

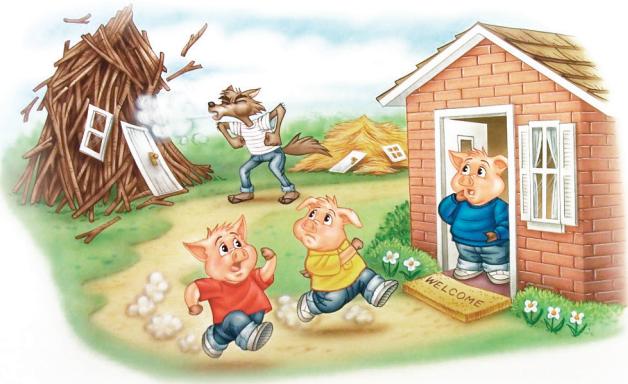
# Structure Matters, Just Ask the Three Little Pigs

By Janel M. Dressen

With the enactment of Minnesota's Revised Uniform Limited Liability Company Act, new limited liability companies (LLCs) (and effective as of Jan. 1, 2018, existing LLCs) are no longer governed by a single board-managed governance structure. Does that matter? In answering this question, I am reminded of the children's fable, "The Three Little Pigs." As it turned out, the three little pigs learned that structure matters during critical times, like when a big bad wolf is trying to eat you. The same is true under the revised act. The selected governance structure matters and will be particularly important at critical times during a company's existence.

The "old" LLC Act, Chapter 322B, pro-

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vides that "[t]he business and affairs of a limited liability company is to be managed by or under the direction of a board of governors," and requires at least two manager positions (which can be held by the same person). Minn. Stat. §§ 322B.606, 322B.67. By contrast, the revised act, Chapter 322C, establishes three alternative governance structures for an LLC: member-managed, manager-managed or board-managed. Minn. Stat. § 322C.0407. The alternative governance structures allow an LLC to fashion the company after either a close corporation under the manager- or board-managed LLC regimes, or after a partnership, under a member-managed LLC regime.

Unless the operating agreement (which can be written, verbal, implied or a combination of all three) expressly provides otherwise, newly formed LLCs are considered member-managed. Minn. Stat. § 322C.0407, subd. 1. An LLC is member-managed unless the operating agreement expressly provides that it is "man-

ager-managed," "managed by managers," management is "vested in the managers," "board-managed," "managed by a board," or management is "vested in a board." *Id.* That being said, a nonprofit LLC must be board-managed. Minn. Stat. § 322C.1101, subd. 5.

In a member-managed LLC, the LLC is to be managed by the members equally, unless the operating agreement provides otherwise. In other words, each member has one vote, regardless of the ownership percentage of that member. "A difference arising among members as to a matter in the ordinary course of the activities of the company may be decided by a majority of the members." Minn. Stat. § 322C.0407, subd 2(2) and 2(3).

The revised act provides that in a manager-managed LLC, "any matter relating to the activities of the company is decided exclusively by the managers." *Id.* at subd. 3(1). Accordingly, "[e]ach manager has equal rights in the management and conduct of the activities of the company," and a "differ-

ence arising among managers as to a matter in the ordinary course of the activities of the company may be decided by a majority of the managers.” *Id.* at subd. 3(2) and 3(3).

The board-managed LLC most closely resembles the structure under Chapter 322B, providing that “[t]he activities and affairs of a limited liability company are to be managed by and under the direction of a board of governors, which shall consist of one or more governors as determined by members holding a majority of the voting power of the members.” Minn. Stat. § 322C.0407 subd. 4.

In addition to the management of the LLC varying by the LLC structure adopted, so does the duties owed. In all three structures, members owe one another the obligation of good faith and fair dealing in the discharge of their duties as members, in exercising any rights under Chapter 322C and under the terms of the operating agreement. The obligation of good faith and fair dealing includes the duty to act “in a manner, in light of the operating agreement, that is honest, fair and reasonable.” Minn. Stat. § 322C.0409, subd. 4. The obligation of good faith and fair dealing is where the similarities among the three different governance structures end by default.

In a member-managed LLC, the members owe fiduciary duties to one another, including the duties of care and loyalty, as well as any “other fiduciary duty” provided for in the operating agreement. Consequently, even a member owning a minority interest will owe fiduciary duties of care and loyalty, and the members will have the protection of the business judgment rule (unlike in a corporation, where the business judgment rule is generally applicable to directors only, not shareholders). Unless otherwise amended by the operating agreement, Chapter 322C expressly provides that competing with the LLC constitutes a violation of the duty of loyalty. Thus, unless otherwise provided for in the operating agreement, in a member-managed LLC, a member (regardless of percentage of ownership interest) may not compete against the LLC without breaching the duty of loyalty. Minn. Stat. § 322C.0409, subd. 2.

In a manager-managed LLC, the managers owe fiduciary duties to one another, including the duties of care and loyalty. Also, in a board-managed LLC, the governors

owe duties of care and loyalty. Minn. Stat. § 322C.0409, subds. 1, 7, 8. These duties include the duty not to compete by either the managers, or governors, as applicable to the governance structure elected by the LLC when formed.

Other rights, obligations and liabilities impacted by the LLC structure elected include, the right to information (322C.0410), indemnification rights (322C.0408), liability for inaccurately filed records (322C.0202, subd. 5), liability for wrongful distributions (322C.0406, subd. 1), demand requirements for derivative claims (322C.0902), appointment of a special litigation committee (322C.0905) and application of the “oppressive” conduct standard to obtain dissolution or other equitable relief (322C.0102 and .0701).

With these differences in mind, do you want to build your LLC with straw, sticks or bricks? The answer to that question will need to be carefully analyzed when an LLC is formed and for existing LLCs in preparation for January 2018 when the revised act becomes applicable to all Minnesota LLCs.

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