duty of loyalty” are obligations to other members of the LLC.

The “duty of care” is also narrowly defined. The new Act limits the duty of care to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or knowing violations of law while conducting or winding up the LLC’s activities. Generally speaking, it is difficult to provide that a managing member’s or manager’s conduct rose to this level of misconduct in a court action challenging a particular act or omission. Accordingly, as a practical matter, the narrowly defined duty of loyalty is unlikely to offer much protection to LLCs and their non-managing members.

Further, the new Act allows an LLC agreement to limit or eliminate liability of a member or manager to the LLC or its members for actions taken as a member or manager, so long as the LLC agreement does not limit or eliminate liability for acts or omissions that involve intentional misconduct or a knowing violation of law, wrongful distributions, or a violation of the implied contractual duty of good faith and fair dealing.

➔ Action Item: We recommend that our clients consider amending their LLC agreements to expand or limit, as appropriate based on a review of the LLC agreement, the fiduciary duties owed by managing members or managers to the LLC and its members. We also encourage our clients to be mindful of the statutory duties described above as they conduct their businesses.

- **The default method of voting is now one vote per member, regardless of the relative equity interests held by each of the members.**

As you probably know, under the default provisions of the former Act, the vote of an LLC member was weighted in proportion to the amount of that member’s equity interest in the LLC. For example, using Alan and Barbara again, Alan’s vote in favor of an action would be sufficient to constitute a majority because he holds 60% of the membership interests in the LLC. However, under the default provisions of the new Act, Alan and Barbara’s votes would count equally and an action requiring majority approval would need both Alan and Barbara to vote in favor of that action. This default method of voting is likely contrary to what most LLC members assume to be the case—that they will have voting power in proportion to their ownership interests.

➔ Action item: We recommend that our clients explicitly address voting procedures in their LLC agreements to avoid issues with this new default provision. If your LLC agreement is silent on voting procedures, we strongly encourage you to amend the agreement to avoid confusion and potential disagreements down the road.

- **Limited liability companies have more record-keeping obligations and must allow members greater access to their records.**

Previously, an LLC was required to keep records of its foundational documents, members’ capital contributions and disbursements, financial statements, and tax returns and reports. The new Act has expanded those requirements to include events triggering dissolution and a wind-up of the LLC, three years’ of member consents and votes, the LLC’s three most recent annual reports, any filed articles of conversion or merger, and any certificates of dissolution or revocation of dissolution.

After receiving a demand to inspect records from a member, an LLC has only ten days to make such records available. Generally, the inspecting member does not need to have any particular purpose in seeking to inspect the records. However, to inspect (i) a current or past list of members and managers, (ii) excerpts from any meeting of the managers or members or records of LLC action approved without such a meeting, or (iii) accounting records of the LLC, the member must be seeking records for a purpose reasonably related to the member's interest in the LLC, and the records must be described with reasonable particularity and directly connected to the member's purpose. This inspection right does not automatically cease when a member disassociates from the LLC.

➔ Action item: We recommend that our clients make sure that a system is in place to meet the LLC's record-keeping obligations. Further, because the new Act allows an LLC to impose reasonable restrictions on members seeking to inspect its records, we recommend that our clients consider requiring that a member sign a non-disclosure agreement before being granted access to confidential LLC records or that the LLC agreement expressly address confidentiality of the LLC's records, including records accessed by members in the exercise of these statutory inspection rights.

- **Limited liability companies may now be formed for not-for-profit purposes.**

Although the previous Act repeatedly made reference to the business purpose and authority of an LLC, the new Act explicitly states that an LLC may be formed "for any lawful purpose, regardless of whether for profit." This clarification removed any ambiguity about whether an LLC may be organized for not-for-profit purposes in Washington.

➔ Action item: This change may open new avenues for organizational structuring in the not-for-profit sphere. If you are interested in forming a not-for-profit, we encourage you to contact us to explore your options.

- **The LLC agreements of limited liability companies now control whether they are member-managed or manager managed.**

Under the previous Act, the Certificate of Formation established how a company was managed. Under the new Act, the LLC agreement now controls, and an LLC will be deemed to be member-managed unless the LLC agreement designates the LLC as being managed by a manager. Hence, one must verify a party's authority to act for an LLC by reviewing the LLC agreement.

➔ Action item: Clients should be mindful of the capacity in which an individual purports to be acting on behalf of an LLC and, particularly in situations where it is important to verify that an individual has actual authority to take actions on behalf of or otherwise bind an LLC, should require the LLC to produce its LLC agreement to confirm the capacity in which the individual is acting.

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