New California LLC Law Effective as of January 1, 2014

By Amy M. Joseph, David A. Hatch, Sansan Lin[1]

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As of January 1, 2014, the California Revised Uniform Limited Liability Company Act (**RULLCA**),[2] a new California law that governs limited liability companies (LLCs), took effect. RULLCA replaces the existing Beverly-Killea Limited Liability Company Act (**Beverly-Killea Act**), which previously governed limited liability companies.[3] Substantively, RULLCA is similar to the Beverly-Killea Act, and follows and recasts several provisions of the prior law. However, RULLCA also includes a number of substantive changes. This article summarizes the timing and transition to RULLCA from the Beverly-Killea Act, highlights some of the key changes in the law, and raises some practical considerations for members and managers of California LLCs.[4]

Formation as an LLC is a popular option for many health care entities, due to its flexibility regarding management and governance structure and favorable tax treatment. As such, it is often used as the preferred form of organization for entities such as surgery centers, ancillary service providers, and health care holding companies, just to name a few. Therefore, such health care entities currently formed as an LLC, and those persons contemplating the formation of a health care entity as an LLC, should take note of the changes under RULLCA.

Importantly, RULLCA does not change the fact that LLCs may not render professional services that require a license, registration, or certification under the California Business and Professions Code,[5] so formation as an LLC has not broadened to include organizations such as medical groups.

I. Transition to RULLCA: Application to Existing LLCs

In addition to governing LLCs formed after January 1, 2014, RULLCA also governs existing LLCs, and applies to “all actions taken by the managers or members” of an LLC from January 1, 2014 forward.[6] However, the Beverly-Killea Act will continue to govern all contracts (including operating agreements), transactions, and other acts taken by an LLC or its members or managers prior to January 1, 2014, including any vote or consent by the managers or members.[7] This raises the question of which law in California, RULLCA or the Beverly-Killea Act, will govern under certain circumstances. For example, if an existing LLC has
an operating agreement in place prior to January 1, 2014, but amends the operating agreement after the effective
date, it is not clear whether the amendment alone, or the entire operating agreement, will be subject to RULLCA.
Thus, some unanswered questions remain regarding the application of RULLCA to existing LLCs under certain
circumstances. For this reason, existing LLCs may wish to consider whether it would be prudent to evaluate their
operating agreements, to determine whether any such ambiguities may exist, and, if so, to amend and restate
their operating agreement, if applicable.

II. Priority of Operating Agreement over Articles of Organization

Under RULLCA, the operating agreement of an LLC takes priority over its articles of organization, such that if
there is any variation between the two documents, the terms of the operating agreement will control.[8] This is a
change from the Beverly-Killea Act, pursuant to which the articles of organization control.[9] Thus, members and
managers of existing LLCs should consider reviewing their current operating agreement and articles of
organization, and consider amending the operating agreement, if needed, to resolve any inconsistencies.

III. Changes to Default Rules Governing LLCs

Similar to prior law, RULLCA sets forth a set of default rules that apply if the issue is not otherwise addressed in
the operating agreement, and some of these default rules are different than the provisions in the Beverly-Killea
Act. Members and managers of LLCs should be aware of these default rules and understand their implications,
because the default rules will apply to any issue on which the LLC’s operating agreement is silent. Members and
managers should ensure that their operating agreements override or modify any default rule that conflicts with
their desired operations. Some of the key changes include:

- **Member-Managed versus Manager-Managed LLCs:** By default, an LLC is presumed to be member-managed
  unless both the articles of organization and the operating agreement specify otherwise.[10] Under prior law, it
  was sufficient to state that the LLC was manager-managed in the articles of organization only.[11] The
  members or managers of manager-managed LLCs should review these documents and, if both do not specify
  that the LLC is manager-managed, consider amending the documents accordingly.

- **Unanimous Consent of Members of a Manager-Managed LLC:** By default, the consent of all members of a
  manager-managed LLC is required for a number of actions, including: the sale, lease, or other disposition of all
  or substantially all of the LLC’s property; approval of a merger or conversion; any other act outside the ordinary
course of the LLC’s activities; and any amendment of the operating agreement.[12] These provisions may only
  be varied by a written operating agreement. For example, if the LLC wants to allow approval of these actions by
  the sole consent of the manager(s), or upon a specific approval of a lesser amount of the manager(s) or
  members, the operating agreement must include that specification. In contrast, although the Beverly-Killea Act
  also required consent of all members to amend the articles of organization or operating agreement, a majority
  vote would have been sufficient in all other circumstances.[13]

- **Disassociation of a Member:** RULLCA preserves existing provisions governing dissolution of an LLC, but also
  adopts new provisions specifically addressing disassociation of a member from an LLC and the related
consequences of disassociation. Pursuant to RULLCA, unless the operating agreement otherwise specifies, certain events will cause disassociation of a member, including but not limited to: resignation or withdrawal; expulsion; judicial order; incapability to perform duties as a member or a member's bankruptcy (in a member-managed LLC); a trust or estate's distribution of all of its transferable interest; dissolution of the member, where the member is a legal entity; or merger of an LLC member where the LLC member is not the surviving entity. The operating agreement may also specify events that will cause disassociation.

- **Indemnification:** By default, RULLCA provides mandatory indemnification for members of member-managed LLCs and managers of manager-managed LLCs, for actions performed in the course of the member's or manager's activities on behalf of the LLC, so long as the member or manager complied with his or her fiduciary duties. However, an LLC may alter or eliminate such indemnification in its operating agreement. In contrast, the Beverly-Killea Act does not provide for mandatory indemnification as a default rule. Rather, it provides that the articles of organization or operating agreement may (but need not) indemnify any person acting on behalf of the LLC.

- **Fiduciary Duties:** RULLCA expressly provides that fiduciary duties include “the duty of loyalty, the duty of care, and any other fiduciary duty,” and clearly defines the fiduciary duties of members and managers operating under both a member-managed or manager-managed LLC. RULLCA also provides the default standards for these fiduciary duties. Notably, RULLCA provides that any modifications to the default fiduciary duties must be “in a written operating agreement with the informed consent of the members.” Further, there is a limit to the amount of permissible modifications. For example, an LLC may not unreasonably reduce or eliminate the duty of care, and an LLC may not eliminate a manager's duty of loyalty, although it may identify categories of activities that do not violate the duty of loyalty, and it may specify the process by which members can authorize an act that would otherwise violate the duty of loyalty.

- **Duty of Good Faith and Fair Dealing:** The default under RULLCA remains that members and managers have an obligation of good faith and fair dealing. However, an LLC may in its operating agreement “prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable.”

- **Transferees:** RULLCA includes new provisions regarding transfers of LLC interests. For the most part, these provisions maintain the same concepts as those in the Beverly-Killea Act, but use different terminology. However, unlike the Beverly-Killea Act, RULLCA does not discuss whether or how an assignee may become a member of an LLC. Nor does it expressly state that a transfer of interest does not entitle the transferee to vote, participate in management, or otherwise exercise rights as a member of an LLC. Rather, RULLCA provides that the operating agreement governs the obligations of an LLC and its members to transferees. Thus, members and managers of an LLC should ensure that the operating agreement sufficiently addresses whether the LLC permits transfers, and if so, the rules governing such transfers.

IV. Limits on an LLC’s Ability to Modify or Eliminate Default Rules
Generally, an operating agreement can be drafted to alter or limit default statutory provisions, such as the provisions addressed above.[28] However, it is worth noting that RULLCA also specifies several statutory provisions that an operating agreement may not alter.[29] Pursuant to RULLCA, generally an operating agreement may not:

- Vary an LLC's capacity to sue or be sued;
- Vary the governing law provisions of RULLCA;
- Vary the power of the court regarding signing and filing records with the Secretary of State;
- Unreasonably restrict the duties and rights related to access to company records, financial statements, or the operating agreement;
- Vary the dissolution and winding up provisions of RULLCA, including the provisions governing judicial dissolution;
- Unreasonably restrict the right of a member to maintain an action against the LLC on behalf of all or a class of members;
- Restrict the right to approve a merger, conversion, or domestication to a member that will have personal liability with respect to a surviving, converted, or domesticated organization;
- Restrict the rights under RULLCA of a person other than a member or manager;
- Vary any of the merger, conversion, or class provisions;
- Vary the statutory definitions pursuant to RULLCA; or
- Vary certain statutory rights of members.[30]

RULLCA also clarifies the extent to which the operating agreement may alter, limit, or eliminate the duty of loyalty, the duty of care, any other fiduciary duty, and the duty of good faith and fair dealing.[31]

In particular, it is worth noting that although the default mandatory indemnification of members and managers can be altered in an operating agreement (as discussed in Section III), there are some limitations on the ability to alter or eliminate a member or manager's liability to the LLC and members for money damages. A member or manager's liability to the LLC and members for money damages may not be eliminated or limited if due to: (a) a breach of the duty of loyalty; (b) the receipt of a financial benefit to which the person was not entitled; (c) a member's liability for receipt of excess distributions; (d) an intentional infliction of harm on the LLC or an LLC member; or (e) intentional violation of criminal law.[32]

Although the Beverly-Killea Act also provided some limitations on what may be altered by an operating agreement, those limitations were not as extensive as the current limitations set forth in RULLCA.

V. Conclusion
RULLCA is in many ways similar to the Beverly-Killea Act, but there are also some substantive differences. Members and managers of existing LLCs should be aware of these changes and consider reviewing their current articles of organization and operating agreement to determine the potential impact of RULLCA. While it is not clear the exact extent to which RULLCA will be applied to existing LLCs, as a conservative approach it is recommended that members or managers of existing LLCs be familiar with RULLCA and consider making amendments as needed to preserve desired operations. In addition, those persons considering forming new LLCs should be aware that although RULLCA is in many ways similar to the Beverly-Killea Act, any newly drafted operating agreements will need to vary from operating agreements drafted prior to January 1, 2014, to incorporate new statutory references, new terminology, and new provisions to address or alter RULLCA’s default rules.

For additional information, please contact: In Los Angeles, Todd Swanson, David Hatch, or Amy Joseph at 310.551.8111; in San Francisco, Paul Smith or Steve Phillips at 415.875.8500; in San Diego, Stephen Treadgold or Mary Norvell at 619.744.7300; and in Washington D.C., Bob Roth at 202.580.7700.

[1] Sansan Lin was a summer associate in 2013, and will be joining the firm in the fall of 2014.
[4] While this article is intended to serve as a summary of some of the key changes and practical considerations related to RULLCA, it is not a comprehensive survey of the new law.


[19] Cal. Corp. Code §§ 17704.09, 17701.10(c)(4). The Beverly-Killea Act also imposed fiduciary duties on managers, but did not expressly define such duties at the same level of detail as found in RULLCA. Rather, the Beverly-Killea Act incorporated the fiduciary duties of partners in partnerships by reference. See Cal. Corp. Code § 17153.


[21] Cal. Corp. Code § 17701.10(e). Although RULLCA does not specify what constitutes informed consent, it appears to be a heightened level of awareness different from the statutorily assumed consent of Section 17701.11(b), which provides that a member is deemed to have assented to an operating agreement simply by becoming a member of the LLC.


[23] Cal. Corp. Code § 17701.10(c)(14). See also Cal. Corp. Code § 17701.10(c)(16) (LLC may prescribe the standards regarding the duty of good faith and fair dealing, so long as “the standards are not manifestly unreasonable”).


[26] Cal. Corp. Code §§ 17705.01-17705.04; Cal. Corp. Code, §§ 17300-17304. For example, the term “transfer” is used instead of “assignment.”


[30] For a comprehensive list and description of the default provisions that an operating agreement may not alter, including the applicable exceptions and limitations to those restrictions, see Section 17701.10 of the Corporations Code.

[31] Cal. Corp. Code § 17701.10(c). See Section III.