



2017

## Making the Case for the Uniform Limited Liability Company Act (2013) in Arkansas

Carol Goforth

Follow this and additional works at: <https://lawrepository.ualr.edu/lawreview>



Part of the [Business Organizations Law Commons](#)

---

### Recommended Citation

Carol Goforth, *Making the Case for the Uniform Limited Liability Company Act (2013) in Arkansas*, 40 U. ARK. LITTLE ROCK L. REV. 187 (2017).

Available at: <https://lawrepository.ualr.edu/lawreview/vol40/iss2/1>

This Article is brought to you for free and open access by Bowen Law Repository: Scholarship & Archives. It has been accepted for inclusion in University of Arkansas at Little Rock Law Review by an authorized editor of Bowen Law Repository: Scholarship & Archives. For more information, please contact [mmserfass@ualr.edu](mailto:mmserfass@ualr.edu).

## MAKING THE CASE FOR THE UNIFORM LIMITED LIABILITY COMPANY ACT (2013) IN ARKANSAS

*Carol Goforth\**

### I. INTRODUCTION

Imagine three law school graduates who decide to form a professional Limited Liability Company (“LLC”) together. They, having sadly neglected to take Business Organizations during law school, fail to draft a written operating agreement dealing with issues such as dissociation<sup>1</sup> of members. Even more upsetting, one of the three engages in unethical practices, and it becomes impractical to carry on business with him. The other two members ask him to leave the business voluntarily, but he steadfastly refuses to do so. Surely they can remove the attorney who has made it impossible to practice law together in an ethical manner! Regrettably, the Arkansas LLC statute does not give them this right.<sup>2</sup> In fact, they do not have the right to expel him even if he is disbarred and it becomes illegal to practice law with him.<sup>3</sup> In fact, under Arkansas’s current LLC statute, even if they had an informal verbal understanding that they could kick such a person out of the law firm, the Arkansas statute would not recognize that as a valid operating agreement.<sup>4</sup> Their only option is to dissolve the entire practice, and to do so, they must first obtain a court order for dissolution,<sup>5</sup> an expensive, time-consuming proposition, especially when the unauthorized and unethical practice of law is involved. Regardless, this is the state of the current Arkansas LLC Act. It does not have to be this way, however. There are other

---

\* University Professor and Clayton N. Little Professor of Law, University of Arkansas School of Law.

1. In the LLC context, an event of dissociation is defined as “an event that causes a person to cease to be a member . . . .” ARK. CODE ANN. § 4-32-102(4) (2016).

2. Under the current Arkansas statute governing LLCs, a member may be removed by a vote of the other members only as provided in the operating agreement or following the transfer of all of his interest in the LLC. ARK. CODE ANN. § 4-32-802(a)(3) (2016).

3. *Id.* Contrast this with the right to remove a partner under the Arkansas UPA. “A partner is dissociated from a partnership upon . . . the partner’s expulsion by the unanimous vote of the other partners if it is unlawful to carry on the partnership business with that partner.” ARK. CODE ANN. § 4-46-601(4)(i) (2016).

4. Under the current statute, an operating agreement is defined as being “the *written* agreement” among members. ARK. CODE ANN. § 4-32-102(11) (2016) (emphasis added).

5. The LLC statute provides, “a circuit court may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business of the limited liability company in conformity with the operating agreement.” ARK. CODE ANN. § 4-32-902 (2016). There is no mention of power to expel a member under any circumstances.

statutory options available, so how did Arkansas wind up with the problematic statute it has now?

LLCs were first authorized in Arkansas on April 12, 1993, when then-Arkansas Governor Jim Guy Tucker signed into law “The Small Business Entity Tax Pass Through Act.”<sup>6</sup> This statute, typically referred to as the “Arkansas LLC Act” despite its official name, was based on a draft of a prototype bill that was the preliminary work product of a group of attorneys in the American Bar Association.<sup>7</sup> The first finalized model or uniform act was not available until August of 1994, when the Uniform Law Commission promulgated the original Uniform Limited Liability Company Act (“ULLCA”).<sup>8</sup> Unfortunately for those hoping for uniformity, few states adopted that iteration of the ULLCA.<sup>9</sup>

Fast-forward a decade, however, and the original ULLCA has now been replaced with an updated version, sometimes known as the Revised Uniform Limited Liability Company Act (“RULLCA”).<sup>10</sup> Because there are multiple revisions, this article will refer to the most recent version of the

---

6. 1993 Ark. Acts, No. 1003 (codified at ARK. CODE ANN. §§ 4-32-101 to -1401) (2016).

7. The original ABA project was conducted under the auspices of a working group officially entitled the “Working Group on the Prototype Limited Liability Company Act, Subcommittee on Limited Liability Companies, Committee on Partnerships and Unincorporated Business Organizations, Section of Business Law, American Bar Association.” The Draft Prototype LLC Act was actually in progress in 1992, but it was abandoned while still in the preliminary stages and was never formally approved by the ABA or any of its standing sections or committees. See generally Mary Elizabeth Matthews, *The Arkansas Limited Liability Company: A New Business Entity Is Born*, 46 ARK. L. REV. 791, 799 (1994). A Revised Prototype Act has since been produced. See *infra* notes 209–24 and accompanying text.

8. UNIF. LTD. LIAB. CO. ACT §§ 101–1206, 6A U.L.A. 429 (1996).

9. Alabama, Hawaii, Illinois, Montana, Oregon, South Carolina, South Dakota, Vermont, and West Virginia were among the minority of states that adopted an LLC Act based on ULLCA. See Carol R. Goforth, *Why Arkansas Should Adopt the Revised Uniform Limited Liability Company Act*, 30 U. ARK. LITTLE ROCK L. REV. 31, 31 (2007) (hereinafter “Goforth”).

10. Unlike the uniform partnership statutes, the official name of the uniform LLC Act omits the date. UNIF. LTD. LIAB. CO. ACT § 101, 6C U.L.A. 14 (2013). The revised version of the ULLCA was originally promulgated in 2006, and has since been amended twice, in 2011 and 2013. As explained by the Uniform Law Commission (“ULC”), “[t]he 2011 and 2013 amendments, enacted as part of the Harmonization of Business Entity Acts project, updated and harmonized the language in this act with similar provisions in other uniform and model unincorporated entity acts.” The changes were generally not substantive in nature. Legislative Fact Sheet, Uniform Laws Commission, [http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Limited%20Liability%20Company%20\(2006\)%20\(Last%20Amended%202013\)](http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Limited%20Liability%20Company%20(2006)%20(Last%20Amended%202013)) (last visited June 15, 2018) (hereinafter “ULC Factsheet”). This article examines the most recent version. References to the Uniform Act here will be to the ULLCA (2013), although the 2006 and 2011 versions are not substantially different.

uniform act as “ULLCA (2013)”, although most of the statute’s substantive provisions have not changed significantly from the 2006 version.<sup>11</sup>

When the provisions of ULLCA (2013) are contrasted with the Arkansas LLC Act, there are a number of obvious comparative advantages that could be realized if Arkansas was to adopt that statute.<sup>12</sup> For example, returning to the hypothetical law graduates, under ULLCA (2013) members would have a statutory right to expel any member if it is illegal to carry on the business with them.<sup>13</sup> The LLC itself could get a court to order expulsion<sup>14</sup> without having to dissolve the business.<sup>15</sup> Finally, as is the case in partnerships,<sup>16</sup> an oral agreement by the owners would be sufficient to modify any statutory rules.<sup>17</sup> All of these would be substantial improvements, and in addition to these kinds of specific benefits, there are also potential advantages of having a more uniform set of rules applicable to LLCs, which could be realized if Arkansas joined with the other eighteen states that have enacted ULLCA (2013) as of the date this article was written.<sup>18</sup>

This article examines the potential benefits of increased uniformity in general, and then considers four distinct issues where Arkansas’s current statute creates significant problems that could be resolved with the ULLCA (2013). These are far from the only problems with the current statute, but they are illustrative of the kinds of issues that the current LLC Act creates. The first of those issues involves the rules regarding when an LLC comes

---

11. UNIF. LTD. LIAB. CO. ACT § 101, 6C U.L.A. 14 (2013).

12. I have made similar arguments before. About a decade ago, I published an article in the University of Arkansas at Little Rock Law Review urging the state to consider ULLCA (2006). *See* Goforth, *supra* note 9. At that time, however, few states had adopted the newly promulgated revised uniform statute, and as a result, there was less certainty that moving in that direction would help achieve any of the benefits of a more uniform system of regulating LLCs. In addition, that article focused on an overview of a range of issues, rather than attempting to illustrate in detail why certain provisions are problematic or offer comparative benefits. Perhaps the approach taken in this article of dealing with a relatively small number of the most significant issues in more detail will be more persuasive.

13. UNIF. LTD. LIAB. CO. ACT § 602(5)(A), 6C U.L.A. 340 (2013).

14. *Id.* § 602(5)(C)(i). This section also authorizes the court to expel a member who has engaged in wrongful conduct that “adversely and materially affects” the company or who “willfully or persistently” breaches the operating agreement of the company. § 602(6)(A)–(B).

15. UNIF. LTD. LIAB. CO. ACT § 701(5), 6C U.L.A. 340 (2013).

16. For example, the Arkansas general partnership statute specifies that a partnership agreement includes “the agreement, whether written, oral, or implied, among the partners . . . .” ARK. CODE ANN. § 4-46-101(7) (2016).

17. UNIF. LTD. LIAB. CO. ACT § 102(13), 6C U.L.A. 16 (2013), defining operating agreement to include arrangements that are “oral, implied, in a record or in any combination thereof.”

18. In addition, the ULC’s website notes that two additional states introduced the ULLCA (2013) in the first six months of 2017. ULC Fact Sheet, *supra* note 10.

into existence, which are idiosyncratic and cumbersome.<sup>19</sup> The second is the statute's requirements regarding the necessity of a written operating agreement and the concomitant requirement that operating agreements be in writing, which illustrates how the current LLC Act creates traps for the unwary and is likely to produce confusion among those working with the legislation.<sup>20</sup> The third issue involves the failure of the current statute to articulate standards of care or duties of loyalty for persons with management authority in their LLCs, which illustrates how omissions and gaps in the statute again create problems for both the public and attorneys trying to provide competent legal advice about the Arkansas LLC Act.<sup>21</sup> The fourth and final problem involves the inability of members to remove another member from a business or partnership who engages in wrongful conduct, even if it would be illegal to continue operating the business with such a person.<sup>22</sup>

This is by no means an exhaustive list of issues and problems created by the current statute, but these kinds of provisions, ambiguities, and omissions provide a compelling case for replacing the current LLC Act. Because of national trends and the comparative advantages offered by ULLCA (2013), this article urges Arkansas to adopt the ULLCA (2013) to replace the Arkansas LLC Act.

## II. THE POTENTIAL BENEFITS OF UNIFORMITY

There are many benefits of having a system of law where states are free to experiment.<sup>23</sup> Such experimentation allows for both innovation and the enactment of rules adapted to special circumstances or needs that may not be present in all parts of the country. A variety of rules could also allow business owners to choose among competing options, locating the most efficient organizational structures and forms. Unfortunately, these benefits do not always materialize, and there are also a large number of potential disadvantages to such a system.

First, the option for experimentation may not produce optimal statutes. Individual state legislatures may not have the expertise or willingness to spend the time or commit the resources necessary to draft comprehensive and efficient statutes, and may not even have the ability to choose wisely among alternative options where there is no generally agreed-upon approach. On the other hand, sophisticated states may engage in a race to en-

---

19. See *infra* Part III, Section A.

20. See *infra* Part III, Section B.

21. See *infra* Part III, Section C.

22. See *infra* Part III, Section D.

23. For a discussion of the tension between the benefits of diversity and uniformity see generally Eric Stein, *Uniformity and Diversity in a Divide-Power System: The United States' Experience*, 61 WASH. L. REV. 1081 (1986).

courage managers to organize in a given jurisdiction, even if that means rejecting rules that would be optimal from a societal perspective. This phenomenon was often criticized in the context of corporate statutes, where various commentators argued that as states “competed” to attract corporate charters, a “race for the bottom” ensued.<sup>24</sup>

A wide array of options may also be less efficient, both for entrepreneurs looking for an optimal organizational approach and for lawyers advising them. Entrepreneurs may need to spend more time than is desirable trying to choose among competing options. It may be more expensive to organize under the laws of a state other than where the business intends to operate because of the costs of domesticating in the state of operations, even if the other state has seemingly superior default rules or requirements. It is likely more expensive to seek legal advice about the laws and options available in other jurisdictions. Choosing the home state’s laws may be less than optimal from an operational standpoint, but less expensive up front, resulting in a need to change the organizational state later, which also increases the expense of doing business. A myriad of rules creates confusion because explanatory materials prepared in reliance upon the laws of another jurisdiction may be inapplicable in this state, including forms drafted under a given state’s laws that work properly in other places but would not function well here. This can create particular issues for entrepreneurs who are wed to the

---

24. Professor William Cary, former Chairman of the Securities and Exchange Commission, famously claimed that Delaware had achieved its dominance in the market for corporate charters by enabling management to further its own interests at the expense of shareholders in this “race to the bottom.” See William Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974). Many other commentators, however, echoed his concern. See, i.e., Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992); Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461 (1989); Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J.L. ECON. & ORG. 32 (2004). It is worth noting that other, equally distinguished, commentators have disagreed with this assessment, characterizing the variation in state corporate law as a race to the top. See William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEGAL STUD. 303 (1997); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001); Daniel R. Fischel, *The “Race to the Bottom” Revisited: Reflections on Recent Developments in Delaware’s Corporation Law*, 76 NW. U. L. REV. 913 (1982); Ralph K. Winter, *The “Race for the Top” Revisited: A Comment on Eisenberg*, 89 COLUM. L. REV. 1526 (1989).

One commentator explained this as follows: “[P]rofessional interests and life experiences cause rule-makers to align with the preferences of managers. This alignment may result from the fact that managers (as opposed to investors) are the most likely clients of the drafters . . . [V]iewpoints and biases of lawyers tend to drift towards those of the clients they serve over time.” Rutherford B. Campbell, Jr. *Bumping Along the Bottom: Abandoned Principles and Failed Fiduciary Standards in Uniform Partnership and LLC Statutes*, 96 KY. L.J. 163, 167–68 (2007-2008).

“do-it-yourself” model of form preparation. Variation among state statutes also leads to greater uncertainty because helpful interpretive guidance from other courts is likely to be unavailable where different statutory language is being applied. Different statutory provisions therefore reduce predictability and increase the risk of unanticipated outcomes.

A uniform approach has at least the following benefits. First, from society’s perspective, there is no risk of a race to the bottom between states pandering to special interests, and there is less risk that a particular state will lack the resources to develop a complete and functional statute. Second, from the perspective of entrepreneurs, there is no need for the additional expense of forum shopping, either during the formation stage or after the business is in operation. Finally, for attorneys, there is decreased uncertainty because forms, advice, and opinions developed or rendered in other jurisdictions would be following and applying the same statutory language.<sup>25</sup>

These considerations alone may not be enough to justify the adoption of an entirely new LLC statute in the state, but they certainly provide a basis for seriously evaluating the options. When the problems created under the current Arkansas LLC Act are also taken into consideration, the case for change is strengthened considerably.

### III. FOUR SPECIFIC PROBLEMS WITH THE ARKANSAS LLC ACT

#### A. Forming a De Jure LLC

One of the quirks of the Arkansas LLC Act relates to how a de jure LLC<sup>26</sup> comes into existence under the terms of that statute.<sup>27</sup> Under the other for-profit business enterprise statutes in this state, formation occurs upon the filing of the appropriate organizational paperwork unless a later effective date is specified in the document being filed.

The simplest statement of this rule occurs in the Arkansas Business Corporation Act, which unambiguously provides that “[u]nless a delayed effective date is specified, the corporate existence begins when the articles

---

25. The official website of the Uniform Law Commission lists a number of potential benefits of uniformity. About the ULC, Uniform Law Commission, <http://www.uniformlaws.org/Narrative.aspx?title=About%20the%20ULC> (last visited June 15, 2018). In addition to the benefits listed in the text, the ULC suggests that consistency between the states strengthens the federal systems, helps states remain up-to-date, facilitates economic development, brings national expertise to the drafting process, and allows states to benefit from the kinds of expertise that most could not afford to duplicate.

26. A de jure entity is simply one that has been properly created under applicable law. Derived from the Latin phrase “de jure,” the literal translation is “in law.” See *Legal English: “De Facto/De Jure,”* @WashULaw Blog (Dec. 28, 2012), <https://onlinelaw.wustl.edu/blog/legal-english-de-factode-jure/>.

27. See *infra* notes 35–38 and accompanying text.

of incorporation are filed.”<sup>28</sup> While general partnerships do not protect the owners from personal liability and do not require any organizational document to be filed, limited liability partnerships (LLPs) have a similar rule. LLPs require a statement of qualification to be filed, and they are effectively formed (or granted their status as an LLP), “on the later of the filing of the statement or a date specified in the statement.”<sup>29</sup>

The rule for limited partnerships and limited liability limited partnerships (LLLPs) is a little more complicated but essentially works out to the same thing. The most obvious provision regarding formation of a limited partnership or LLLP provides that “[i]f there has been substantial compliance with [the filing requirements, and no later effective date is specified in the document] . . . a limited partnership is formed when the Secretary of State files the certificate of limited partnership.”<sup>30</sup> This is slightly complicated by the requirement that a limited partnership must have a least one general partner and one limited partner.<sup>31</sup> While only general partners need to be named in or sign the certificate of limited partnership,<sup>32</sup> there is no limited partnership without at least one limited partner as well. However, once a certificate is filed, it serves as “notice that the partnership is a limited partnership and the persons designated in the certificate as general partners are general partners.”<sup>33</sup> With regard to the “substantial compliance” requirement, the Arkansas Limited Partnership Act allows for the filing of a statement of correction, which is also effective when filed for the purpose of providing notice of the existence of the limited partnership and the status of the general and limited partners.<sup>34</sup> Therefore, even for limited partnerships and LLLPs, it is the filing which seems to be important, not the delivery of a document to the Secretary of State.

The current Arkansas LLC Act does not work in quite this way. For LLCs, it is not the filing that matters, but rather the time the articles of or-

---

28. ARK. CODE ANN. § 4-27-203(a) (2016).

29. *Id.* § 4-46-1001(e) (2016).

30. *Id.* § 4-47-201(c) (2016). The section actually has a cross reference to section 206(c), but that provision deals with deferred effective dates, and also provides that if there is no delayed effective date specified, a document generally takes effect “on the date and at the time the record is filed as evidenced by the Secretary of State’s endorsement of the date and time on the record.” *Id.* § 4-47-206(c) (2016).

31. *Id.* § 4-47-102(11) (2016) (defining “limited partnership” to require one or more general partners and one or more limited partners).

32. *See Id.* § 4-47-201(3) (requiring the name and address of each general partner); ARK. CODE ANN. § 4-47-204(a)(1) (2016) (requiring all general partners to sign the certificate).

33. *Id.* § 4-47-103(c) (2016).

34. *Id.* § 4-47-207(c) (2016) (provides that as to other matters, the statement of correction is “effective retroactively as of the effective date of the record the statement corrects” unless the issue is its application “to persons relying on the uncorrected record and adversely affected by the correction.”).



ganization are delivered for filing. The LLC Act states that “[u]nless a delayed effective date is recited in the articles of organization, a[n] [LLC] is formed when the articles of organization are delivered to the Secretary of State for filing, even if the Secretary of State is unable at the time of delivery to make the determination required for filing . . . .”<sup>35</sup> The statute then goes on to provide that if the articles are not “brought into conformance” within a time period specified in another section, “the existence of the limited liability company terminates at the end of such time period.”<sup>36</sup> The time period referred to is twenty days after the Secretary of State gives notice of “nonperformance,” and the cross-referenced section states that “[i]f the filing and determination requirements of this chapter are not satisfied within the time prescribed” then the documents will not be filed.<sup>37</sup> On the other hand, if the correction is made within the time period specified, or if the Secretary of State later determines that the document was satisfactory as delivered, then the “documents are deemed to have been filed at the time of delivery . . . .”<sup>38</sup> This implies that the documents “are not deemed to have been filed” if the corrections are not made within the statutory time frame.

These rules create a series of needless potential problems. When are documents considered to be “delivered,” and how do you prove delivery has been made, particularly if the articles are not submitted electronically? How does an attorney, an entrepreneur, or a third party check to see if an LLC’s organizational documents have been delivered but not filed? How does the Secretary of State give notice of noncompliance with the statute following delivery, particularly if the problem is that the organizer failed to provide a valid return address or contact information?<sup>39</sup> How do you reconcile the provision that says that an LLC’s existence terminates 20 days after notice of noncompliance unless a correction is made in that time frame, with the later provision specifying that the relation back to the time of delivery applies only if the document is corrected? Is there a valid LLC if no correction is ever made?

This complexity might make sense if the statute included difficult filing requirements that could complicate the Secretary of State’s job in assessing whether particular articles of organization comply with statutory require-

---

35. *Id.* § 4-32-206(a) (2016). This appears to suggest that there is a de jure LLC for the period of time between the delivery of the invalid document, and expiration of the 20-day period following notice from the Secretary of State, even if the deficiency is never corrected and nothing is ever filed.

36. *Id.* (cross-referencing *Id.* § 4-32-1308).

37. ARK. CODE ANN. § 4-32-1308(f)(2)–(3) (2016).

38. *Id.*

39. The statute does specify that the Secretary of State should provide “notification of nonperformance” to the “person who delivered the documents for filing or that person’s representative,” but surely that does not mean the mail carrier or other delivery service person. ARK. CODE ANN. § 4-32-1308(f)(2)(B).

ments; however, a review of the statutory filing requirements reveals no such basis for concern. The only information that articles must include is the following: the name of the company,<sup>40</sup> which must not contain an appropriate indication that the business is organized as a limited liability company and may not be confusingly similar to other entity names on file;<sup>41</sup> the identification of an agent for service of process in compliance with the Model Registered Agents Act;<sup>42</sup> and a statement about the company's management, "[i]f management of the limited liability company is vested in a manager or managers[.]"<sup>43</sup> The sample articles included on the Secretary of State's website for LLCs are, not surprisingly, very brief and straightforward.<sup>44</sup>

The only other filing requirements that are embedded in the LLC Act are equally simple. "[T]he person or persons forming the limited liability company[.]" will sign the articles, and the person executing the document must sign beneath or opposite the signature and must specify the capacity in which the document is being executed.<sup>45</sup> "The document must be typewritten or printed."<sup>46</sup> It must be in English, although a foreign LLC may have a name in a foreign language so long as it is "written in English letters or Arabic or Roman numerals[.]"<sup>47</sup> These requirements are not significantly different from those that appear in other business statutes,<sup>48</sup> and none of them appear to place an undue burden on the Secretary of State's office in its ability to ascertain whether there has been compliance with the statute. Therefore, there is no rational reason why LLCs are formed upon delivery of the articles rather than upon filing like the other business organizations authorized in this State.

Admittedly, this is not likely to be a major problem for most LLCs because most articles will be filed very promptly, and it is unlikely that there will be a gap during which any organizers attempt to enter into contracts. It

---

40. *Id.* § 4-32-202(1) (2016).

41. *Id.* § 4-32-103(a)–(b) (2016). Subsection (d) adds a requirement that an LLC providing professional services should include a designation of that in its name as well, and prohibits the inclusion of the name of any person in the name of a professional LLC unless the person was a prior member or member of a predecessor organization. *Id.* § 4-32-103(d). This limitation on the use of names of non-members appears to borrow from old limited partnership rules, now abandoned in our current limited partnership act.

42. *Id.* § 4-32-202(2) (cross-referencing *Id.* § 4-20-105(a), which also applies to all Arkansas partnerships and corporations created by a filing with the Secretary of State).

43. ARK. CODE ANN. § 4-32-202(3) (2016).

44. A one-page PDF form is available online from the Secretary of State's office at <http://www.sos.arkansas.gov/BCS/Documents/Corporations/LL-01.pdf>. Filing instructions regarding the name and management section information are included on the form itself.

45. ARK. CODE ANN. § 4-32-204(a)–(b) (2016).

46. *Id.* § 4-32-1308(d) (2016).

47. *Id.* § 4-32-1308(e).

48. *See, e.g., Id.* § 4-27-120 (2016) (setting out these same requirements for documents filed on behalf of corporations).

does, however, illustrate one of the enduring problems with the Arkansas LLC Act. The current statute has multiple sections that are inconsistent with the other Arkansas business organization acts and in ways that are unnecessarily complicated. This creates potential unintended legal issues and traps for the unwary.

## B. The Written Operating Agreement

One of the more problematic issues created by the Arkansas LLC Act is its insistence that the members sign a written operating agreement,<sup>49</sup> and the even more unfortunate requirement that operating agreements must be in writing.<sup>50</sup> These two requirements are related but not the same, although they both stem from the way in which the current Arkansas LLC Act defines “operating agreement.”<sup>51</sup>

The requirement that members of an Arkansas LLC must have a written operating agreement is oddly placed in the definitions section of the statute, which provides that an operating agreement is “the written agreement which shall be entered into among all of the members as to the conduct of the business and affairs of a limited liability company.”<sup>52</sup> What has to be in that document, and what are the consequences of not having one? Neither of those questions has an obvious answer. As to the contents of the agreement, a careful perusal of the statute does not indicate that anything has to be in the required agreement. As for the consequences of not having one, other than the obvious result that the statutory default rules will then control the relationship of the parties and the operation of the business, there also appears to be no specified consequence for not following the explicit statutory mandate.

It is true that the LLC Act requires certain information to be kept in writing by the LLC. For example, the LLC must keep copies of its articles of organization together with all amendments, three years of tax returns and financial statements, and all versions of the LLC’s operating agreement.<sup>53</sup> In addition, “unless otherwise provided in writing in an operating agreement,”<sup>54</sup> the necessary documentation also includes the following:

---

49. *Id.* § 4-32-102(11) (2016).

50. *Id.*

51. ARK. CODE ANN. § 4-32-102(11).

52. *Id.* (emphasis added). Because of the use of the word “shall,” the requirement of a written operating agreement appears to be mandatory, and the definition also does not appear to allow the LLC itself to be a party to the agreement.

53. *Id.* § 4-32-405(a) (2016).

54. *Id.* § 4-32-405. This language is one of several ways that the statute refers to operating agreements and the ability of members to change various default rules under the Act. Section 404 says that changes may be made by “[a]n operating agreement which is in writing.” *Id.* § 4-32-404 (2016). Single sections can contain inconsistent rules about whether a

- 1) A current and past list, of the full name and last known mailing address of each member and manager, if any, in alphabetical order;<sup>55</sup>
- 2) The amount of cash and a statement of the agreed value of other property or services contributed, as well as the time or events upon which any additional contributions are to be made;<sup>56</sup> and
- 3) A list of the events upon which the LLC is to be dissolved and its affairs wound up.<sup>57</sup>

While these items are not required to be in the operating agreement, with the statute merely stating that they are to be kept at the LLC's "principal place of business,"<sup>58</sup> it might make sense to include these informational items in the operating agreement. On the other hand, so long as the documents are somewhere at the LLC's office, a written operating agreement among the members saying nothing more than "this is the operating agreement" would technically fulfill the requirements of the statute.

In addition, the LLC Act does state that failure to "keep or maintain any of the records or information required pursuant to [section 405] shall not be grounds for imposing liability on any member or manager for the debts and obligations of the limited liability company."<sup>59</sup> It is not completely clear, however, if this applies to the requirement that there be a written operating agreement, which appears in a different section of the LLC Act. If it does not, failure to have a written operating agreement might be relevant in

---

writing is required. Section 403(a) governs the way business decisions are to be made "[u]nless otherwise provided in an operating agreement," while 403(b) requires that certain kinds of decisions can be modified if "otherwise provided in writing in an operating agreement." *Id.* § 4-32-403 (2016). However, since the definitions section of the Act requires the operating agreement to be in writing, presumably the differences in terminology are merely confusing rather than substantively different.

55. ARK. CODE ANN. § 4-32-405(a)(1). This section does not specify what is meant by a "past" list, or whether every list of members and managers and their then current addresses must always be kept.

56. *Id.* § 4-32-405(a)(5)(A).

57. *Id.* § 4-32-405(a)(5)(B). This requirement is particularly odd because the LLC Act does provide for a default rule on the duration of an LLC. As currently set out in the statute, an LLC "is dissolved and its affairs shall be wound up upon the happening of the first to occur of the following: (1) At the time or upon the occurrence of events specified in writing in the articles of organization or an operating agreement, but if no such time is set forth in either of the foregoing, then the limited liability company shall have a perpetual existence[.]" *Id.* § 4-32-901(1) (2016).

58. *Id.* § 4-32-405(a) (2016).

59. *Id.* § 4-32-405(d).

an action to pierce the veil of limited liability normally enjoyed by members of an LLC.<sup>60</sup>

The reason for concern in this regard comes from the fact that in applying the doctrine of “piercing the corporate veil” to LLCs, the Supreme Court of Arkansas relies on corporate law.<sup>61</sup> In fact, in explaining when courts might pierce the veil of limited liability that normally protects members of an LLC, the Court stated:

In special circumstances, the court will disregard the corporate facade when the corporate form has been illegally abused to the injury of a third party. The conditions under which the corporate entity may be disregarded or looked upon as the alter ego of the principal stockholder vary according to the circumstances of each case.<sup>62</sup>

In particular, the Court suggested that owners of a company who want to avoid the risk of personal liability are well advised to carefully observe the statutory formalities associated with running their business. It did this, in part, by citing cases where piercing the corporate veil had not been appropriate because the “incorporators took all necessary legal steps to establish a corporation, the shareholders attended corporate meetings, and tax returns were properly filed in the name of the corporation[.]”<sup>63</sup> Similarly, it cited with approval the conduct of the shareholders in *Banks v. Jones*,<sup>64</sup> where the shareholders maintained separate books and filed proper tax returns.<sup>65</sup> It also referenced *Quinn–Matchet Partners v. Parker Corp.*,<sup>66</sup> where it appeared from the evidence that “the corporation adhered to corporate formalities by keeping its own financial records and bank accounts, by filing separate tax returns, and by recording the loans” it had made with its owner.<sup>67</sup>

Citation to cases like these suggest that observing the required formalities is important in the context of piercing the veil in order to reach the assets of members in Arkansas LLCs, which raises the stakes when it comes to having a written operating agreement. The implication is that the current Arkansas LLC Act requires a document with no specific purpose, but if the

---

60. Arkansas has applied the doctrine of piercing to LLCs, and in doing so has explicitly recognized that the rules governing piercing in the corporate setting should govern. *Anderson v. Stewart*, 366 Ark. 203, 234 S.W.3d 295 (2006).

61. *Id.*

62. *Id.* at 206–07, 234 S.W.3d at 298.

63. *Id.* at 209, 234 S.W.3d at 299 (citing *Don G. Parker, Inc. v. Point Ferry, Inc.*, 249 Ark. 764, 766, 461 S.W.2d 587, 589 (1971)).

64. *Bank v. Jones*, 239 Ark. 396, 399, 390 S.W.2d 108, 110 (1965).

65. *Id.*, 390 S.W.2d at 110.

66. *Quinn–Matchet Partners, Inc. v. Parker Corp., Inc.*, 85 Ark. App. 143, 149–50, 147 S.W.3d 703, 707 (2004).

67. *Id.*, cited in *Anderson*, 366 Ark. 203, at 209, 234 S.W.3d at 299.

requirement of having such a document is ignored, there is a risk of substantial liability.

Moreover, this is only part of the problem with how the current Arkansas LLC Act treats operating agreements. The other concern is that in order to have an operating agreement at all, it apparently must be in writing.<sup>68</sup> This requirement is also embedded in the definition of an operating agreement under the current act.<sup>69</sup>

The LLC was designed to be an appropriate form of business for smaller businesses and less sophisticated entrepreneurs.<sup>70</sup> “Mom-and-pop” businesses were supposed to be attracted to this business model, which was touted as both flexible and informal.<sup>71</sup> The LLC was modeled after the general partnership precisely to create the kind of informality deemed likely to mirror how small businesses actually operate. But a general partnership does not require a written operational document, nor does it require that any such agreement between the partners be in writing.<sup>72</sup> While experienced attorneys are likely to encourage their clients to reduce substantive business operating agreements to writing, the reality is that many smaller operations may be run essentially as handshake deals based on informal agreements and arrangements among the participants. A requirement that any agreement deviating from the statutory default rules be in writing could easily create a substantial trap for the unwary.

Consider this example as a means of illustrating the problem. Imagine an agreement between a small group of friends calling for some of the friends to contribute more to the business than others. The participants might also agree to allocate voting power in accordance with the relative value of those contributions. They set up an LLC, intending it to operate in accordance with these arrangements, but they never reduce any of this to writing. Under the current Arkansas LLC Act, these understandings are not

---

68. See *supra* note 54 and the accompanying text.

69. ARK. CODE ANN. § 4-32-102(11) (2016).

70. “Investors in small businesses have long desired to combine limited liability for investors with flexibility in management structure and partnership taxation classification. The achievement of this goal is enhanced with the adoption of Limited Liability Company . . . statutes.” Carol J. Miller, *LLPs: How Limited is Limited Liability?*, 53 J. MO. B. 154, 154 (1997). Therefore, it is not surprising that it is generally accepted that “the LLC should serve the needs of small informal businesses . . .” Sandra K. Miller, *What Buy-Out Rights, Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of a Limited Liability Company*, 38 HARV. J. ON LEGIS. 413, 466 (2001).

71. See, e.g., Larry Ribstein, *Reverse Limited Liability and the Design of Business Associations*, 30 DEL. J. OF CORP. L. 199, 213 (2005) (talking about the “flexible and relatively informal LLC form”).

72. In the current version of the UPA, “partnership agreement” is explicitly defined as “the agreement, whether or not referred to as a partnership agreement and whether oral, implied, in a record, or in any combination thereof, of all the partners of a partnership . . .” UNIF. P’SHIP ACT § 102(12) (1997).

an operating agreement, and therefore they cannot modify the statutory default rules. Each of the members therefore winds up with an equal say in the business' management, contrary to their intent. This result is not consistent with partnership law,<sup>73</sup> or with the dictates of logic or fairness. In an operational form geared towards informality,<sup>74</sup> it seems counterintuitive to prohibit informal arrangements among the parties about how they wish their business to operate. It seems especially questionable when some sections of the statute take pains to remind participants that the default rules may only be changed by a written agreement while others say that any operating agreement can modify the statutory default provision.<sup>75</sup> This kind of distinction is illusory because the statute has previously declared that an operating agreement must be in writing.<sup>76</sup>

### C. Standards of Conduct: The Duties of Care and Loyalty

A third issue concerns how Arkansas addresses, or fails to address, the fiduciary obligations of members or managers, depending on whether the LLC is member or manager-managed. The topic of how LLC statutes should address fiduciary duties has produced considerable debate and discussion over the years,<sup>77</sup> for a number of reasons. Perhaps the most significant is that the problem of abuse of power by persons with management authority in LLCs is regrettably common.<sup>78</sup> Another factor that has contributed to the

---

73. See UNIF. P'SHIP ACT § 102(12) (1997).

74. The general focus on informality appears elsewhere in the Arkansas LLC Act. For example, no formal votes are required, and no record of actions taken need be maintained, unless such formalities are specified in an operating agreement. See ARK. CODE ANN. § 4-32-403(a) (2016) (permitting actions to be taken by "affirmative vote, approval or consent" of the members or managers); *Id.* § 4-32-405 (2016) (listing records to be kept, and not referencing any resolution or record of actions taken by the members or managers). Both of such sections allow modification in the rules by contrary provisions in the LLC's operating agreement.

75. Compare ARK. CODE ANN. § 4-32-403(a) (governing decisions on "any matter connected with the business of the limited liability company" "unless otherwise provided in an operating agreement"), with *Id.* § 4-32-403(b) (governing the approval necessary to amend or contravene any portion of a written operating agreement "[u]nless otherwise provided in writing in an operating agreement . . .").

76. ARK. CODE ANN. § 4-32-102(11) (2016) (defining operating agreement as the "written agreement" of an LLC's members).

77. For an extended discussion about the various approaches that have been urged and taken for this issue see Sandra K. Miller, *What Fiduciary Duties Should Apply to the LLC Manager After More Than a Decade of Experimentation*, 32 J. CORP. L. 565 (2007) (hereinafter "Miller, *Decade*").

78. "Abusive conduct in the context of the LLC spans many jurisdictions with a wide variety of different formulations of the duty of loyalty and the duty of care. The fact patterns vary, but the misconduct is familiar. The cases involve several strains of abusive conduct including furtive sales of the LLC, inventive squeeze-outs, and creative diversions of assets."

volume of discussion on this issue is the extraordinarily wide variety of statutory options governing the fiduciary obligations of LLC participants.<sup>79</sup> Added to that is a stark disagreement about the optimal theoretical perspective from which to approach the question of what default duties should be owed in LLCs, exemplified by the contractarian and traditional schools of thought.<sup>80</sup> A final consideration that has contributed to the volume of commentary in Arkansas is the abbreviated<sup>81</sup> and confusing<sup>82</sup> manner in which

---

Miller, *Decade*, *supra* note 77, at 588. Accord Sandra K. Miller, *The Best of Both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 J. CORP. L. 295, 307 (2014) (noting the “significant body of case law” as of 2014 addressing fiduciary obligations in the context of LLCs) (hereinafter “Miller, *Worlds*”). Arkansas has had to deal with the issue as well. See *K.C. Properties of N.W. Arkansas, Inc. v. Lowell Investment Partners, LLC*, 373 Ark. 14, 280 S.W.3d 1 (2008).

79. “The variation among LLC statutes is particularly striking with regard to the standard of care applicable to LLC managers, the duty of loyalty owed to the LLC, and the extent to which remedies are available to address wrongful treatment when one LLC member or manager has mistreated another.” Miller, *Decade*, *supra* note 77, at 568 (fn omitted).

80. Some scholars believe that LLCs are fundamentally contractual in nature and the parties should be completely free to contract for or around any duties. For the classic explanation of the contractarian view, see Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993) (“Fiduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings.”). Other commentators take the position that there should be minimum obligations mandated in any closely held enterprise where exit rights are limited. Lawrence E. Mitchell, *Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1725 (1990) (“The debate really is about the way we, as a society, believe that people can and should conduct themselves in business relationships and the extent to which we are willing to use the law to encourage and, if necessary, compel them to conform to that level of conduct.”). See also Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 832 (1983) (“To the extent that the law induces fiduciaries to work for the collective good, the law helps shape desirable social trends.”). In Arkansas, Professor Frances Fendler has been an especially vocal advocate of the traditional point of view as it applies to LLCs. See Frances S. Fendler, *A License to Lie, Cheat, and Steal? Restriction or Elimination of Fiduciary Duties in Arkansas Limited Liability Companies*, 60 ARK. L. REV. 643, 653 (2007) (hereinafter “Fendler, *License*”) (“In sum, to allow dilution of fiduciary obligation enables opportunistic conduct by the stronger party against the weaker . . . .”)

81. Arkansas’s LLC Act has such a minimal treatment of fiduciary obligations that one commentator has said it is essentially “silent as to fiduciary duties.” Miller, *Decade*, *supra* note 77, at 586 n.124 (citing ARK. CODE ANN. § 4-32-402 (2016), noting that the statute “contain[s] no statements about the duty of good faith or loyalty but indicat[es] that a member or manager shall not be liable unless the act or omission constitutes gross negligence or willful misconduct”).

82. Others have commented on the lack of clarity in the Arkansas LLC Act provisions dealing with fiduciary duties. See John M. Cunningham & Frances S. Fendler, *Revising Arkansas LLC Fiduciary Law to Protect the Unrepresented*, ARK. LAW., Spring 2011, at 14–15 (hereinafter “Cunningham & Fendler”) (“The language of the duty-of-loyalty provision in the Arkansas LLC Act is murky.”).

Case law has not done much to clarify these provisions. For example, the Arkansas Supreme Court “missed an opportunity to analyze the fiduciary duties of loyalty and good faith, the



our statute addresses the issue of what duties are owed by and among participants in a domestic LLC, and the extent to which these default rules can be changed by agreement.

There are certainly statutes that adopt the contractarian point of view, providing minimal default rules and allowing organizers of an LLC to contract for or around duties of care and loyalty.<sup>83</sup> This Article, however, concludes that a traditional approach to fiduciary duties would work better than either the odd and incomplete language that Arkansas currently has in its statute, or a narrow, contractarian statutory framework. As one commentator opined, “a broader formulation better reflects society’s norms of ethical conduct, more adequately serves all sectors of the private business community, may be more effective in combating subtle freeze-out schemes, and does not presume that the parties’ relationship is governed by a highly negotiated contract.”<sup>84</sup> This approach seems especially desirable because the LLC is supposed to be appropriate for smaller, less sophisticated businesses and investors.<sup>85</sup>

---

relationship between those fiduciary duties, and the privilege of doing business through LLCs in Arkansas[]” in *K.C. Properties of N.W. Arkansas, Inc. v. Lowell Investment Partners, LLC*, 373 Ark. 14, 280 S.W.3d 1 (2008). Frances S. Fendler, *Losing Faith: Limited Liability Companies in Arkansas and the Fiduciary Duties of Loyalty and Good Faith*, 31 U. ARK. LITTLE ROCK L. REV. 245, 246 (2009) (hereinafter “Fendler, *Faith*”). Professor Fendler contends in this article that the Court essentially misanalysed the behavior of the defendants, and therefore failed to recognize a breach of the duty of loyalty. *Id.* This case was also the subject of a student case note, where the author concluded that the opinion leaves “much uncertainty” with regard to the fiduciary obligations of LLC participants. Michael A. Thompson, Note, *An Uncertain Duty: K.C. Properties, Inc. v. Lowell Investment Partners, LLC and the Duty of Loyalty in an Arkansas Limited Liability Company*, 62 ARK. L. REV. 563, 591 (2009). See also *infra* notes 91-100 for a discussion of the opinion in *K.C. Properties*.

83. See DEL. CODE ANN. Tit. 6, §§ 17-1101(d), 18-1101(c) (2005) (permitting duties to be expanded, restricted, or eliminated in the Delaware Revised Uniform Limited Partnership Act and the Delaware Limited Liability Company Act to 18-1109 (2005)). The Delaware LLC Act places great emphasis on freedom of contract, declaring that one of its primary thrusts is “to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.” DEL. CODE ANN. tit. 6, § 18-1101(b) (2005 & Supp. 2006). For an examination of these statutory provisions, see Paul M. Altman & Srinivas M. Raju, *Delaware Alternative Entities and the Implied Contractual Covenant of Good Faith and Fair Dealing Under Delaware Law*, 60 BUS. LAW. 1469, 1473-74 (2005) (discussing the increased ability to waive fiduciary duties under Delaware law and analyzing the meaning of good faith as an implied contractual duty that cannot be waived). The Revised Prototype LLC Act, discussed as a possible alternative to ULLCA (2013) in Part V of this article, also takes this approach. See *infra* Part V, notes 209-24 and accompanying text.

84. Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1609 (2004) (hereinafter “Miller, *Balancing*”).

85. Even commentators highly critical of the original LLC noted the potential benefits of providing suitable default rules geared towards unsophisticated participants. Larry E.

As currently written, the Arkansas LLC Act provision that talks about a member or manager's obligations is entitled: "Duties of Managers and Members Liability to Company--Duties."<sup>86</sup> This section does not label these "duties" as being fiduciary obligations, and the statutory language is more focused on limiting liability rather than imposing it. Subject to a contrary provision in the LLC's operating agreement, the first subsection of this provision states that members or managers are not to be liable "in damages or otherwise" for any act or omission unless it "constitutes gross negligence or willful misconduct[.]"<sup>87</sup> The next subsection sets out some obligations that would traditionally be associated with a duty of loyalty. That provision states that, without the approval of at least one-half of the disinterested members or managers, or other person with management authority, a member or manager must:

account to the limited liability company and hold as trustee for it any profit or benefit derived by that person . . . from any transaction connected with the conduct or winding up of the limited liability company or any use by the member or manager of its property, including, but not limited to, confidential or proprietary information of the limited liability company or other matters entrusted to the person as a result of his or her status as manager or member . . .<sup>88</sup>

Regardless of whether these duties are characterized as fiduciary in nature, the statutory language is certainly subject to being criticized as inadequate and ambiguous.<sup>89</sup>

As a default rule, the failure of the current Arkansas LLC Act to articulate an obligation of good faith and fair dealing is also concerning. Generally regarded as less burdensome than traditional fiduciary obligations, the current statute does not even include it as an affirmative standard of care that should be observed. In fact, even if one reads in such an obligation as a common law default position, the statute has no indication that there is any minimum level of conduct that cannot be contracted around. This is certainly problematic from a traditional perspective.

---

Ribstein, *A Critique of the Uniform Limited Liability Company Act*, 25 STETSON L. REV. 311, 333 (1995) ("Legislators can, therefore, minimize transaction costs by drafting default rules that suit relatively small, unsophisticated firms because unsuitable defaults are more burdensome for such firms than for more sophisticated firms.").

86. ARK. CODE ANN. § 4-32-402 (2016).

87. *Id.* § 4-32-402(1).

88. *Id.* § 4-32-402(2).

89. "The Arkansas LLC Act prescribes default fiduciary duty rules applicable to managers and members, but the provisions are inadequate to protect the interests of unrepresented LLC members. The duty of care is too lax, and the duty of loyalty is expressed in archaic language that gives little guidance to lay persons about what constitutes disloyal behavior." Cunningham & Fendler, *supra* note 82, at 14.

A similar issue arises because of the ambiguities present in the statute. Are there minimum standards of care? May they be removed completely? The statute does not specify. Even where there are statements of potential liability, such as the provision stating that members or managers may be liable for “any profit or benefit” derived from “any transaction connected with the conduct” of the LLC involving “matters entrusted to the person as a result of his or her status as a manager or member[,]” the statutory language is certainly not a model of clarity.<sup>90</sup>

To illustrate how issues about duties owed in an LLC might play out in the real world, consider the facts and legal outcome in *K.C. Properties of N.W. Arkansas, Inc. v. Lowell Inv. Partners, LLC*.<sup>91</sup> The case involved an LLC owned by two entities, one holding a 51% interest, referred to as “LIP” in the opinion, and the other, referred to as “KC,” which owned 49%.<sup>92</sup> Pursuant to an operating agreement, the LLC was managed by a manager (referred to as “PMS”), appointed by LIP.<sup>93</sup> PMS was owned and managed by the same individuals, either directly or through their own LLCs, as LIP.<sup>94</sup> The same individuals also owned another entity (“PHR”), which in turn owned a piece of land that, pursuant to an understanding of the parties, was to be sold to the LLC at a specific price.<sup>95</sup> Instead of selling the land to the LLC as agreed, the land was secretly sold by PHR to a third party for substantially more money than the LLC expected to pay.<sup>96</sup> In litigation brought by KC, the trial court granted summary judgment in favor of LIP and its individual members and managers. The Supreme Court of Arkansas affirmed, based in part on a finding that the conduct of LIP did not amount to gross negligence or willful misconduct,<sup>97</sup> and further based on a determination that PHR was neither a member nor manager of the LLC nor a party to its operating agreement.<sup>98</sup> This rather convoluted fact pattern clearly seems to involve a “conflict of interest that implicated the fiduciary duties of loyal-

---

90. ARK. CODE ANN. § 4-32-402(2) (2016). Interestingly, that provision is called “Duties of Members and Managers,” but its first subsection contains a limitation on liability rather than any affirmative level of care that is owed. *Id.* § 4-42-402(1).

91. See generally *K.C. Properties of N.W. Arkansas, Inc. v. Lowell Investment Partners, LLC*, 373 Ark. 14, 280 S.W.3d 1 (2008).

92. This relatively complicated ownership and management structure are described in various places throughout the opinion, although the basic information appears in *K.C. Properties*, 373 Ark. at 18, 280 S.W.3d at 6.

93. *Id.*, 280 S.W.3d at 6.

94. *Id.*, 280 S.W.3d at 6.

95. *Id.*, 280 S.W.3d at 6.

96. *Id.*, 280 S.W.3d at 6.

97. “[N]either PMS nor LIP committed any act or failure to act constituting gross negligence or willful misconduct for which they could be held liable . . .” *K.C. Properties*, 373 Ark. at 21–22, 280 S.W.3d at 8.

98. The court concluded that “PHR had no fiduciary duty to Appellants.” *Id.* at 23, 280 S.W.3d at 9.

ty and good faith” on the part of the involved individuals and their LLCs.<sup>99</sup> Such obligations, however, are not expressly set out in the Arkansas LLC Act; consequently, the Supreme Court did not rely on or impose them, despite the fact that the conduct seems to violate basic notions of good faith and fair dealing, as well as the obligation of candor that would normally be part of a duty of loyalty.<sup>100</sup>

It is probably worth emphasizing that this is an area where our LLC Act deviates substantially from the rules that exist in other business organizations that may be created under Arkansas law. The rules that govern Arkansas general and limited partnerships, as well as LLPs and LLLPs, provide for significantly more detailed obligations.<sup>101</sup> This fact probably makes it more likely that unsophisticated business persons, and regrettably even inexperienced attorneys, will wrongly believe that in unincorporated, closely held businesses, such as LLCs, a reasonable level of care is expected under default rules.<sup>102</sup>

In general partnerships and LLPs, management power is vested by statute in the general partners.<sup>103</sup> Along with that power comes a commensurate level of responsibility.<sup>104</sup> The partnership act lists both a fiduciary duty of loyalty and duty of care, as well as an obligation of good faith and fair dealing for such partners.<sup>105</sup> The default duty of loyalty includes the following obligations:

- (1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of

---

99. Fendler, *Faith*, *supra* note 82 at 249 (2009).

100. Sometimes the duty of candor is regarded as being a distinct obligation. “In the partnership context, a duty of candor, also referred to as a duty of disclosure, is sometimes articulated as a free-standing fiduciary duty. In the corporate context, when directors, senior executives, or controlling shareholders are interested in a transaction affecting the company, appropriate disclosure and consent serve as a means of discharging one’s overall duty of loyalty, or duty of fair dealing.” Miller, *Decade*, *supra* note 77 at 574. Professor Miller also notes that “[s]ome LLC decisions have recognized a duty of disclosure as part and parcel of the LLC manager’s ‘fiduciary duties.’” *Id.*

101. *See infra* notes 103–110 and accompanying text.

102. “Surely an unrepresented LLC member who has invested his money or property in an enterprise would be surprised to find out that his manager is subject to a lower standard of care than the employees of his company.” Cunningham & Fendler, *supra* note 82, at 14.

103. The Uniform Partnership Act, which governs both Arkansas general partnerships and LLPs, provides that “[e]ach partner has equal rights in the management and conduct of the partnership business.” ARK. CODE ANN. § 4-46-401(f) (2016). While this is subject to the contrary agreement of the partners, their status as agents is not normally something that can be varied just by agreement of the partners because it could affect the rights of third parties. *See Id.* § 4-46-301(1) (“each partner is an agent of the partnership”); *Id.* § 4-46-103 (2016) (listing the nonwaivable provisions of a partnership agreement).

104. *Id.* § 4-46-404 lists the “[g]eneral standards of partner’s conduct.”

105. *Id.* § 4-47-408 (2016).

the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity;

(2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and

(3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.<sup>106</sup>

The statutory duty of care is “limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law”<sup>107</sup> unless the partners have otherwise agreed. In addition to these fiduciary obligations, the act specifies that a “partner shall discharge the duties to the partnership and the other partners under this chapter or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing.”<sup>108</sup> Moreover, while these obligations may be increased if the parties so choose, the partnership statute also provides that these duties may not be eliminated or unreasonably reduced.<sup>109</sup> The rules applicable to general partners in limited partnerships and LLLPs are essentially identical.<sup>110</sup>

The Arkansas corporate statute is somewhat older, and must be understood in light of the well-accepted business judgment rule as applied by Arkansas courts. In general terms, the Arkansas corporate statute imposes upon

106. *Id.* § 4-46-404(b).

107. ARK. CODE ANN. § 4-46-404(c) (2016).

108. *Id.* § 4-46-404(d).

109. The actual language of the statute is that a partnership agreement may not:

(3) eliminate the duty of loyalty under 4-46-404(b) or 4-46-603(b)(3), but:

(i) the partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; or

(ii) all of the partners or a number or percentage specified in the partnership agreement may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty;

(4) unreasonably reduce the duty of care under 4-46-404(c) or 4-46-603(b)(3);

(5) eliminate the obligation of good faith and fair dealing under 4-46-404(d), but the partnership agreement may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable . . .

*Id.* § 4-46-103(b).

110. Just as is the case in general partnerships, it is the general partners in limited partnerships who have both management power and fiduciary duties. ARK. CODE ANN. § 4-47-406(a) (2016) (“Each partner has equal rights in the management and conduct of the partnership business.”) General partners owe the same fiduciary duties of loyalty and care, and the same obligation of good faith and fair dealing. *Id.* § 4-47-408(b) to (d). And just as is the case with general partnerships, these duties may not be eliminated or unreasonably reduced. *Id.* § 4-47-110(b)(5)–(7) (2016).

directors and officers the duty to act with ordinary care and reasonable prudence.<sup>111</sup> This standard, however, is subject to judicially-created rules, which essentially insulate disinterested and reasonably informed managers who have acted in good faith from after-the-fact second-guessing by investors or courts.<sup>112</sup> “Only if the managers act with a conflict of interest or make uninformed decisions are they denied the protection of the business judgment rule.”<sup>113</sup> This means that corporate managers have reasonable discretion in making business judgments, but they are certainly not insulated from decisions that do not meet the standards of good faith and fair dealing. Moreover, much stricter scrutiny can be expected if a director is engaged in self-dealing or other behavior implicating a potential violation of the duty of loyalty.<sup>114</sup>

A standard of care for LLCs that is less ambiguous than that which currently appears in the Arkansas LLC Act, that has minimum standards, and which includes the concepts of good faith and fair dealing would certainly seem better designed to protect the kinds of unsophisticated entrepreneurs

---

111. ARK. CODE ANN. § 4-27-830(a) (2016) specifies that a “director shall discharge his duties as a director, including his duties as a member of a committee: (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner he reasonably believes to be in the best interests of the corporation.” The liability of a director for misconduct can be reduced by an appropriate provision in the corporation’s articles of incorporation, but not for “acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law.” ARK. CODE ANN. § 4-27-202(b)(3)(ii) (2016).

112. One of the clearest articulations of the business judgment rules comes from the American Law Institute, Principles of Corporation Governance. Section 4.01 of that project includes in subsection (a) a general statement of the typical statutory standards, and then in subsection (c) a statement of the business judgment rule, which operates to protect directors who meet certain standards:

(c) A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer: (1) is not interested in the subject of the business judgment; (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.

ALI, PRINCIPLES OF CORP. GOVERNANCE § 4.01 (1994). For statements of the rule as adopted and applied in Arkansas, see *Long v. Lampton*, 324 Ark. 511, 521–22, 922 S.W.2d 692, 698–99 (1996); see also *Hall v. Staha*, 303 Ark. 673, 678, 800 S.W.2d 396, 399 (1990) (business judgment rule is a tool of judicial review).

113. Cunningham & Fendler, *supra* note 82, at 15.

114. “Absent a conflict of interest,” directors are generally “subject to the business judgment rule, which places a heavy burden on a plaintiff seeking to establish a breach of fiduciary duty.” Frederick H. Alexander, *Reining in Good Intentions: Common Law Protections of Voting Rights*, 26 Del. J. Corp. Law 897, 899-900 (2001) (noting that board level conflicts of interest “may be subject to the entire fairness test, which carries a much higher standard of scrutiny . . .”).

the LLC was supposed to attract.<sup>115</sup> As will be discussed in more detail later, the ULLCA (2013) would certainly accomplish this.

#### D. The Misbehaving Member

The lack of clear and suitable fiduciary standards of care by which a member or manager's acts can be judged is not the only problem that can arise when someone in an LLC fails to behave appropriately. Fiduciary duties normally apply when those with management power abuse their authority. Sometimes the issue is with a member who lacks management authority, but nonetheless is acting in a manner that might be substantially detrimental to the LLC, so that even if there were appropriate fiduciary obligations associated with management power, the other participants in the venture might not be protected from the acts of the member. Moreover, damages arising out of a breach of duty claim might not always be sufficient to protect others in an LLC even if it is a member with management power who is abusing his or her position.

Perhaps the clearest way to illustrate this problem is with a concrete example. Suppose a group of attorneys decide to form a professional LLC in order to enter the practice of law together. Further, suppose that either they do not have a written operating agreement, or for whatever reason, the one that they have does not address the issue of whether a member may be expelled. What happens if, after a few years, one of the members of the PLLC develops a substance abuse problem, fails to adhere to appropriate standards of conduct, and is disbarred? Presumably every attorney would immediately recognize the professional responsibility issues this would present. A disbarred attorney who attempts to stay in practice is clearly violating the rules of professional conduct,<sup>116</sup> and other members of the disbarred attorney's

---

115. The flexibility and informality of the LLC have long been offered as reasons why this form of business is so popular. Miller, *Decade*, *supra* note 77, at 567 (noting that the LLC "provides freedom from cumbersome corporate processes by offering unparalleled flexibility in management structure."). The conventional wisdom suggesting that this kind of statute will attract smaller, unsophisticated businesses seems backed up by at least some empirical research. Professor Miller surveying the states of California, Delaware, New York, and Pennsylvania, found that 56% of the attorney respondents frequently represented majority LLC owners while only 20% frequently represented minority LLC owners Sandra K. Miller, *A New Direction for LLC Research in a Contractarian Legal Environment*, 76 S. CAL. L. REV. 351, 356 (2003) (Hereinafter "Miller, *Direction*"). Obviously, not all LLCs are owned or managed by persons lacking sophistication or experienced legal counsel, but the law should certainly seek to protect those who are.

116. Rule 5.5(a) of the Arkansas Rules of Professional Conduct specifies that "[a] lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction, or assist another in doing so." Comment 4 to that rule further explains that "a lawyer who is not admitted to practice generally in this jurisdiction violates paragraph (b)(1) if the lawyer establishes an office or other systematic and continuous presence in this

firm also have an ethical obligation to see that such person is removed from the law firm.<sup>117</sup> Even if the other attorneys stop the disbarred member from working with clients, it is unethical to engage in the practice of law with anyone who is not licensed as an attorney or to have that person as an owner of the firm.<sup>118</sup>

If the law firm is organized as a partnership, the right to expel the disbarred partner who refuses to withdraw voluntarily is clear. The Arkansas partnership statute says that if it is illegal to continue business with a partner, that partner may be removed either upon the unanimous vote of the other partners,<sup>119</sup> or pursuant to a court order upon application of the partnership or any partner.<sup>120</sup> This statutory language authorizes the other owners of

---

jurisdiction for the practice of law.” ARK. RULES OF PROF’L. CONDUCT, 5.5(a) (amended 2014).

117. Rule 5.1(a) states that “[a] partner in a law firm and a lawyer who individually or together with other lawyers possesses comparable managerial authority in a law firm, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the rules of professional conduct,” and subsection (c) of that provision adds that a lawyer who is either a partner or has comparable managerial authority in a law firm “shall be responsible for another lawyer’s violation of the rules of professional conduct.” ARK. RULES OF PROF’L. CONDUCT, 5.1(a) (2005).

118. Rule 5.4(d) of the Arkansas Rules of Professional Conduct provides as follows:

(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

- (1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;
- (2) a nonlawyer is a corporate director or officer thereof; or occupies the position of similar responsibility in any form of association other than a corporation; or
- (3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

ARK. RULES OF PROF’L. CONDUCT, 5.4(d) (2005). This rule makes it clear that the disbarred lawyer may not remain as a member of a PLLC following disbarment. The question raised by the hypothetical in the text is how the other members would get rid of the disbarred attorney if he or she refuses to leave voluntarily.

119. With regard to the other partners’ rights to remove a partner whose continued involvement would be unlawful, section 4-46-601, entitled “[e]vents causing partner’s dissociation,” reads in pertinent part: “A partner is dissociated from a partnership upon . . . (4) the partner’s expulsion by the unanimous vote of the other partners if: (i) it is unlawful to carry on the partnership business with that partner[.]” ARK. CODE ANN. § 4-46-601 (2016).

120. *Id.* § 4-46-601(5) (2016). This section of the Arkansas Uniform Partnership Act actually gives courts authority to expel a partner for more than illegal conduct. It specifies that a partner’s dissociation is caused:

(5) on application by the partnership or another partner, the partner’s expulsion by judicial determination because:

- (i) the partner engaged in wrongful conduct that adversely and materially affected the partnership business;



a business to act if a partner's continued ownership would be illegal, and also gives courts the power to intervene upon the application of any owner to remove a partner under a range of equitable circumstances.<sup>121</sup>

Similarly, if the attorneys had chosen to organize as a professional association, the statute provides specific ways in which a shareholder in the professional corporation can be removed. The first rule, embodied in the Arkansas Professional Corporation Act, enacted in 1991, is that only members of the licensed profession may have any role in the ownership or management of the professional corporation.<sup>122</sup> There is a default rule for buying out the shares of a disqualified shareholder as well, if the corporation's by-laws or articles do not provide a different mechanism for determining how much to pay.<sup>123</sup> While there are specialized professional corporation acts dedicated to medical professionals<sup>124</sup> and dental corporations,<sup>125</sup> they also limit ownership and management of the business to licensed professionals,<sup>126</sup> and have similar default rules for buying out disqualified shareholders.<sup>127</sup>

The Arkansas LLC Act, however, contains no provision providing for the expulsion of a member under the most extreme of circumstances, not even by judicial intervention.<sup>128</sup> Nor is this problem limited to professional

(ii) the partner willfully or persistently committed a material breach of the partnership agreement or of a duty owed to the partnership or the other partners under 4-46-404; or

(iii) the partner engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with the partner . . . .

*Id.*

121. *Id.*

122. "All of the officers, directors, and shareholders of a corporation subject to this subchapter shall be, at all times, persons licensed pursuant to the laws of this state governing their profession. No person who is not so licensed shall have any part in the ownership, management, or control of the corporation, nor may any proxy to vote any shares of the corporation be given to a person who is not so licensed." ARK. CODE ANN. § 4-29-208 (2016).

123. If the articles of incorporation or bylaws of a corporation subject to this subchapter fail to state a price or method of determining a fixed price at which the corporation or its shareholders may purchase the shares of a deceased shareholder or a shareholder no longer qualified to own shares in the corporation, then the price for the shares shall be the book value as of the end of the month immediately preceding the death or disqualification of the shareholder. Book value shall be determined from the books and records of the corporation in accordance with the regular method of accounting used by the corporation. ARK. CODE ANN. § 4-29-213 (2016).

124. ARK. CODE ANN. §§ 4-29-301 to -313 (2016).

125. *Id.* §§ 4-29-401 to -411 (2016).

126. *Id.* § 4-29-307 (2016) (medical corporations); *Id.* § 4-29-406 (dental corporations).

127. *Id.* § 4-29-312 (2016) (medical corporations); *Id.* § 4-29-411 (dental corporations).

128. ARK. CODE ANN. § 4-32-802 (2016) (listing the circumstances under which a member is dissociated); *Id.* § 4-32-902 (giving a court the right to order dissolution, not expulsion,

associations, or acts by members that would make it illegal to carry on the business. There can be significant problems for members in any LLC if one of the members persists in acting in a manner that substantially interferes with the LLC's ability to conduct its business. Consider a daycare that is run as an LLC. What if one of the members of that LLC decides to become an outspoken advocate for NAMBL, a group known for its activist pro-pedophilia positions?<sup>129</sup> However repugnant such advocacy is, it is not illegal unless it is accompanied by conduct.<sup>130</sup> However, it would undoubtedly be incredibly problematic for a daycare to be owned by someone publicly associated with these positions. It should be possible to remove such a member from employment at the daycare for legitimate business reasons, but that would probably not be sufficient to address the concern with which parents would likely react if they learn that such a person owns any interest in the business. Unfortunately, our LLC Act does not allow for removal of such members, even if it is impractical to carry on the business with them because their advocacy is so harmful to the business.

The Arkansas LLC Act currently lists the following ways in which a person will cease to be a member of an LLC in the absence of additional provisions in an operating agreement:

- (1) the member assigns all of his or her membership interest and the assignee is admitted as a member;
  - (2) the member assigns all of his or her interest and a majority of the non-assigning members vote to remove the assigning member;
  - (3) the member is bankrupt or insolvent as such events are defined in the LLC Act or fails to contest allegations of being such within the time frames provided;
  - (4) the member dies or is adjudicated to be incompetent; or
  - (5) a member which is a trust, estate, or entity terminates, winds up, or dissolves.<sup>131</sup>
- While the LLC Act permits the operating agreement to provide other events of dissociation, there is nothing in the statute as it is currently written that would allow for ex-

---

and only if it is impracticable to carry on the business in conformity with the operating agreement).

129. Mary DeYoung, *The World According to NAMBLA: Accounting for Deviance*, J. SOCIOLOGY & SOC. WEL. 16: 111–126 (1989).

130. The First Amendment does not provide an “unlimited, unqualified right” to speak on any subject, at any time. *Dennis v. United States*, 341 U.S. 494, 503 (1951). However, free speech rights may be abridged only in very specific circumstances. Speech that is considered to be “offensive,” even by a large majority of people, may not be restricted on that ground alone. *See City Council of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789 (1984).

131. All of the following alternatives are listed in ARK. CODE ANN. § 4-32-802(a) (2016), although some statutory cross references are included in this section. Note that section (a)(1) appears to give members the right to withdraw voluntarily, but subsection (c) removes that right unless it is provided in the operating agreement. The numbering in the text does not correspond to numbering in the statute.

pulsion of a member, even if it is illegal to carry on business with such a person.

The courts are similarly limited in their power to intervene in order to remove a member whose presence interferes with the company's business. In fact, the only relevant provision in the current Arkansas LLC Act specifies that a member may apply to have the court dissolve an LLC "whenever it is not reasonably practicable to carry on the business of the limited liability company in conformity with the operating agreement."<sup>132</sup> However, there are a number of problems with this formulation. First, the provision does not give the court authority to expel a member, and instead appears to limit the court's authority to dissolving the LLC.<sup>133</sup> In addition, the grounds for dissolution appear to be extremely narrow. If the LLC's operating agreement does not impose any particular standard of care or duty of loyalty, the grounds for dissolution are narrow indeed. "This statute, on its face, affords no relief to LLC investors who are being mistreated by managers, so long as the business can be carried out in conformity with the operating agreement."<sup>134</sup> It also affords extremely limited relief when one member behaves in such a way that the LLC can no longer be operated profitably with that person as a member. Finally, the statute does not address what happens if, in violation of the statutory mandate, there is no written operating agreement.

---

132. ARK. CODE ANN. § 4-32-902 (2016).

133. This may be less of an issue than at first appears. In the corporate context, courts are similarly empowered to dissolve a corporation upon the application of a shareholder, if the court finds that:

- (i) the directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered, or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally, because of the deadlock;
- (ii) the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent;
- (iii) the shareholders are deadlocked in voting power and have failed, for a period that includes at least two (2) consecutive annual meeting dates, to elect successors to directors whose terms have expired; or
- (iv) the corporate assets are being misapplied or wasted . . .

*Id.* § 4-27-1430(2) (2016). While the statute gives the court authority to appoint a receiver or custodian and take other actions to preserve corporate assets "until a full hearing can be held," (*Id.* § 4-27-1431(c) (2016), or to liquidate the corporation (*Id.* at § 4-27-1432(a) (2016)), the only permanent remedy authorized in the statute is dissolution. Nonetheless, it is generally agreed that even under statutes such as Arkansas's "[c]ourts are not limited to the remedy of dissolution and may, in equity, consider appropriate alternative forms of relief." *Discretion of courts*, 16A FLETCHER CYC. CORP. § 8035 (2017) (also noting that "a decree of dissolution will be entered only when no other adequate remedy is available."). *Id.* at § 8043.

134. Cunningham & Fendler, *supra* note 82, at 16.

#### IV. HOW THE ULLCA (2013) RESOLVES THOSE PROBLEMS

The preceding section of this article has pointed to some significant flaws with the current Arkansas LLC Act. The next question is whether there is a better alternative. This article suggests that, in addition to offering the potential benefits of a more uniform set of provisions,<sup>135</sup> the ULLCA (2013) does indeed address many of the problems created by the current Arkansas LLC Act, including those identified above.

##### A. Rules Regarding Formation

As described above,<sup>136</sup> the Arkansas LLC Act has rules describing when an LLC is formed that are not only generally inconsistent with the statutes applicable to other forms of business, but are also ambiguous and confusing. Most Arkansas businesses are formed upon “filing” of an organizational document with the Secretary of State,<sup>137</sup> while Arkansas LLCs are formed when articles are “delivered,” with complicated and confusing rules about what to do if the documents cannot be filed at that time.<sup>138</sup> The ULLCA (2013) has a clearly articulated rule on when the LLC is “formed” that primarily relies on when the organizational documents are filed, although the issue of when an LLC is technically formed is a little more complicated than simply looking for the time of filing.

As is true under Arkansas’s current rules, ULLCA requires that articles be prepared in order to form an LLC.<sup>139</sup> However, under ULLCA (2013), formation occurs when the articles are filed and the company has at least one member.<sup>140</sup> The secondary requirement, that there be at least one member, addresses what was considered to be a difficult conceptual issue of whether a so-called “shelf LLC,” i.e., an LLC without at least one member upon formation, could be formed by providing that the LLC may be “pre-filed,” but that it is not “formed” until there is at least one member.<sup>141</sup> Thus,

---

135. See *supra* Part II of this Article for an analysis of the relative merits of a more uniform approach to LLCs.

136. See *supra* Part III, Section A.

137. See *supra* notes 28–34 and accompanying text.

138. See *supra* notes 35–38 and accompanying text.

139. “One or more persons may act as organizers to form a limited liability company by delivering to the [Secretary of State] for filing a certificate of organization.” UNIF. LTD. LIAB. CO. ACT § 201(a), 6C U.L.A. 61 (2017).

140. “A limited liability company is formed when the certificate of organization becomes effective and at least one person has become a member.” UNIF. LTD. LIAB. CO. ACT § 201(d), 6C U.L.A. 61 (2017). The exact time at which a filed document becomes effective is further explained in section 207. *Id.* § 207.

141. *Id.* See also explanation at UNIF. LTD. LIAB. CO. ACT Prefatory Note, 6C U.L.A. 5-6 (2017).

filing is a pre-requisite to formation, but that alone is insufficient to create an LLC.<sup>142</sup>

These rules are not completely consistent with rules applicable to corporations though since, as an example, a de jure corporation comes into existence under Arkansas law upon filing the articles of incorporation before there are any shareholders.<sup>143</sup> It is, however, consistent with language in the Arkansas limited partnership statute, which provides that a limited partnership must have at least one general partner and one limited partner,<sup>144</sup> although formation also requires that a certificate of limited partnership be delivered to the Secretary of State,<sup>145</sup> which is effective upon filing unless a delayed effective date is specified.<sup>146</sup>

Still, even though ULLCA (2013) is not completely consistent with the other business organization statutes, it is a considerable improvement over the current Arkansas LLC Act. First, it relies on filing rather than delivery.<sup>147</sup> Second, there is nothing in the statute that refers to a retroactive formation in some circumstances and not others, a requirement that the Secretary of State affirmatively notify an organizer of deficiencies, or a limited time frame in which any deficiencies are to be corrected. In addition, the complexity, which requires that the LLC have at least one member, is consistent with the state's limited partnership statute; this makes sense given that without members, there is no one to act on behalf of the business, even to the extent of selecting managers, if managers are required. The complexity, ambiguity, and needless inconsistencies of the current statute are addressed.

## B. Operating Agreements

Admittedly, because there is unlikely to be a significant delay between the delivery and filing for most businesses, the problem caused by the confusing language regarding the actual timing of formation for an Arkansas LLC is not likely to affect many LLCs. The same cannot be said for the cur-

---

142. UNIF. LTD. LIAB. CO. ACT § 201 cmt., 6C U.L.A. 61 (2017).

143. ARK. CODE ANN. § 4-27-123(a) (2016) (“[A] document accepted for filing is effective . . . at the time of filing on the date it is filed . . .” unless a delayed effective date is provided in the document).

144. *Id.* § 4-47-102(11) (2016) (defining “limited partnership” to mean “an entity, having one or more general partners and one or more limited partners, which is formed under this chapter by two or more persons . . .”)

145. *Id.* § 4-47-201(a) (2016).

146. *Id.* § 4-47-206(c) (2016).

147. This not only makes the LLC Act provisions consistent with other business organization statutes, but also comports with the way in which records are maintained by the Arkansas Secretary of State. For a more detailed examination of these concerns, see *supra* Part II, Section A.

rent rules regarding operating agreements. As described above,<sup>148</sup> the statutory definition of “operating agreement” in the Arkansas LLC Act makes such an agreement mandatory, and that applies to all LLCs. In addition, and even more importantly, the requirement that operating agreements be in writing creates the risk of significant problems for any LLC where the members fail to properly document their arrangements. Given that the LLC is supposed to appeal particularly to closely held businesses,<sup>149</sup> where participants are more likely to want to avoid the formalities of operation often required by corporate statutes,<sup>150</sup> and further given that the LLC is generally understood as having been modeled on the informal partnership,<sup>151</sup> the re-

---

148. See *supra* note 52.

149. “[T]he LLC is viewed by many as the ‘entity of choice’ for small businesses.” Michael K. Molitor, *Eat Your Vegetables (or at Least Understand Why You Should): Can Better Warning and Education of Prospective Minority Owners Reduce Oppression in Closely Held Businesses?*, 14 *FORDHAM J. CORP. & FIN. L.* 491, 501 (2009), citing Larry E. Ribstein & Robert R. Keatinge, 1 *RIBSTEIN AND KEATINGE ON LTD. LIAB. COS.* § 1.1, at 1-1 (2d ed. 2004) (the LLC is “the preferred choice for many businesses”).

150. The problem appears to be that “[g]eneral corporation laws impose unnecessary and burdensome requirements on close corporations . . . .” Tara J. Wortman, *Unlocking Lock-in: Limited Liability Companies and the Key to Underutilization of Close Corporation Statutes*, 70 *N.Y.U. L. REV.* 1362, 1375 (1995). This commentator further describes the problem of burdensome formalities as follows:

General corporation statutes have numerous formalities, such as the annual meeting and the requirement that they be managed by a distinct board of directors, which are unnecessary for close corporations. These features, set up to protect the stockholders of a public corporation in which managers are distinct from owners, have little relevance to the close corporation and often impede its efficient operation. These requirements are impractical in the case of a close corporation, which would have to interrupt regular operations in order to convene unnecessarily or, in the alternative, waste funds in order to comply with a formality. Requiring close corporations to run all management decisions through the board only increases the amount of drafting and additional steps close corporations must take in order to manage business operations effectively. Time spent satisfying these formalities detracts from time better spent operating the business. Moreover, failure to carry out these formalities precipitates the chance that a court will pierce the corporate veil. These drawbacks reveal that close corporations governed under the general corporation laws are obligated to comply with certain rules that result in inefficiency.

*Id.* at 1375–76 (footnotes omitted).

It is therefore not surprising that “[m]any LLC statutes were drafted to avoid formalities in the conduct of business.” Sandra K. Miller, *What Buy-Out Rights, Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of A Limited Liability Company?*, 38 *HARV. J. ON LEGIS.* 413, 416 (2001) (hereinafter “Miller, *Buy-Out*”).

151. “An LLC resembles a partnership in its informality of organization and operation, internal governance by contract, direct participation by members in the company, and no taxation at the entity level.” *Limited Liability Companies*, 1 *FLETCHER CYC. CORP.* § 20 (2017). In the context of piercing of the veil, commentators and courts alike have noted that “LLC statutes provide for fewer management formalities.” Larry E. Ribstein & Robert R. Keatinge, *Veil-piercing*, 2 *RIBSTEIN AND KEATINGE ON LTD. LIAB. COS.* § 12:3. See also

quirement that operating agreements be written is a considerable problem. ULLCA (2013) addresses and resolves these issues clearly and logically.

ULLCA (2013) contains an expansive explanation of what constitutes an “operating agreement”:

“Operating agreement” means the agreement, whether or not referred to as an operating agreement and whether oral, implied, in a record, or in any combination thereof, of all the members of a limited liability company, including a sole member, concerning the matters described in Section 105(a). The term includes the agreement as amended or restated.<sup>152</sup>

This definition neither makes such an agreement mandatory, nor requires any such arrangement to be express or in writing. Instead, this language carefully reflects the reality that members in a smaller LLC may operate informally, but may nonetheless have certain understandings and arrangements about how their business is to be run and how their relationships within the business are to be structured.

There are also other sections in the ULLCA that apply to operating agreements. In fact, the comment to the definition of “operating agreement” references a number of such provisions.<sup>153</sup> These referenced provisions include: notations that the agreement may cover not only the relation of members, but also all “activities and affairs” of the company;<sup>154</sup> it may be in a number of separate documents or records;<sup>155</sup> new members are deemed to assent to an existing operating agreement;<sup>156</sup> and the LLC itself is bound by and may enforce the agreement.<sup>157</sup> Even a single person who is the sole member of an LLC may have an agreement, if desired.<sup>158</sup>

---

Kaycee Land and Livestock v. Flahive, 2002 WY 73, 46 P.3d 323, 328 (2002) (“Certainly, the various factors which would justify piercing an LLC veil would not be identical to the corporate situation for the obvious reason that many of the organizational formalities applicable to corporations do not apply to LLCs.”). *Accord* NetJets Aviation, Inc. v. LHC Communications, LLC, 537 F.3d 168 (2d Cir. 2008) (noting that in piercing cases involving LLCs there is “somewhat less emphasis” on formalities because LLC statutes impose fewer formalities).

152. UNIF. LTD. LIAB. CO. ACT § 102(13), 6C U.L.A. 11 (2017).

153. *Id.* § 102(13) cmt, 6C U.L.A. 16–18 (2017).

154. *Id.* § 105(a)(3), 6C U.L.A. 27 (2017).

155. *Id.* § 102(13) cmt, 6C U.L.A. 17 (2017).

156. *Id.* § 106(b), 6C U.L.A. 39 (2017).

157. *Id.* § 106(a), 6C U.L.A. 38 (2016).

158. The comments to the definitions section specifically note the incongruity of having a single person enter into an “agreement,” but also point out that this nomenclature is common in LLC statutes. See UNIF. LTD. LIAB. CO. ACT § 102(13) cmt, 6C U.L.A. 17 (2017), observing that “[i]t may seem oxymoronic to refer an ‘agreement of . . . a sole member,’ but this approach is common in LLC statutes.” (citing ARIZ. REV. STAT. ANN. § 29-601 (14)(b) (2012) & WASH. REV. CODE ANN. § 25.15.005 (5) (2012) as examples of this approach).

There is considerable flexibility in what an operating agreement may do, but the statute does include some limitations. The ULLCA (2013) has a comprehensive list of things that an operating agreement may not do, including all of the following.<sup>159</sup> First, there are a number of things that seem relatively obvious as being essential from an administrative standpoint, or which are important to the rights of third parties. These include the requirement that the LLC not vary the laws applicable to its internal affairs, limit its right to sue or be sued, change anything relating to registered agents or the documents required to be filed with the Secretary of State, or with very few exceptions, impact the rights of third parties.<sup>160</sup>

Second, the statute restricts the ways in which the parties may alter the duties that are imposed on an LLC's members and managers. In general, an operating agreement may define and alter the default rules in any way that is not "manifestly unreasonable," and may also restrict the obligations of good faith and fair dealing to a similar degree.<sup>161</sup> However, the parties may not relieve or exonerate a person from liability for conduct involving bad faith, willful or intentional misconduct, or a knowing violation of law.<sup>162</sup>

There is also a range of general rights of members that an operative agreement may not unreasonably limit, or in some cases change at all. An operative agreement may not unreasonably restrict the duties and rights regarding availability of information from the LLC, although it may impose reasonable restrictions on the availability and use of information obtained and may define appropriate remedies, including liquidated damages, for a breach of any reasonable restriction on use.<sup>163</sup> Similarly, an operating agreement may not unreasonably restrict members' rights to bring direct or derivative actions.<sup>164</sup> In addition, an operative agreement may not vary the statutory right of members to petition for judicial dissolution,<sup>165</sup> or modify the requirement to wind up the company's activities and affairs as specified in the Act.<sup>166</sup> If an LLC is to have a special litigation committee in the event of a derivative suit, the committee must follow the statutory guidelines, and if the LLC is to participate in a merger, interest exchange, conversion, or

---

159. All of the following limitations appear in UNIF. LTD. LIAB. CO. ACT § 105(c), as clarified by 105(d), 6C U.L.A. 24–25 (2017). This numbering does not follow the numbering in the statute. Note that although this may seem lengthy and confusing at first, it parallels restrictions on what partnership agreements may not do, so Arkansas Legal practitioners are likely to be familiar with these kinds of limits already.

160. *Id.*

161. *Infra* notes 186–189 (discussing the details of how an operating agreement may affect the default duties owed by members or managers in an LLC under ULLCA (2013)).

162. UNIF. LTD. LIAB. CO. ACT § 105(c)(7), 6C U.L.A. 27 (2017).

163. *Id.* § 105(c)(8), 6C U.L.A. 27–28 (2017).

164. *Id.* § 105(c)(11), 6C U.L.A. 28 (2017).

165. *Id.* § 105(c)(9).

166. *Id.* § 105(c), 6C U.L.A. 27–28 (2017).



domestication, members must be given the statutory right to approve the plan.<sup>167</sup>

Taken together, these rules create a clear picture of an operating agreement as any arrangement between the members, or by a sole member, about how the LLC is to be operated. The statute is quite flexible, although it does specify some things that may not be accomplished by agreement. This approach mirrors what is already present in the Arkansas general and limited partnership acts,<sup>168</sup> and should therefore be reasonably familiar to Arkansas attorneys. It addresses the questions of whether a formal agreement is mandatory, whether an agreement must be in a single document, and whether a written instrument is required.<sup>169</sup> It specifies how new members become parties to an existing operating agreement, which is likely to resolve some potential conflicts before they arise.<sup>170</sup> It also deals with the issue of whether there are certain irreducible minimums that may not be changed by the members, particularly with regard to fiduciary obligations. The importance of this consideration, in particular, will be further examined in the next section.

Before turning to fiduciary obligations in Arkansas LLCs, it is probably also worth noting that ULLCA (2013) does not expressly address whether there may be some situations in which an operating agreement would have to be in writing – not because of the LLC Act, but because of the Statute of Frauds. The Reporter to ULLCA (2013) forthrightly notes in comments that the act itself “states no rule as to whether the Statute of Frauds applies to operating agreements.”<sup>171</sup> On the other hand, the same comment refers the reader to case law suggesting that “the answer is yes.”<sup>172</sup> This includes not only cases dealing with LLCs, but also partnership cases, which have held, for example, that a contract creating a partnership for a term exceeding one year is within the Statute of Frauds and is void unless it is in a signed writing.<sup>173</sup> The Statute of Frauds has similarly been held to apply to oral contracts for the conveyance of realty from a partnership.<sup>174</sup>

---

167. *Id.* § 105(c)(13)-(14), 6C U.L.A. 28 (2017).

168. ARK. CODE ANN. § 4-46-103 (2016) (non-waivable provisions in a general partnership’s partnership agreement); *Id.* § 4-47-110 (2016) (non-waivable provisions in a limited partnership’s partnership agreement).

169. UNIF. LTD. LIAB. CO. ACT § 102(13), 6C U.L.A. 16 (2017).

170. *Id.* § 106(b), 6C U.L.A. 40 (2017).

171. *Id.* § 102(13) cmt., 6C U.L.A. 21 (2017).

172. *Id.* (citing a Delaware case which held that “[t]he legislative history of the LLC Act does not demonstrate the General Assembly’s intent to place LLC agreements outside of the statute of frauds.” *Olson v. Halvorsen*, 986 A.2d 1150, 1161 (Del. 2009), negated by 2010 DEL. LAWS, ch. 287 (H.B. 372), §§ 1, 31 (statutes of fraud generally)).

173. *Abbott v. Hurst*, 643 So.2d 589, 592 (1994).

174. UNIF. LTD. LIAB. CO. ACT § 102(13) cmt, 6C U.L.A. 21 (2017) (referencing the following opinions on this point: *Froiseth v. Nowlin*, 156 Wash. 314, 316, 287 P. 55, 56

Absent these kinds of issues, however, ULLCA does not require a writing in order to prove that the participants in an LLC have entered into an operating agreement, which may be very informal, may be oral, and may be in multiple formats or separate records, however labeled.<sup>175</sup>

For these reasons, ULLCA (2013) seems to be a very significant improvement over the current Arkansas LLC Act with regard to most issues affecting operating agreements.

### C. Standards of Care and Loyalty

As previously discussed, the Arkansas LLC Act provides little in the way of protection for minority owners in an LLC against predatory behavior by majority owners of the business.<sup>176</sup> While the immediately preceding section of this article might suggest that the easiest solution would be for the members to address desired duties in an operating agreement, or for shareholders to enter into protective arrangements, historical information from shareholders in closely held corporations suggests that this has not been a particularly viable alternative for minority owners.<sup>177</sup> Moreover, even though an LLC is designed to allow members substantial flexibility in structuring the way in which they run their business, the considerations that made participants in close corporations unlikely to have sophisticated agree-

---

(Wash. 1930); *E. Piedmont 120 Associates, L.P. v. Sheppard*, 209 Ga. App. 664, 665, 434 S.E.2d 101, 102 (1993) (stating that “the fact that promises covered by the Statute of Frauds are made in the context of a partnership or joint venture agreement does not render the statute inapplicable”); *Filippi v. Filippi*, 818 A.2d 608, 618 (R.I. 2003) (“applying the Statute of Frauds to an alleged oral agreement to transfer land owned by a limited partnership to one of its partners”). UNIF. LTD. LIAB. CO. ACT § 102(13), 6C U.L.A. at 21–22 (2017).

175. See UNIF. LTD. LIAB. CO. ACT § 111, 6C U.L.A. at 47 (2017) (incorporating supplemental principles of law and equity); UNIF. LTD. LIAB. CO. ACT § 105(a)(4), 6C U.L.A. 30 (2017) (if there is a written operating agreement which purports to be an integrated whole, the parol evidence rule would present parties from relying on extraneous evidence of an unwritten agreement to vary the written terms).

176. See *supra* Part III, Section C.

177. Consider the following excerpt from an article on the topic from Professor Moll:

Despite this apparent opportunity for ex ante bargaining, it is widely recognized that close corporation investors typically fail to engage in such contracting. A number of reasons have been advanced for this failure. Because close corporation owners are frequently linked by family or other personal relationships, there is often an initial atmosphere of mutual trust that diminishes the sense that contractual protection is needed. Commentators have also argued that close corporation owners are often unsophisticated in business and legal matters such that the need for contractual protection is rarely recognized.

Douglas K. Moll, *Minority Oppression & the Limited Liability Company: Learning (or Not) from Close Corporation History*, 40 WAKE FOREST L. REV. 883, 911–12 (2005) (footnotes omitted).

ments<sup>178</sup> are just as likely to apply to participants in LLCs.<sup>179</sup> These concerns appear to be borne out by the limited empirical data available. Research suggests that many LLC operating agreements are “based on form agreements” rather than being individually negotiated or tailored to the needs of the participants in particular deals.<sup>180</sup> This is troublesome because standard form agreements “rarely” incorporate substantial protections for minority owners.<sup>181</sup> This backdrop helps explain why ULLCA’s approach to fiduciary obligations creates a significantly better set of default rules for LLCs than Arkansas currently has, and also why ULCCA’s (2013) required minimum standards are important.<sup>182</sup>

The default rules under the ULLCA (2013) do not propose to establish the “only” fiduciary duties that are owed by members or managers in an LLC, but the enumerated obligations include both a duty of loyalty and a

---

178. Such as the problem of over-trusting others in the venture, a lack of sophistication, or an unwillingness to invest the resources needed for an individually negotiated document.

179. “There is no apparent reason to believe that minority members of LLCs are more likely to engage in advance planning for dissension than minority shareholders of close corporations. If ‘over-trust’ (due to family or friendship ties) and unsophistication help to explain the failure of close corporation owners to recognize that contractual protections are needed, those rationales would seem to apply to LLC owners as well. After all, just like a close corporation, an LLC is typically a closely held venture with relatively few owners. In such a small business environment, the owners will frequently be linked by family or friendship bonds, and the owners’ business and legal ‘savvy’ may differ widely. Put differently, the LLC is, at bottom, simply another structure within which a small business can be operated. To the extent that the typical characteristics of small business owners help to explain the lack of planning for dissension, those characteristics are quite likely to be found in the LLC context as well.”

Moll, *supra* note 177, at 952, footnotes omitted. See also Dennis S. Karjala, *Planning Problems in the Limited Liability Company*, 73 WASH. U. L.Q. 455, 477 (1995) (“Many small businesses . . . will elect not to assume the expense of negotiating, and hiring an attorney to draft, a carefully worded operating agreement.”).

180. Miller, *Direction*, *supra* note 115, at 422 (reporting survey data in response to a question asking “Do you believe that many LLC agreements formed under [CA, DE, NY, PA] law or elsewhere are based on form agreements that are not extensively negotiated?”) *Id.* at 383. In addition to providing empirical evidence based on surveys of attorneys, Professor Miller also noted that in supplemental comments “many practitioners expressed concern about the prevalence of form LLC agreements.” *Id.* at 357.

181. Miller, *Buy-Out*, *supra* note 150, at 437 (“The difficulty a minority LLC investor may have in effectively negotiating buy-out rights and obtaining other contractual protections from majority overreaching cannot be over-emphasized.”). See also Moll, *supra* note 177, at 956.

182. In addition, the ULLCA default rules “were derived from the Revised Uniform Partnership Act (RUPA), which in turn evolved, with some variation, from the basic constructs of partners as agents under the Uniform Partnership Act (UPA).” Miller, *Worlds*, *supra* note 78, at 304 (footnotes omitted). Because Arkansas has had these partnership provisions in place for some time, the rules enunciated in the ULLCA should be familiar to Arkansas practitioners.

duty of care.<sup>183</sup> The duty of loyalty is further defined, at least under the default rules, to include the following: the duty to account to the LLC for any property, profit, or benefit derived in conducting or winding up the company's business, and using the company's property of appropriating a company opportunity.<sup>184</sup> The duty of care, again under the default rules, is "to refrain from engaging in grossly negligent or reckless conduct, willful or intentional misconduct, or knowing violation of law."<sup>185</sup>

In addition to these default obligations, ULLCA (2013) limits to some extent the ways in which an operating agreement may modify these duties. For example, an operating agreement may not alter or eliminate the duty of loyalty in a manner that is manifestly unreasonable, although the agreement may specify the method by which a specific act or transaction may be authorized or ratified.<sup>186</sup> It may also identify specific types or categories of activities that do not violate the duty of loyalty.<sup>187</sup> Similarly, it may not alter the duty of care in a manner that is manifestly unreasonable or which would involve bad faith, willful or intentional misconduct, or a knowing violation of law.<sup>188</sup> In addition, an operating agreement may not eliminate the contractual obligation of good faith and fair dealing, but the operating agreement may prescribe the standards, if not manifestly unreasonable, by which the performance of the obligation is to be measured.<sup>189</sup>

This reflects a considered compromise between the various statutory options that currently exist. While most states recognize that some fiduciary obligations are important in the context of closely held business such as LLCs, there are, in fact, a large number of statutory approaches to the issue.<sup>190</sup> Arkansas's current LLC Act is an outlier, providing no default fiduciary duties, neither specifying whether there are limitations on what the members might agree to permit, nor whether common law obligations such

---

183. UNIF. LTD. LIAB. CO. ACT § 409(a), 6C U.L.A. 106 (2017) (applying to members in a member-managed LLC Subsection (j) governs if the LLC is manager-managed, in which case the obligations are owed by managers.)

184. UNIF. LTD. LIAB. CO. ACT § 409(b), 6C U.L.A. 106–07 (2017).

185. UNIF. LTD. LIAB. CO. ACT § 409(c), 6C U.L.A. 107 (2017). Although this may sound similar to the standard found in the current LLC Act, remember that the Arkansas statute does not actually state this as an affirmative obligation at all. Instead, it merely provides that a member is not to be "liable, responsible, or accountable in damages or otherwise . . . unless the act or omission constitutes gross negligence or willful misconduct." ARK. CODE ANN. § 4-32-402(1). That rule does not create a duty as a matter of the statutory default – it limits responsibility.

186. UNIF. LTD. LIAB. CO. ACT §§ 110(c)(5), (d)(3), 6C U.L.A. 27-28 (2017).

187. *Id.* § 110(d)(1), 6C U.L.A. 28 (2017).

188. *Id.* §§ 110(c)(5), (d)(3), 6C U.L.A. 27–28 (2017).

189. *Id.* § 110(c)(6), 6C U.L.A. 27 (2017).

190. Miller, *Worlds*, *supra* note 78, at 303 (stating "Statutory approaches to fiduciary duties are extremely varied . . . but, by and large, fiduciary duties are widely recognized in state statutes and in case law.").

as the duties of good faith and fair dealing must be read into any arrangement among members.<sup>191</sup> Delaware's LLC Act is less ambiguous than the Arkansas LLC Act, but is just as dismissive of the position that fiduciary duties should exist as a default rule in LLCs.<sup>192</sup> At the other end of the spectrum are statutes such as those adopted in New York<sup>193</sup> and the recently repealed Minnesota LLC act,<sup>194</sup> which appear to borrow from corporate law to impose the obligation on managers in LLCs to act in good faith and with ordinary prudence.<sup>195</sup>

ULLCA (2013) has default fiduciary duties, which are somewhat limited although they are subject to expansion by agreement.<sup>196</sup> It also contains limits on the extent to which such obligations can be reduced or eliminated.<sup>197</sup> Notably, an operating agreement may not be manifestly unreasonable, and it may not countenance bad faith, knowing or willful misconduct, or a knowing violation of law.<sup>198</sup> Moreover, there is an express recognition that members in an LLC are obligated to deal with each other in a manner consistent with the obligations of good faith and fair dealing. This is, at the very least, a marked improvement over the current Arkansas LLC Act's provisions.

---

191. See *supra* Part III, Section C.

192. The relevant statutory provision is DEL. CODE ANN. tit. 6(c), § 18-1101 (2013) (which talks about the law or equity imposing duties, and then specifies that the LLC agreement may expand, restrict, or eliminate such duties, provided that it “may not eliminate the implied contractual covenant of good faith and fair dealing.”). The history of how Delaware arrived at this approach is set out in Miller, *Worlds*, *supra* note 78, at 311–13.

193. N.Y. LTD. LIAB. CO. LAW § 409 (McKinney) (specifying that an LLC manager shall act “in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances.”) Note that in New York, a member exercising management power is “deemed to be a manager for purposes of applying the provisions of this chapter.” N.Y. LTD. LIAB. CO. LAW § 401 (McKinney).

194. MINN. STAT. § 322B.69 (repealed 2014 effective 2018), (specifying that an LLC manager shall act “in good faith, in a manner the manager reasonably believes to be in the best interests of the limited liability company, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.”). Note that in Minnesota, “managers” were required, although they did not have to be denominated as such. See MINN. STAT. ANN. § 322B.67 (repealed 2014 effective 2018) (“A limited liability company must have one or more natural persons exercising the functions of the offices, however designated, of chief manager and treasurer.”). Minnesota has now adopted the Revised Uniform Limited Liability Company Act, codified at MINN. STAT. ANN. §§ 32C.0101 et seq.

195. Presumably, the intent is that courts will also borrow from corporate cases to apply something akin to the business judgment rule so that management decisions are not continually being second-guessed.

196. UNIF. LTD. LIAB. CO. ACT § 409, 6C U.L.A. 106–07 (2017).

197. *Id.* § 105, 6C U.L.A. 27–29 (2017).

198. *Id.*

#### D. The Misbehaving Member

The last problem created by the current Arkansas LLC Act that is singled out in this article involves the inability to remove a member who is acting in a manner that is actively harmful to the LLC. The hypothetical used to frame this issue in the earlier section of this article focused on a professional LLC organized for the practice of law, where one of the LLC members is disbarred and yet refuses to withdraw.<sup>199</sup> Ideally, the other members would have provided for a right to expel a member if it becomes illegal to carry on the business with such person, but it is not implausible to think that even lawyers can forget the importance of having carefully documented written agreements. Recall that under the Arkansas LLC Act, the other members have no power to expel the disbarred member over his or her objection.<sup>200</sup> How would the ULLCA (2013) resolve this problem?

The default rules under ULLCA (2013) provide that a member is dissociated when “the person is expelled as a member by the affirmative vote or consent of all the other members,” which is expressly allowed if “it is unlawful to carry on the limited liability company’s activities and affairs with the person as a member.”<sup>201</sup> Thus, unless the articles or operating agreement inexplicably and specifically chose to remove the right to expel a member with whom it becomes illegal to conduct business, the problem posed by the hypothetical disappears.

In addition, ULLCA (2013) also allows a member to petition a court to expel another member under certain circumstances, so it is not necessary to hypothesize the relatively rare case where illegality is involved to obtain the ability to expel a misbehaving member. In fact, ULLCA (2013) gives the LLC and/or any member the right to bring an action to have a court expel another member if any of three situations arise. First, the court may expel a member if such person “has engaged or is engaging in wrongful conduct that has affected adversely and materially, or will affect adversely and materially, the company’s activities and affairs[.]”<sup>202</sup> Alternatively, a court may order expulsion if a member “has committed willfully or persistently, or is committing willfully or persistently, a material breach of the operating agreement or a duty or obligation” under the statutory provision establishing standards of care for members.<sup>203</sup> Finally, a member may be expelled by court order if he or she “has engaged or is engaging in conduct relating to

---

199. *See supra* Part III, Section D.

200. *See supra* note 128 and accompanying text. This illustration is also used to introduce the subject of this article. *See supra* notes 1–5 and accompanying text.

201. UNIF. LTD. LIAB. CO. ACT § 602(5)(A), 6C U.L.A. 127 (2016).

202. *Id.*

203. *Id.* § 602(6)(B), 6C U.L.A. 128 (2016).

the company's activities and affairs which makes it not reasonably practicable to carry on the activities and affairs with the person as a member[.]”<sup>204</sup>

Contrast this kind of authority with the limited right of courts under the current Arkansas LLC Act to order dissolution, not expulsion, and only if “it is not reasonably practicable to carry on the business of the limited liability company in conformity with the operating agreement.”<sup>205</sup> If there is no operating agreement, or no relevant provision in the operating agreement, the current Arkansas statute may not give the courts any power to intervene.

Adopting language such as that found in ULLCA (2013) would also bring the Arkansas LLC act more in line with other business statutes in the state.<sup>206</sup> Furthermore, it would allow courts to consider jurisprudential guidance from other states that have adopted similar language and have already considered litigation against members alleged to have engaged in problematic behavior.<sup>207</sup> Finally, ULLCA (2013) avoids the potential problems caused by a statute that gives members no convenient way to continue an otherwise profitable business if a single member is willing to lose his or her investment by obstructionist behavior.

## V. WHY ULLCA (2013), AND WHY NOW?

Hopefully, the preceding sections of this article have presented compelling evidence that Arkansas's current LLC Act is flawed and that ULLCA (2013) offers a better alternative. It is true that there are other statutory models out there, and it is equally true that Arkansas has functioned with a poorly drafted statute for a number of years already. These two facts raise the questions of why legislators should be encouraged to adopt ULLCA (2013) rather than some other model act, and why they should act now.

With regard to the first question, it is clearly true that ULLCA (2013) is not the only act out there upon which Arkansas might choose to base a new LLC statute. A number of states, including Delaware,<sup>208</sup> (which has other

---

204. *Id.* § 602(6)(C).

205. ARK. CODE ANN. § 4-32-902 (2016).

206. *See supra* notes 119–27 and accompanying text.

207. UNIF. LTD. LIAB. CO. ACT § 602 cmt. 6C U.L.A. 127 (2017) (listing the following opinions as providing “examples of conduct warranting an expulsion order”: All Saints Univ. of Med. Aruba v. Chilana, A-2628-09T1, 2012 WL 6652510 (N.J. Super. Ct. App. Div. Dec. 24, 2012) (pattern of behavior); Sherwood Park Bus. Ctr., L.L.C. v. Taggart, 323 P.3d 551, 561 (Or. Ct. App. 2014) (theft, failure to provide information, and lack of availability); CCD, L.C. v. Millsap, 116 P.3d 366, 373 (Utah 2005) (misappropriation of trust funds and pattern of wrongdoing causing losses to the business)).

208. Many of Delaware's business statutes are widely followed. *See* Stuart R. Cohn, *Dover Judicata: How Much Should Florida Courts Be Influenced by Delaware Corporate Law Decisions?*, FLA. B. J., Apr. 2009, at 20, 21 n.1 (quoting *Mullen v. Academy Ins. Co.*, 705 F. 2d 971, 974 (8th Cir. 1983) (“Although New Jersey law governs the Pension Life

business statutes that have been widely followed) have statutes that have taken a different approach, but that have clearer language than that currently governing Arkansas LLCs. If there are indeed benefits to be achieved from a more uniform approach to LLC legislation, however, modeling the Arkansas statute on the law of any other single jurisdiction is not likely to be particularly successful. There is, however, a Revised Prototype LLC Act that could be chosen as the basis for improving upon the current LLC Act.<sup>209</sup> It might seem that this would be a more obvious choice for Arkansas, given that the original Arkansas LLC Act was modeled on a draft of the Prototype legislation. Intuitively, it would seem likely this would make any transition to an updated act smoother as changes might be less dramatic. A review of the Revised Prototype LLC Act, however, indicates that this is not likely to be the case.

The differences between the current Arkansas LLC Act and the Revised Prototype LLC Act are significant. Documents and procedures are renamed, and many default rules are changed considerably. Even the name of the organic document used to form an LLC would be changed, from articles of organization<sup>210</sup> to a certificate of formation.<sup>211</sup> Similarly, instead of the familiar “operating agreement,”<sup>212</sup> the statute would refer to it as a “limited liability company agreement.”<sup>213</sup> The split between member and manager managed LLCs<sup>214</sup> is removed, and both apparent and actual authority would be governed by the internal LLC agreement.<sup>215</sup> There are, however,

---

acquisition, we discuss Delaware case law as well, because of Delaware’s position as a leader in the field of corporate law. The courts of other states commonly look to Delaware law . . . for aid in fashioning rules of corporate law.”).

209. See REVISED PROTOTYPE LTD. LIAB. CO. ACT, 67 BUS. LAW. 117, 118 (2011) [hereinafter *Prototype Act*]. The sections of the Prototype LLC Act are set out in this article and will be referred to here as “R.P. LLC Act § \_\_\_”.

210. ARK. CODE ANN. § 4-32-201 (2016) (providing that an LLC is formed upon delivery of “articles of organization”).

211. R.P. LLC Act § 102(2) (definitions section); R.P. LLC Act § 201 (laying out the required contents of such a certificate). This act does provide that formation occurs upon filing unless a later date is specified. *Id.* at § 201(b)(1).

212. ARK. CODE ANN. § 4-32-102 (2016).

213. R.P. LLC Act § 102(14) (defining this to include oral agreements and arrangements, in a manner parallel to that provided in ULLCA (2013)). See also R.P. LLC Act § 110 (laying out the scope, function, and limitations of the LLC Agreement).

214. See ARK. CODE ANN. §§ 4-32-102(9)–(10) (2016). (defining both manager(s) and member(s)). Member management is set as the default rule in *Id.* § 4-32-301(a) (2016) and *Id.* § 302(b) (2016) deals with the creation of manager-management.

215. R.P. LLC Act § 301. In fact, the Revised Prototype act no longer refers to managers as such at all. “The Act changes significantly the original Prototype Act in that it eliminates the member-managed and manager-managed bifurcation of management structures and the statutorily conferred actual and apparent authority of members and managers in those paradigms.” *Prototype Act, supra* note 209 at 120–21.



no specified or defined fiduciary duties,<sup>216</sup> although the prototype act does recognize the implied covenant of good faith and fair dealing, and prohibits its elimination.<sup>217</sup> The Revised Prototype Act would change the rules regarding how a member is dissociated.<sup>218</sup> The concept of a “delinquent” LLC would be added,<sup>219</sup> which addresses what happens when the LLC fails to stay current in its filings and payment of taxes. Not only is this terminology unique, the new provisions do not provide for dissolution of the business when the company fails to pay its required taxes,<sup>220</sup> perhaps ostensibly to avoid issues associated with administrative dissolution, but also in an approach that has no parallel in Arkansas business association law.<sup>221</sup> There are extensive provisions relative to derivative actions,<sup>222</sup> a process that was not explicitly recognized in the draft prototype act.<sup>223</sup> Series LLCs are authorized as well.<sup>224</sup> In fact, the changes in LLC law that would result if Ar-

---

216. “The Act does not specify or define fiduciary duties or standards of conduct. Those matters are determined by the limited liability company agreement and other applicable law.” ABA, *supra* note 209 at 120. This, at least, parallels current Arkansas law, but the failure of the current Arkansas LLC Act to address fiduciary obligations is one of the issues identified in this article as a deficiency in the current approach. *See infra* Part III, Section C.

217. R.P. LLC Act § 110(b)(2)(A) (providing that an LLC Agreement “may not limit or eliminate liability” for “a bad faith violation of the implied contractual covenant of good faith and fair dealing.”).

218. R.P. LLC Act § 602 (providing for both the power to withdraw even in violation of the LLC Agreement and a default right to withdraw voluntarily, the possibility of expulsion by other members if it is unlawful to keep that person as a member, and the possibility of judicial expulsion). These rules are quite similar to the dissociation rules that would be put in place under ULLCA (2013). *See* UNIF. LTD. LIAB. CO. ACT §§ 601–602, 6C U.L.A. 126–29 (2016).

219. R.P. LLC Act §§ 701–705.

220. R.P. LLC Act § 703(a) (providing that the delinquent business is not permitted to maintain a proceeding in court until the delinquency is cured).

221. Arkansas relies on administrative dissolution to redress the issue of failure to pay taxes. *See, e.g.*, ARK. CODE ANN. § 4-47-809(a)(1) (2016) (limited partnerships); *Id.* §§ 4-27-1420 to -1423 (corporations). General partnerships do not require administrative dissolution since the partners are already personally liable, but LLPs may have their statement of qualification revoked administratively for failure to file reports or pay fees. *Id.* § 4-46-1003(c)–(d) (2016). The Arkansas LLC Act does not address administrative dissolution. *Id.* § 4-32-901 (2016) (governing dissolution).

222. R.P. LLC Act §§ 901–908.

223. For a comment on this, *see generally* Allison R. Gladden, *Beyond Direct vs. Derivative: What Muccio v. Hunt Tells Us About Arkansas LLCs*, ARK. LAW., Winter 2016, at 34. This commentator expresses concern about the court’s adoption of corporate law applicable to derivative actions to assess standing to sue, when the Arkansas LLC Act expressly provides that “suits may be brought, only in the LLC’s name, by one or more members who have been so authorized by the affirmative vote of more than one-half, in number, of the disinterested members.” *Id.* at 35 (citing ARK. CODE ANN. § 4-32-1102(a) (2016)).

224. R.P. LLC Act §§ 1101–1116. While not discussed in any detail in this article, I have previously written about the potential problems with the series LLC. *See* Carol R. Goforth, *The Series LLC, and a Series of Difficult Questions*, 60 ARK. L. REV. 395 (2007).

kansas adopts the Revised Prototype LLC Act are just as substantial in most regards as the changes that the ULLCA (2013) would require.

In addition, there are a number of reasons why ULLCA (2013) seems preferable to the Revised Prototype LLC Act regardless of which would be a bigger initial change in Arkansas. First, ULLCA offers a far better chance of achieving the benefits of wider uniformity than the Revised Prototype LLC Act. ULLCA has been adopted in seventeen states and the District of Columbia, and bills have been proposed in two additional states in the first half of 2017.<sup>225</sup> Contrast that with the prototype act, which has far fewer enactments, and is actually seeing declining influence. An article published in 2012 indicated that as of that date, ten states had statutes modeled on the Prototype Limited Liability Company Act.<sup>226</sup> A review of the listed states, however, indicated that most of the cited statutes were older and not based on the revised version of the prototype act.<sup>227</sup> In addition, even that article, which was generally quite positive in its treatment of the Prototype approach, noted that at least two states had already abandoned the Prototype Act approach in favor of ULLCA.<sup>228</sup> Moreover, since 2012, two additional states that began with the Prototype Act have replaced their LLC statute with one based on ULLCA.<sup>229</sup>

In addition, the ULLCA relies on an organizational framework and drafting options that are consistent with other business statutes that are already in place in Arkansas. Because ULLCA was intentionally drafted so as

---

225. The Uniform Law Commission tracks legislative enactments. For a current list of states with statutes modeled on ULLCA as well as states where such legislation has been proposed, see ULC *Factsheet*, *supra* note 10.

226. James R. Burkhard, *Resolving LLC Member Disputes in Connecticut, Massachusetts, Pennsylvania, Wisconsin, and the Other States That Enacted the Prototype LLC Act*, 67 BUS. LAW. 405, 407 (2012) (hereinafter “Burkhard”). Professor Burkhard suggests in this article that the ten states had statutes based on the prototype act “prepared and updated by the LLCs, Partnerships and Unincorporated Entities Committee of the ABA Section of Business Law . . . .” *Id.* However, any inference that the states have adopted the revised version of the prototype legislation appears to be unwarranted.

227. Among the states that had statutes based on the Prototype Act, Professor Burkhard listed Alaska, Arkansas, Connecticut, Indiana, Kentucky, Massachusetts, New Hampshire, New Mexico, Pennsylvania, and Wisconsin. See Burkhard, *supra* note 226, at 407.

228. “Montana at one time had adopted these provisions, but repealed them and replaced them with the 1996 Uniform Limited Liability Company Act derivative provisions, Mont. Code Ann. § 35-8-1104 (2009). In 2008 Idaho replaced the Prototype Act with the 2006 Revised Uniform Limited Liability Company Act, Idaho Code Ann. §§ 30-6-101 to -1104 (Supp. 2010).” Burkhard, *supra* note 226, at 407, n. 5.

229. Professor Burkhard’s 2012 list included Alaska, Arkansas, Connecticut, Indiana, Kentucky, Massachusetts, New Hampshire, New Mexico, Pennsylvania, and Wisconsin. Burkhard, *supra* note 226, at 407. Of those states, Connecticut and Pennsylvania are now also listed by ULC as having adopted ULLCA. See ULC *Factsheet*, *supra* note 10. New Hampshire adopted a new unique statute effective January 1, 2013. N.H. REV. STAT. ANN. § 304-C:3 (2017).

to be consistent with the current Uniform Partnership and Limited Partnership Acts,<sup>230</sup> and because Arkansas has already adopted versions of those two statutes,<sup>231</sup> ULLCA (2013) itself should be easier to work with.<sup>232</sup> In addition, forms and interpretive guidance in the form of opinions relying on similar language is more likely to be available because those uniform statutes have been widely adopted.<sup>233</sup>

Finally, there are drafting choices embodied in the ULLCA that seem preferable to those included in the Revised Prototype Act, foremost among them being the default and minimum fiduciary duties. As previously explained, the Revised Prototype LLC Act chooses not to have any default fiduciary obligations, and it does not mandate a minimum level of care or specify duties of loyalty owed to minority members.<sup>234</sup> This appears to be a poor choice of default rules, both because of the risk of over-reaching by majority owners, as demonstrated by a number of claims that have been made in this context,<sup>235</sup> and because it appears that minority members do not avail themselves of their right to contract for such protections.<sup>236</sup> In contrast, ULLCA has rules that set out specific obligations that apply unless they are contracted around,<sup>237</sup> and has at least some limits on what can be reduced or eliminated.<sup>238</sup>

This is not to say that there will not be some significant changes in Arkansas law beyond those addressed in this article. For example, the current Arkansas LLC Act follows the general partnership model of giving members “statutory apparent authority.” In other words, if an Arkansas LLC

230. “The structure of the Proposed Act closely resembles that of the RUPA, the ULLCA, and the ULPA (2001). Using a common and familiar structure has many advantages . . . .” Russell K. Smith, *Utah Should Adopt A Modified Version of the Revised Uniform Limited Liability Company Act*, 2013 UTAH L. REV. ON LAW 12, 32 (2013).

231. ARK. CODE ANN. §§ 4-46-101 *et seq.* (2016) (adopting the Uniform Partnership Act (1996)); ARK. CODE ANN. §§ 4-47-101 *et seq.* (2016) (adopting the Uniform Limited Partnership Act (2001)).

232. “Using a common and familiar structure has many advantages . . . .” Smith, *supra* note 230, at 32.

233. According to the ULC, as of June, 2017, thirty-nine states plus the U.S. Virgin Islands have adopted the revised UPA. See ULC, *Legislative Fact Sheet- Partnership Act (1997)*,

[http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Partnership%20Act%20\(1997\)%20\(Last%20Amended%202013\)](http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Partnership%20Act%20(1997)%20(Last%20Amended%202013)) (last visited June 17, 2018). In addition, twenty-two states have adopted ULPA (2001). See ULC, *Legislative Fact Sheet - Limited Partnership Act (2001)*,

[http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Limited%20Partnership%20Act%20\(2001\)%20\(Last%20Amended%202013\)](http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Limited%20Partnership%20Act%20(2001)%20(Last%20Amended%202013)) (last visited June 17, 2018).

234. See *supra* note 216 and accompanying text.

235. See *supra* note 78 and accompanying text.

236. See *supra* notes 177–181 and accompanying text.

237. UNIF. LTD. LIAB. CO. ACT § 301, 6C U.L.A. 78–79 (2017).

238. *Id.*

chooses the default, member-managed model, all members have statutory authority to bind the business as agents for any act that is “apparently carrying on in the usual way the business or affairs of the limited liability company . . . .”<sup>239</sup> This parallels the authority granted to general partners in both the Arkansas UPA (1996)<sup>240</sup> and ULPA (2001).<sup>241</sup> If the LLC chooses manager-management, the statutory apparent authority transfers to the managers.<sup>242</sup>

The ULLCA (2013) is drafted on the assumption that this partnership attribute is not one that belongs in an LLC statute. Therefore, ULLCA (2013) eliminates the statutory link between being a member or manager and having the power to bind the LLC regardless of agreement, instead, leaving the question of authority to traditional agency principles. In fact, the ULLCA (2013) states that members have no statutory apparent authority,<sup>243</sup> and provides no express grant of power to managers, leaving them in the same position as corporate directors. This drafting choice is addressed by the following commentary to section 301 of ULLCA (2013):

Codifying power to bind according to position makes sense only for organizations that have well-defined, well-known, and almost paradigmatic management structures. Because: flexibility of management structure is a hallmark of the limited liability company; and an LLC’s name gives no signal as to the organization’s structure, it makes no sense to: require each LLC to publicly select between two statutorily preordained structures (*i.e.*, manager-managed/member-managed); and then link a “statutory power to bind” to each of those two structures. Under this act, other law – most especially the law of agency – will handle power-to-bind questions. Thus, LLCs formed under this act and corporations are subject to the same principles for attributing to the entity the conduct of those who act or purport to act on the entity’s behalf.<sup>244</sup>

In an entity designed to be flexible and easy to work with, mandating that all members or all managers must have statutory apparent authority seems a poor choice, albeit not one that by itself would justify a new statute.<sup>245</sup>

In fact, there are a number of changes from current law that would result if Arkansas chooses to enact ULLCA (2013). The benefits of having a more uniform, clearly drafted, consistent, and logically updated statute,

---

239. ARK. CODE ANN. § 4-32-301(a) (2016).

240. *Id.* § 4-46-301(1).

241. *Id.* § 4-47-402(a) (2016).

242. *Id.* § 4-32-101 (2016).

243. UNIF. LTD. LIAB. CO. ACT § 301(a), 6C U.L.A. 75 (2017).

244. *Id.* § 301(a) cmt., 6C U.L.A. 76 (2017).

245. Other commentators have also applauded this change from older LLC statutes. *See, i.e.*, Smith, *supra* note 230, at 37.

however, seem to outweigh the temporary inconvenience that would be associated with yet another new business organization statute. Once the state has an updated LLC Act, hopefully the legislature will not have to act again in the foreseeable future.

As Arkansas strives to be seen as pro-business, and seeks to have modern and convenient business organizational options, the time seems absolutely right to move to a new and improved LLC Act. With seventeen states and the District of Columbia already having adopted ULLCA (2013), Arkansas would assuredly be part of the trend towards greater uniformity and consistency.

## VI. CONCLUSION

The purpose of this article is not to describe all of the problems created by Arkansas's current LLC Act, nor is it to point out all the ways that the ULLCA (2013) would change Arkansas law. However, by focusing on a handful of specific deficiencies with the current Arkansas LLC, and by explaining how the ULLCA (2013) could resolve those concerns, perhaps this Article will convince legislators that it is time for a new LLC law in this state.

Arkansas was ahead of the curve in adopting its first LLC statute and was well advised to take that step. The LLC has proven to be extraordinarily popular with new businesses, and this alone should provide a substantial incentive to make sure that Arkansas's statute continues to make sense for entrepreneurs. Arkansas might not be at the vanguard of a charge towards the ULLCA if it were to enact that statute now, but at least it would not be left in the dust. Arkansas can claim the benefits of a better statute, help with progress towards a more uniform approach that reduces uncertainty and ambiguity, and in this way, continue to be responsive to the needs of small business owners and investors in the state.