

HOUSE BILL REPORT

SSB 5030

As Passed House - Amended:
April 8, 2015

Title: An act relating to the limited liability company act.

Brief Description: Addressing the limited liability company act.

Sponsors: Senate Committee on Law & Justice (originally sponsored by Senators Pedersen and O'Ban; by request of Washington State Bar Association).

Brief History:

Committee Activity:

Judiciary: 3/12/15, 3/19/15 [DPA].

Floor Activity:

Passed House - Amended: 4/8/15, 97-0.

**Brief Summary of Substitute Bill
(As Amended by House)**

- Adopts numerous revisions to the Washington Limited Liability Company Act.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: Do pass as amended. Signed by 13 members: Representatives Jinkins, Chair; Kilduff, Vice Chair; Rodne, Ranking Minority Member; Shea, Assistant Ranking Minority Member; Goodman, Haler, Hansen, Kirby, Klippert, Muri, Orwall, Stokesbary and Walkinshaw.

Staff: Edie Adams (786-7180).

Background:

A limited liability company (LLC) is a popular form of business entity that is owned by its members and that has a flexible management structure. Limited liability companies provide members with the limited liability attributes of a corporation and the taxation attributes of a

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

partnership. A LLC may be managed by its members, or by one or more managers appointed by the members, and may be formed to carry on any lawful business or activity.

The Washington Limited Liability Company Act (LLC Act) provides rules for the formation, governance, and operation of LLCs. A LLC is formed by one or more individuals or entities through the filing of a certificate of formation with the Secretary of State (SOS). The LLC Act generally provides default rules that apply if the LLC has not adopted different rules in its LLC agreement, which governs the affairs of the LLC and the conduct of the LLC's business. The LLC Act establishes provisions governing: the formation of LLCs; the rights, duties, liabilities and relationships of members and managers of a LLC; the members' contributions to and rights to receive distributions from a LLC; assignment of LLC interests; mergers, conversions, and dissolution of LLCs; and requirements for foreign LLCs to do business in the state.

The LLC Act was originally enacted in 1994 and has not been comprehensively revised since that time. In 2008 the Partnership and Limited Liability Company Law Committee of the Business Law Section of the Washington State Bar Association began a review of the LLC Act and recommends adoption of amendments to update and improve the LLC Act.

Summary of Amended Bill:

The LLC Act is revised. The revised LLC Act contains changes to many aspects of limited liability company law to update and modernize the statute and to conform the provisions more closely to statutes governing other business entities in Washington. In particular, many provisions of the LLC Act have been altered to conform to similar provisions in the Uniform Limited Partnership Act, and in some cases to the Washington Business Corporations Act or the Revised Uniform Limited Liability Company Act adopted by the Uniform Law Commission. An overview of some of the more substantial changes is provided below.

Purpose and Governing Law.

The purposes of a LLC are specifically designated to include not-for-profit purposes. A new section is added stating that the laws of Washington govern the internal affairs of a LLC and the liability of members and managers for the debts, obligations, or other liabilities of the LLC.

Formation and Administrative Provisions.

The certificate of formation is no longer required to identify whether the LLC will be managed by a manager or managers or managed by the members.

The requirements relating to restating a certificate of formation are altered and standards for filing records are updated. The requirement that a foreign LLC submit an initial report to the SOS is removed, and a specific statement is added that a LLC must pay its annual license fee and any applicable penalty fees to the SOS at the time the LLC files its initial or annual report with the SOS.

A new section specifically allows the SOS to provide a certificate of existence for a domestic LLC and a certificate of authorization for a foreign LLC. Criteria for the issuance of

certificates of existence and authorization and the meaning of an issued certificate are specified.

LLC Agreements.

The requirement that LLC agreements be in writing is revised to allow LLC agreements to be oral, implied, in a record, or in any combination. Except for provisions that may not be altered or waived, the default provisions of the LLC Act may be altered by a written, oral, or implied LLC agreement. A new section is created listing all of the provisions of the LLC Act that may not be altered by a LLC agreement.

Members and Managers.

Management of the LLC. The designation of whether a LLC will be managed by members or by managers may be made in the LLC agreement rather than the certificate of formation. Provisions specifying the statutory apparent authority of a member to act on behalf of the LLC are eliminated.

A manager of an LLC can be a board, committee, or other group of persons. If a LLC is managed by a board or committee, the board or committee as a group is considered the manager and a board or committee member alone is not an agent of the LLC. The fiduciary duties imposed by the LLC Act apply to each person in the board or committee.

Voting Requirements. A default rule is established that decisions must be made by the approval of a majority of the members of the LLC on a per capita basis rather than based on the value of member contributions. A provision is added listing all actions that require the unanimous approval of the members. A LLC agreement may provide that any member or class of members shall have no voting rights.

Access to Records. A member's access to LLC records is expanded. A member has a right to access specific records and may access a specified list of additional records only if the member seeks the records for a purpose reasonably related to the member's interest in the LLC and the records are directly connected to the member's purpose. Procedures are provided for requesting and providing access to LLC records.

Standards of Conduct. A new section is created setting forth the fiduciary duties of members and managers of a LLC. The only fiduciary duties that a member in a member-managed LLC or a manager has to the LLC and its members are the duties of loyalty and care. If a manager is a board, committee, or other group, the duties and liabilities apply to each person included in the board, committee, or other group as if each person were a manager.

The duty of loyalty is limited to the duty to: (1) account to the LLC and hold as trustee for it any property or benefit derived by the member or manager in the conduct and winding up of the LLC's activities or derived from a use by the member or manager of LLC property; (2) refrain from dealing with the LLC as or on behalf of a party having an interest adverse to the LLC; and (3) refrain from competing with the LLC in the conduct or winding up of the LLC's activities.

The duty of care is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law in the conduct and winding up of the LLC's activities.

The LLC agreement may modify, expand, restrict, or eliminate a member's or manager's duties if not inconsistent with law and as long as it does not eliminate or limit: the duty of a member or manager to avoid intentional misconduct and knowing violations of law, or violations of distribution rules; and the implied contractual duty of good faith and fair dealing.

Distributions.

Provisions governing LLC distributions are revised to conform to similar provisions in the Uniform Limited Partnership Act.

A member does not have a right to receive a distribution prior to dissolution and winding up unless the LLC decides to make an interim distribution, and a member does not have a right to a distribution on account of dissociation.

A LLC may distribute an asset in-kind if each member receives a percentage of the asset equal to the member's share of distributions. A LLC may offset any amount due to the LLC by a person from the LLC's obligation to make a distribution to the person.

Provisions governing standards for making distributions and liability for improper distributions are revised to be more consistent with the Uniform Limited Partnership Act. A member of a member-managed LLC or a manager of a manager-managed LLC that consents to an improper distribution in violation of the duty of care is personally liable to the LLC for the amount of the distribution that exceeds the amount that could have been properly made. A LLC agreement may expressly relieve a member in a member-managed LLC of authority and responsibility to consent to distributions, and in that case the member has no liability for an improper distribution. An action based on an improper distribution must be commenced within two years after the distribution.

Transfers of LLC Interests.

Provisions governing assignment of LLC interests are revised to conform to similar provisions in the Uniform Limited Partnership Act. References to "assignment" of "LLC interests" are revised to refer to "transfers" of "transferable interests." Definitions are provided for "transfer," "transferable interest," and "transferee."

A transferor of less than all of the transferor's transferable interests retains all rights, duties, and obligations that are not transferred to the transferee. A transfer does not entitle the transferee to access to information or records of the LLC except as specifically authorized in the LLC Act. Provisions governing the transferee's liability as a result of the transfer are specified.

Standards are established for a judgment creditor of a member or transferee to satisfy the judgment out of the judgment debtor's transferable interest. When a court charges a transferable interest of a judgment debtor with payment of the unsatisfied judgment amount, the charging order constitutes a lien on the judgment debtor's transferable interest. A court

may order a foreclosure on the transferable interest and any purchaser of the transferable interest at the foreclosure sale has the rights of a transferee. Procedures for redeeming a charged transferable interest are specified.

Mergers.

Provisions governing mergers are updated to be consistent with similar provisions in the Uniform Limited Partnership Act and provide more specificity with respect to merger procedures and requirements. A new provision is added that if a member of a LLC that is a party to a merger will have personal liability with respect to the surviving organization, that member must execute a separate written consent to become subject to the personal liability in order for the merger to be approved.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date of Amended Bill: The bill takes effect January 1, 2016.

Staff Summary of Public Testimony:

(In support) Limited liability companies are now the most popular form of business entity. Limited liability company filings far outnumber corporate filings. Given that, it is important to make the LLC Act as user friendly and transparent as possible. The current LLC Act was enacted in 1994, and since that time many other states have modernized their acts and two new uniform acts have been adopted.

The proposal brings the LLC Act up to current and modern standards and is the culmination of seven or eight years of work by members of the Washington State Bar Association's Partnership and LLC Act Committee. The group consisted of 20 lawyers from geographically diverse areas of the state with a variety of legal specialties. One of the main goals of the rewrite was to make the statute user friendly since many LLC formations are made without the assistance of lawyers. Other goals were to preserve flexibility and freedom of contract for the members, eliminate pitfalls and inconsistencies, and eliminate needless differences between the LLC Act and other entity statutes.

The changes include important provisions about liability of managers and members for unlawful distributions so that creditors are not left without a remedy when a LLC becomes insolvent. Another significant provision details the fiduciary duties of a managing member or manager of a LLC. The changes also provide minority protections, including a broader right for a member to access LLC records. User-friendly changes include allowing oral LLC agreements and providing default rules that match the way LLCs are used.

(Opposed) None.

Persons Testifying: Senator Pedersen, prime sponsor; and Brian Todd and Doug Batey, Washington State Bar Association.

Persons Signed In To Testify But Not Testifying: None.