

May 25, 2017

It May Be Time to Tune Up Your Connecticut LLC Operating Agreement

As Day Pitney [reported](#) a year ago, the new Connecticut Uniform Limited Liability Company Act (New Act) is poised to replace the existing Connecticut Limited Liability Company Act (Old Act) effective July 1. Last year, we highlighted some of the changes made in the New Act and encouraged clients to review their limited liability company operating agreements (LLC agreements) with us to determine whether any modifications were warranted. In this Alert, we consider some of the issues that may arise in the course of such a review.

Overview

The New Act was written to minimize the number of changes an existing Connecticut LLC might have to make to an existing LLC agreement. The discussion below points out what we believe are some common drafting issues. Provisions can vary significantly among operating agreements, so LLC managers and members are advised to consult with counsel.

New Terminology

The New Act changes some of the defined terms for LLCs. For example, the LLC's "articles of organization" will now be called the "certificate of organization." By themselves, such changes in terminology do not warrant an amendment to an operating agreement. In fact, the New Act accounts for this by providing that for an LLC formed prior to July 1, its "articles of organization" are deemed to be its "certificate of organization."[\[1\]](#)

Beware of New Gap-Fillers

The New Act does not automatically account for all such changes, however. In areas where an operating agreement is silent, the New Act provides default provisions that will act as "gap-fillers." The question for existing LLCs is whether such filler provisions will be consistent with the managers' and members' expectations where New Act provisions diverge from those of the Old Act. For example, under the Old Act, if an operating agreement was silent on the vote of members required to admit a new member, the vote of a majority in interest of current members is required. Under the New Act, the default vote is unanimous consent of the members. Consequently, if the members want to retain the majority-in-interest vote, the operating agreement will need to be amended.

Another example is the vote required to amend the operating agreement. The Old Act requires the approval of two-thirds in interest of the members for an amendment, if the operating agreement is silent, whereas the New Act requires unanimous member approval.

An important area of change is the default rules on standards of conduct for members and managers. The New Act spells out the fiduciary duties of loyalty and care owed by a member and a manager to the LLC and its other members.[\[2\]](#) However, the New Act also provides that so long as it is not "manifestly unreasonable" an operating agreement may (i) alter or eliminate certain aspects of the duty of loyalty, (ii) identify specific behaviors that do not violate the duty of loyalty, (iii) alter but not eliminate the duty of care and (iv) alter or eliminate any other fiduciary duty.[\[3\]](#) The ultimate arbiter of what is "manifestly

unreasonable" is the Connecticut courts.^[4] Members and managers of Connecticut LLCs should consider with counsel the merits of modifying or eliminating these fiduciary duties to the maximum extent permitted.

The gap-filler provision for making distributions also makes an important change. Unless the operating agreement provides otherwise, the New Act requires that distributions be made to the members based on their capital contributions, rather than percentage ownership. This could be significant if, for example, one member receives an LLC interest as "sweat equity" and another contributes cash or property.^[5]

Prohibited Terms Under the New Act

In general, the New Act gives a great deal of latitude to an LLC to modify its operating agreement. However, the New Act specifies 14 situations in which the operating agreement is prohibited from overriding the statutes or limited in its ability to do so.^[6] An important area is the liability for breach of fiduciary duties by members and managers, which can only be modified as described above. One of the New Act's prohibitions is that an operating agreement may not relieve or exonerate a person from liability for conduct involving bad faith, willful or intentional misconduct, or knowing violation of the law.^[7] A similar prohibition found in many operating agreements limits such liability excepting only "fraud, gross negligence or willful misconduct." To the extent the statutory prohibition and an existing prohibition in an operating agreement are inconsistent, the members should consider harmonizing these terms.

The right of members to access and inspect LLC records and information is another area controlled by the statute. Under the New Act, an operating agreement may not impose unreasonable restrictions on information rights, but it may impose reasonable restrictions on the availability and use of such information (such as requiring confidentiality agreements) and may define certain remedies for breaches of reasonable restrictions on use.^[8]

Modifying Provisions of the New Act

Some options exist for the operating agreement to vary the gap-fillers in the New Act that result from terms entirely new to Connecticut LLC statutes by virtue of the New Act. Among these are the new provisions that impose solvency tests on an LLC's ability to make distributions.^[9] Taking advantage of specific provisions in the New Act allows an LLC to apply more liberal solvency measures.^[10]

Superfluous Provisions From the Old Act

Although most of the provisions of the Old Act have analogs in the New Act, the Old Act contains certain requirements for LLC operating agreements that no longer apply under the New Act. A prime example of this is Section 34-144 of the Old Act, which requires an LLC to maintain certain specified records. Those specific requirements no longer exist under the New Act. An LLC may well want to maintain the records specified in the Old Act in order to facilitate compliance with the new record inspection provisions described above, but the change in law makes this a provision worth reviewing.

No Operating Agreement?

A Connecticut LLC that has never had an operating agreement does not necessarily need one now, but the LLC will now be subject to the default provisions of the New Act, which can be different in some significant respects.

The New Act continues the "freedom of contract" provision in the Old Act, stating, "It is the policy of the act to give maximum effect to the principle of freedom of contract and to enforceability of LLC agreements."^[11] This important provision will allow LLCs to structure their operating agreements in the manner best suited to grow their business, subject to the prohibitions on certain provisions described above.

Our attorneys are prepared to review existing LLC operating agreements and advise on any issues raised by application of the New Act as well as provide recommendations for potential modifications.

[1] Conn. Gen. Stat. § 34-243i(b)

[2] Conn. Gen. Stat. § 34-255h

[3] Conn. Gen. Stat. § 34-243d(d)(3)

[4] Conn. Gen. Stat. § 34-243d(e)

[5] Conn. Gen. Stat. § 34-255c(a)

[6] Conn. Gen. Stat. § 34-243d(c)

[7] Conn. Gen. Stat. § 34-243d(c)(7)

[8] Conn. Gen. Stat. § 34-243d(c)(8)

[9] Conn. Gen. Stat. § 34-255d(a)

[10] Conn. Gen. Stat. § 34-243d(d)(1)(B)

[11] Conn. Gen. Stat. § 34-283d(a)

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