COMMENTARY
TO THE
ARIZONA LIMITED LIABILITY COMPANY ACT

A.R.S. §§ 29-3101 to 4202, as enacted in 2019 and amended in 2021

drafted by the
Editorial Subcommittee
of the
Committee on Legislation of the Business Law Section
of the
State Bar of Arizona

INTRODUCTION TO COMMENTARY
TO THE
ARIZONA LIMITED LIABILITY COMPANY ACT
(Rev. 2/23/2024)

Short History

The Arizona Limited Liability Company Act, A.R.S. §§ 29-3101 to 4202, enacted in 2019 and amended in 2021 (the "**Act**"), is based in large part on the Uniform Limited Liability Company Act (2013) ("**RULLCA**"), promulgated by the Uniform Laws Commission (the "**ULC**"). The Act replaced Chapter 4, Title 29 of the Arizona Revised Statutes (the "**Prior Act**"), first enacted in 1992 and amended several times thereafter. However, as described later in this Introduction, many elements of the Prior Act were incorporated into the Act.

In 2010, representatives of the ULC informed the Business Law Section of the Arizona State Bar of the ULC's desire to introduce RULLCA in the Arizona legislature to replace the Prior Act. The ULC at that time invited the Business Law Section to review and comment on RULLCA. Because the Prior Act had been drafted about 20 years earlier without the benefit of any uniform act or other model legislation, many members of the Business Law Section believed that it was in need of comprehensive revision to update the law in the light of two decades of experience. Accepting the ULC's invitation, the Committee on Legislation of the Business Law Section designated a subcommittee of interested business lawyers (the "**Drafting Subcommittee**") to review and adapt RULLCA to Arizona customs and practice. The composition and procedures of the Drafting Subcommittee are described later in this Introduction.

Principal Benefits of the Act

While the Act departs in important ways from RULLCA to preserve certain Arizona procedures and policies in the Prior Act, it follows the organization of the uniform law and incorporates many beneficial concepts from RULLCA, including the following:

1. **Modification of Default Rules.** The Act centralizes in one section a list of the statutory rules that cannot be varied by an operating agreement, and rules that can be modified by the operating agreement within specified limits. *See* A.R.S. § 29-3105. The Act allows more freedom of contract than the Prior Act, including regarding each member's rights to obtain financial information and to bring derivative actions.

2. **Fiduciary and Other Duties of Managers and Members.** The Act clarifies the fiduciary duties owed by the managers and members and expressly allows the modification of those duties by agreement. The Prior Act did not address the subject of fiduciary duties and left to the common law whether and the extent to which those duties could be altered by contract. Further, the Act expressly allows the members to elect the Arizona corporate code's rules governing director liability (including the business judgment rule) to apply to LLC managers in lieu of the Act's default rules on fiduciary duties. *See* A.R.S. §§ 29-3105 and 29-3409.

3. **Indemnification and Reimbursement Rights.** The Act provides default rules governing the right of a manager or member to be indemnified by the LLC against third-party claims arising out of proper acts taken by the manager or member within his or her authority. The Prior Act did not address the subject of indemnification. *See* A.R.S. § 29-3408.

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4. **Member Expulsion.** The Act provides default rules that permit the expulsion of a member for specified types of wrongful conduct. The Prior Act did not provide a default rule for the circumstances under which a member may be expelled. *See* A.R.S. § 3602(4) and (5).

5. **Derivative Actions.** The Act provides more detailed rules governing derivative and direct actions brought by members. In particular, company management will be able to appoint a special litigation committee composed of disinterested people to obtain the dismissal of frivolous derivative claims that impair the operations of the company, which was not possible under the Prior Act. *See* A.R.S. § 29-3801 *et seq.*

6. **Foreign Series LLCs.** The Act acknowledges the existence of "series LLCs" formed under the laws of other states and provides a procedure for registering a foreign series LLC to do business in Arizona. However, the liability shield that exists between the individual series of a foreign LLC is not enforceable against Arizona creditors with respect to transactions in this state. *See* A.R.S. § 29-3901(D).

7. **Dissolution Procedures for Resolving Creditor Claims.** The Act provides a public notice procedure whereby an Arizona LLC that is winding up its affairs and liquidating its assets may identify and discharge its liabilities within a time period that is shorter than the statute of limitations applicable to most claims. The notice requirements and procedures are substantially the same as in Arizona's current corporate code. *See* A.R.S. §§ 29-3704 and 29-3705.

8. **Default Rules for Member Voting.** The default rule for member voting on issues for which unanimous consent is not required in the Prior Act was per capita, i.e., one member, one vote. The Act changes this default voting rule so that the members' voting rights are weighted in the proportions in which the members share in the company's profits. See A.R.S. §§ 29-3102(12) and 29-3407(A)(3).

9. **Virtual LLCs.** The Act removes obstacles under the Prior Act regarding the formation of "virtual" LLCs. Specifically, the Act permits company records to be maintained electronically rather than at a specified physical location. The Act also deletes the requirement to designate a "known place of business" in the articles of organization and substitutes the term "principal address," which can be any mailing address. *See* A.R.S. § 29-3201(B)(2).

10. **Judicial Dissolution.** The Act modifies and expands the grounds for obtaining a judicial decree of dissolution. *See* A.R.S. § 29-3701(A)(4).

11. **Expanded Legal Resources.** Because it is based on RULLCA, the Act will greatly increase the primary and secondary legal sources available to resolve interpretational issues. *See* A.R.S. § 29-4201.

Once Arizona lawyers become familiar with the Act, they will be better equipped to advise their Arizona clients regarding their rights and obligations with respect to LLCs formed under the laws of a growing number of states, including California, that have adopted a version of RULLCA. In situations where prospective LLC members are represented by lawyers in different states that have adopted a version of RULLCA, an Arizona LLC formed under the Act is more likely to be acceptable to out-of-state lawyers.

Procedures and Policies of the Prior Act Retained in the Act

Most of the Act's departures from RULLCA relate to the preservation of desirable policies and procedures under the Prior Act, including the following:

1. **Public Disclosures.** The transparency of existing Arizona LLCs has been retained under the Act. The names and addresses of the members and managers of Arizona LLCs (and of foreign LLCs doing business in Arizona) continue to be required to be identified in the articles of organization (or foreign registration statement) to the same extent as under the Prior Act. The name and contents of the document required to form an Arizona limited liability company (or to amend a previously filed document) remain unchanged except for the substitution of "principal address" for "known place of business" (for the reasons described above).

2. **No Annual Report.** No annual reports or other periodic filings are required to be made by Arizona LLCs, nor are Arizona LLCs required to pay annual fees, franchise taxes, or other periodic fees.

3. **Charging Orders.** The remedies of judgment creditors of a member of an Arizona LLC are generally limited to a charging order on distributions from the LLC. A member's judgment creditors may not foreclose or otherwise obtain control of the member's interest in the LLC.

4. **Liability for Wrongful Distribution.** A member that receives a distribution from an insolvent LLC is liable to the LLC for the amount of the wrongful distribution. Managers and members who approve the wrongful distribution are not personally liable for the amount distributed.

5. **Statutory Authority.** The Act's default rules authorize each member of a member-managed company and each manager of a manager-managed company to act for the company in the ordinary course of its activities and affairs.

6. **Survival of Operating Agreements.** Although the Act applies to all Arizona LLCs after September 1, 2020, the Act does not affect the enforcement of any terms of an operating agreement that was entered into when the Prior Act was in effect, so long as the terms were enforceable under the Prior Act and the common law.

Purpose and Format of the Commentary

One of the benefits of a RULLCA-based statute is the availability of more legal aids and authorities, including the RULLCA comments promulgated by the ULC, as interpretational aids. However, as noted above, the Act departs from RULLCA in multiple substantive ways, which makes some of the RULLCA comments misleading or inapplicable. To remedy this problem, the Business Law Section authorized formation of the LLC Act Editorial Subcommittee (the "**Editorial Subcommittee**") to prepare commentary that identifies and explains the differences between the Act and RULLCA.

The Arizona LLC Act commentary (the "**Commentary**") is organized according to the Act's sections and each section's commentary consists of two parts: "Arizona Comments" and "Modified RULLCA Comments." The primary purpose of the Arizona Comments is to identify and explain the specific substantive departures from RULLCA contained in each section of the Act. The purpose of the Modified RULLCA Comments for the same section is to (i) modify or delete those portions that pertain to provisions of RULLCA that were modified by or deleted from the Act, (ii) substitute section references to the Act in place of section references to RULLCA to ease the location of cross references for the reader, and (iii) substitute defined terms used in the Act for defined terms under RULLCA where appropriate. For example, the term "articles of organization" has been substituted in place of "certificate of organization" in the modified RULLCA comments. Each modified RULLCA Comment appears in a redline format that shows the changes to the RULLCA comment for each section. The Editorial Subcommittee generally did not attempt to restate commentary in the Arizona Comments where the RULLCA comment is still applicable.

To aid the reader's understanding of how both comments fit together, a redline version of the Act has been prepared to highlight how the Act differs from RULLCA. The ideal approach to understand a section of the Act is to first read the Act, then the redline version of the Act against RULLCA, then consult the applicable Arizona Comment for an explanation of how the Act differs from RULLCA, and finally review the Modified RULLCA Comment for an explanation of the RULLCA provisions that were not changed in the Act.

Drafting Subcommittee Goals and Procedures

Enactment of the Act capped a seven-year effort to review and analyze the latest version of RULLCA, as well as the Delaware LLC Act and the Prototype LLC Act. The Drafting Subcommittee's goal was to prepare a comprehensive revision of the Prior Act that reflects the latest and best analyses of LLC statutes from around the country, while preserving the most fundamental policies in the Prior Act that the Arizona legal and business communities had come to reply upon.

The Drafting Subcommittee invited the participation of every Arizona lawyer who was willing to devote substantial time and effort to the project. Regular meetings were generally held twice a month for one and one half to two hours each. All-day meetings were occasionally held to resolve some of the more complicated provisions that initially resisted consensus. Those interested lawyers who were unable to make a substantial time commitment were added to the Drafting Subcommittee's email list. They received the same materials prepared in advance of each meeting and were invited to submit comments or to participate in individual meetings as they chose.

During this seven-year project, representatives of the Drafting Subcommittee also made periodic presentations at Arizona State Bar-sponsored CLE programs and meetings of the Business Law Section to report on the subcommittee's progress. The representatives invited comments and questions at these events, which were helpful to resolve difficult policy choices.

Drafting Subcommittee Composition

Most (but not all) of the participants were members of the Business Law Section. Their practice areas included business transactions, real estate, corporations, securities, estate planning, and tax. Both large and small law firms were represented on the subcommittee. Several subcommittee members had participated in the drafting of the Prior Act in 1989 and 1990.

Kevin Hunter and Jim Reynolds co-chaired the Drafting Subcommittee from its inception. Throughout the project, the subcommittee enjoyed the active participation of twelve to fourteen lawyers who regularly attended most meetings. During that lengthy period, some participants withdrew because of conflicting commitments or health issues, and several other lawyers joined the effort. Each made valuable contributions to the project during his or her time on the subcommittee.

The lawyers who actively participated during substantially the entire drafting project are:

Andy Anderson
Quinn DeAngelis
Scott DeWald
Matthew Engle
Gregg Hanks
John Hay
Kevin Hunter
Richard Onsager
Jim Reynolds
Terry Thompson

Patricia Barfield, then director of the Corporations Division of the Arizona Corporation Commission, also actively participated on the subcommittee (in her individual capacity and not as a representative of the Commission).

Additional lawyers who made valuable contributions during one or more years of the drafting project are:

Jonathan Bennett
Sam Efird
Linda Marie Brown
Ryan Opel
Michael Patterson
Tim Ronan
Susan Wells

The Editorial Subcommittee

The Editorial Subcommittee consists of Scott DeWald, Jim Reynolds, Matthew Engle, and Andy Anderson. Although the Editorial Subcommittee intends the Commentary to be accessible on the Business Law Section page of the Arizona State Bar website, neither the Business Law Section nor the State Bar has endorsed our comments. The opinions expressed in the Commentary are those of the authors and not necessarily those of the ULC.

The Commentary was informed by our participation in hundreds of hours of debate and discussion among the members of the Drafting Subcommittee. However, it is a continuing project that the Editorial Subcommittee intends to update periodically and the Editorial Subcommittee welcomes constructive suggestions and criticism and encourages your emails and phone calls for that purpose. The Editorial Subcommittee intends to revise the Commentary from time to time to reflect developments in the law and incorporate suggestions from the practicing bar. Editorial Subcommittee members may be contacted here:

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The Editorial Subcommittee hopes that you find this Commentary helpful to your legal practice.

ARTICLE 1
GENERAL PROVISIONS

Modified RULLCA Comment
(Rev. 2/23/2024)

This Act is drafted to replace a state's current limited liability company statute, regardless of whether that statute is based on ULLCA (1996), ULLCA (2006), or other source. A.R.S. § 29-3110 ~~Section 110~~ contains transition provisions.

A.R.S. § 29-3101. SHORT TITLE.

Arizona Comment
(Rev. 2/23/2024)

As used in the Arizona Comments, the "Act" refers to Chapter 7 of Title 29, Arizona Revised Statutes, which was enacted in 2018 as part of SB 1353 and amended in 2021 by SB 1230. SB 1353 contains many other statutory provisions relevant to limited liability companies, including important transition rules in Sections 5 and 6. These transition rules are discussed in the Arizona Comment to A.R.S. § 29-3110.

A.R.S. § 29-3102. DEFINITIONS.

Arizona Comment
(Rev. 2/23/2024)

A.R.S. § 29-3102 adds several defined terms not found in RULLCA, excludes one of RULLCA's defined terms, and modifies several of RULLCA's defined terms in material ways.

Subsection (1). RULLCA's term "certificate of organization" has been changed to **"articles of organization"** to preserve the terminology of the Prior Act to refer to a limited liability company's formation document filed under A.R.S. § 29-3201. The articles of organization serve primarily as a public disclosure document rather than the locus of rules governing the relationship among the company and its members and managers. Although the word "certificate" may be conceptually better suited to describe a disclosure document, the Drafting Subcommittee determined that it was more important to preserve the Prior Act's terminology to avoid confusion and mistakes during the transition from the Prior Act to the Act.

Subsection (2). The term **"commission"** refers to the Arizona Corporation Commission. Although the term appears in the Act without initial letter capitalization, both the Arizona Comments and the modified RULLCA Comments use the term with initial letter capitalized to draw attention to the fact that it is a defined term in the Act.

Subsection (3). The statutory right of a member to implead a right of contribution from another member in the context of a legal action for the return of improper distributions under RULLCA § 406 was deleted from A.R.S. § 29-3406. *See* the Arizona Comment to A.R.S. § 29-3406 regarding the reasons for that departure from RULLCA. The phrase "except in the phrase 'right of contribution'" has been deleted from RULLCA's definition of **"contribution"** to reflect this departure from RULLCA.

Subsections (5), (8) and (24). The Act departs from RULLCA by expressly providing for the registration of a series of a foreign limited liability company to do business in Arizona. *See* Article 9 of

the Act and the Arizona Comments under Article 9 for an explanation of the registration requirements and the conditions applicable to a foreign series doing business in Arizona. These subsections set forth the definitions of a **“foreign series”**, a **“registered foreign series”**, and a **“designating foreign company”** for the purpose of applying the provisions of Article 9. RULLCA does not contain these defined terms because it does not address the treatment of a foreign series in a jurisdiction that adopts RULLCA.

Subsection (11). The definition of **“limited liability company”** in the Act departs from RULLCA’s definition only by the addition of the phrase “includes a limited liability company with a single member”. The purpose of this addition is merely to clarify and remove any doubt that a limited liability company need not have more than one member.

Subsection (12). The term **“majority in interest”** is defined as one or more members whose combined interests in profits of the company comprise a majority of the total interests in profits held by all members, disregarding any interest in in profits held by a nonmember. The members’ respective interests in profits are based upon the proportions in which they share in distributions that exceed the repayment of their respective contributions. *See* the Arizona Comment to A.R.S. § 29-3407 for an explanation and examples of a “majority in interest”.

Subsection (27). The Act substitutes the term **“statutory agent”** for RULLCA’s term “registered agent” in order to preserve the terminology of the Prior Act. The definitions of both terms are substantively the same. The purpose of the substitution is to avoid confusion and mistakes during the transition from the Prior Act to the Act.

Subsection (20). The term “principal office” under RULLCA has been changed to **“principal address”** in the Act, and the definition has been modified to permit a limited liability company to operate without a physical executive office as long as the company maintains a mailing address.

All of the other defined terms in A.R.S. § 29-3102 have substantively the same definitions as in RULLCA § 102.

Modified RULLCA Comment
(Rev. 2/23/2024)

This Section contains definitions for terms used throughout the act~~, while Section 1001 contains definitions specific to Article 10’s provisions on mergers, conversions, interest exchanges, and domestications~~.

~~**“Certificate of organization” [(1)]**—The original ULLCA and most other LLC statutes use “articles of organization” rather than “certificate of organization.” This act purposely uses the latter term to signal that the certificate: (i) merely reflects the existence of an LLC (rather than being the locus for important governance rules); and (ii) is significantly different from articles of *incorporation*, which have a substantially greater power to affect *inter se* rules for the corporate entity and its owners. For the relationship between the certificate of organization and the operating agreement, see Section 107(d).~~

“Contribution” [(3~~2~~)]—This definition serves to distinguish capital contributions from other circumstances under which a member or would-be member might provide benefits to a limited liability company (*e.g.*, providing services to the LLC as an employee or independent contractor, leasing property to the LLC).

This definition also distinguishes “contributions” from capital raised from transferees who invest; to be a contribution, the property or benefit must be “provided by a person … to become a ~~partner~~

member or in the person's capacity as a ~~partner~~member." This distinction is ubiquitous in the law of unincorporated business organizations. *See, e.g.*, N.Y. LTD. LIAB. CO. LAW § 102(f) (McKinney 2013) ("'Contribution' means any cash, property, services rendered, or a promissory note or other binding obligation to contribute cash or property or to render services that a member contributes to a limited liability company in his or her capacity as a member."); DEL. CODE ANN. tit. 6, § 17-101(2) (West 2013) ("'Contribution' means any cash, property, services rendered or a promissory note or other obligation to contribute cash or property or to perform services, which a person contributes to a limited liability company in the person's capacity as a partner.").

In contrast, operating agreements sometimes provide for contributions from transferees. In such circumstances, the default rules for liquidating distributions should be altered accordingly. *See* Section 29-3707(B~~b~~)(1) (referring to distributions to be made "to each person owning a transferable interest that reflects *contributions* made and not previously returned") (emphasis added).

"Distribution" [(6~~4~~)(b~~A~~)—redemptions included]—This provision specifically refers to transactions between a limited liability company and one of its members, which in the corporate context would be labeled a "redemption." The paragraph has subparts because ownership interests in an LLC are conceptually bifurcated into economic rights ("transferable interest") and governance and information rights.

Under Section 29-3404(A~~a~~), "[a]ny distribution made by a limited liability company before its dissolution and winding up must be in equal shares among members and persons dissociated as members . . . ." Since a redemption is a distribution, absent authorization in the operating agreement an LLC may not redeem the interest of one member or transferee without redeeming (or at least offering to redeem) the interests of all other members and transferees to a comparable extent.

The law of close corporations has flirted with a similar notion. *See, e.g.*, *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 367 Mass. 578, 598, 328 N.E.2d 505, 518 (1975) (stating, with regard to closely held corporations, "if the stockholder whose shares were purchased was a member of the controlling group, the controlling stockholders must cause the corporation to offer each stockholder an equal opportunity to sell a ratable number of his shares to the corporation at an identical price"); *Toner v. Baltimore Envelope Co.*, 304 Md. 256, 273, 498 A.2d 642, 650 (1985) (rejecting the "per se breach of duty" approach); *Wilkes v. Springside Nursing Home, Inc.*, 370 Mass. 842, 850, 353 N.E.2d 657, 663 (1976) (stating that "untempered application of the strict good faith standard enunciated in *Donahue* to . . . will result in the imposition of limitations on legitimate action by the controlling group in a close corporation which will unduly hamper its effectiveness in managing the corporation in the best interests of all concerned").

An operating agreement can override Section 29-3404(A~~a~~)'s equal treatment requirement without specifically mentioning redemptions.

> EXAMPLE**:** Ryan, LLC is a manager-managed limited liability company whose operating agreement: (i) includes a list (the "protected list") of decisions or actions that may be taken only with the consent of all members; and (ii) provides that all other decisions and acts may be taken as the manager determines. The protected list does not include redemptions. The operating agreement overrides the Section 29-3404(a)'s equal treatment requirement.

[(6~~4~~)(c~~B~~)—exclusion]—This exclusion affects the reach of: (i) the charging order remedy under Section 29-3503; and (ii) Section 29-3405's clawback provision. The effect on the clawback provision reflects the law in several states, *see, e.g.*, DEL. CODE ANN., tit. 6, § 18-607(b) (2012) and VA. CODE ANN. § 13.1-1036 (2012), and makes sense conceptually and as a matter of policy. *See In re Tri-River*

Trading, LLC, 329 B.R. 252, 266 (B.A.P. 8th Cir. 2005), *aff'd,* 452 F.3d 756 (8th Cir. 2006) ("We know of no principle of law which suggests that a manager of a company is required to give up agreed upon salary to pay creditors when business turns bad.").

"Foreign limited liability company" [(7~~5~~)]—Some statutes have elaborate definitions addressing the question of whether an entity organized under the law of another jurisdiction is a "foreign limited liability company." The New York statute, for example, defines a "foreign limited liability company" as:

> an unincorporated organization formed under the laws of any jurisdiction, including any foreign country, other than the laws of this state (i) that is not authorized to do business in this state under any other law of this state and (ii) of which some or all of the persons who are entitled (A) to receive a distribution of the assets thereof upon the dissolution of the organization or otherwise or (B) to exercise voting rights with respect to an interest in the organization have, or are entitled or authorized to have, under the laws of such other jurisdiction, limited liability for the contractual obligations or other liabilities of the organization.

N.Y. LTD. LIAB. CO. LAW § 102(k) (McKinney 2012). In contrast, Delaware takes a succinct and entirely formalistic approach. DEL. CODE ANN. tit. 6, § 18-101(4) (2012) (stating that the foreign limited liability company is one that is "denominated as such").

This definition, in contrast, intends a flexible, comparative approach. If a particular type of foreign entity has key legal characteristics that approximate the essential legal characteristics of a domestic limited liability company, that particular type of foreign entity is a foreign limited liability company under this act.

"Jurisdiction of formation" [(10~~7~~)]—This definition is not limited to United States jurisdictions.

"Limited liability company" [(11~~8~~)]—This definition makes no reference to a limited liability company having members upon formation, but Section 29-3401~~201~~(A~~d~~) does.

"Manager" [(13~~9~~)]—The act uses "manager" as a term of art, whose applicability under this act is confined to manager-managed LLCs. The phrase "manager-managed" is itself a term of art, referring only to an LLC whose articles of organization ~~operating agreement~~ refer~~s~~ to the LLC as such. *See* Paragraph 14~~10~~ (defining "manager-managed limited liability company"). Thus, for purposes of this act, if the members of a *member*-managed LLC delegate plenipotentiary management authority to one person (whether or not a member), this act's references to "manager" do not apply to that person, even if the members or their operating agreement refers to the person as a "manager."

This approach has the potential for confusion, but confusion around the term "manager" is common to all LLC statutes. The confusion stems from the choice to define "manager" as a term of art in a way that can be at odds with other, common usages of the word. For example, a member-managed LLC might well have an "office manager" or a "property manager." Moreover, in a manager-managed LLC, the "property manager" is not likely to be a manager as the term is used in many LLC statutes. For this nomenclature problem, the best solution is to have the operating agreement carefully delineate who is and is not a manager as this act uses that label.

For cases exemplifying the complexity and problems, *see, e.g.*, *In re Weddle*, 353 BR 892, 895 n.2 (Bankr. D. Idaho 2006) ("Plaintiff appears to argue that Debtors were managers of the LLC. However,

Plaintiff's use of the term 'managers' to describe Debtors' duties under their employment agreement is not synonymous with 'manager' of the LLC within the use of that term in the operating agreement, the articles of incorporation, or chapter 6 of title 53 of the Idaho Code. The court views Debtors' 'management' role in the daily operation of the lodge as separate and distinct from management of the LLC."); *Brown v. MR Group, LLC*, 693 N.W.2d 138, 143 (Wis. App. 2005) (declining to use the dictionary definition of "manager" in determining coverage of a policy applicable to a limited liability company and its "managers" and relying instead on the meaning of the term under the Wisconsin LLC act); *Old Nat'l Villages, LLC v. Lenox Pine,' LLC*, 659 S.E. 2d 891, 893 (Ga. Ct. App. 2008) (treating the label "general manager" as a manager "under Georgia's LLC statute").

Under this act, the category of "person" is not limited to individuals. Therefore, a "manager" need not be a natural person. For example, one limited liability company can serve as the manager of another limited liability company.

After a person ceases to be a manager, the term "manager" continues to apply to the person's conduct while a manager. *See* Section 29-3407(C~~c~~)(7~~6~~).

"Manager-managed limited liability company" [(14~~10~~)]~~—This act authorizes a private agreement (the operating agreement) rather than a public document (certificate or articles of organization) to establish an LLC's status as a manager-managed limited liability company, thereby departing from most existing LLC statutes. Using the operating agreement makes sense, because under this act managerial structure creates no statutory power to bind the entity. *See* Section 301 (eliminating statutory apparent authority).~~

The only direct consequences of manager-managed status are *inter se*—principally the triggering of a set of rules concerning management structure, fiduciary duty, and information rights—and third party reliance rights with respect to a manager's acts in the ordinary course of the company's activities and affairs. *See* Sections 29-3407–3410 and 29-3301(B). The rules on management structure are entirely default provisions—subject to change in whole or in part by the operating agreement. The operating agreement can also significantly affect the provisions on fiduciary duty and information rights. *See* Section 29-3105.

An LLC that is "manager-managed" under this definition does not change its management structure simply because the members fail to designate anyone to act as a manager. In that situation, absent additional facts, the LLC is manager-managed and the manager position is vacant. Non-manager members who exercise managerial functions during the vacancy (or at any other time) will have duties as determined by other law, most particularly the law of agency.

"Member" [(15~~11~~)]—After a person has been dissociated as a member under Section 29-3602, the term "member" continues to apply to the person's conduct while a member. *See* Section 29-3603(B~~b~~).

"Member-managed limited liability company" [(16~~12~~)]—Under this act, member-management is the default mode. *See* Section 29-3407(A~~a~~).

Some member-managed LLCs give important managerial responsibilities to one or more members. Because "manager" is a term of art under this act and applies only to manager-managed LLC, referring to such members as "managers" risks confusion. *See* the comment to Paragraph 13~~9~~ (Manager). In contrast, "managing member" or some other designation such as Chief Executive Officer avoids the defined term of "manager" and thereby avoids confusion.

"Operating agreement" [(17~~13~~)]—This definition must be read in conjunction with Sections 29-

3105 through 29-3107, which further describe the operating agreement. In particular, although this definition refers to “the agreement . . . of all the members,” the limited liability company itself is bound by and may enforce the agreement. Section 29-3106(A~~a~~).

An operating agreement is a contract, and therefore all statutory language pertaining to the operating agreement must be understood in the context of the law of contracts.

The definition in Paragraph 17~~13~~ is very broad and recognizes a wide scope of authority for the operating agreement: “the matters described in Section 29-3105(A~~a~~).” Those matters include not only all relations *inter se* the members and the limited liability company but also all “activities and affairs of the company and the conduct of those activities and affairs.” Section 29-3105(A~~a~~)(1~~3~~). Moreover, the definition puts no limits on the form of the operating agreement. To the contrary, the definition contains the phrase “whether oral, implied, in a record, or in any combination thereof.”

Unless the operating agreement itself provides otherwise:

- an operating agreement may comprise a number of separate documents (or records), however denominated; and
- subject to Section 29-3106(B~~b~~) (deeming new members to assent to the then-existing operating agreement), a document, record, understanding, etc. can be part of the operating agreement only with the assent of all persons then members.

An agreement among less than all members might well be enforceable among those members as parties, but would not be part of the operating agreement. However, under Section 29-3105(A~~a~~)(1~~4~~)(d), an amendment to an operating agreement can be made with less than unanimous consent if the operating agreement itself so provides.

An agreement to form an LLC is not itself an operating agreement. The term “operating agreement” presupposes at least one “member,” and a person cannot be a member of an LLC before the LLC exists. However, as soon as a limited liability company has any members, the limited liability company perforce has an operating agreement. For example, suppose: (i) two persons orally and informally agree to join their activities in some way through the mechanism of an LLC; (ii) they form the LLC or cause it to be formed; and (iii) without further ado or agreement, they become the LLC’s initial members. An operating agreement exists. In the words of Paragraph 17~~13~~, “all the members” have agreed on who the members are, and that agreement—no matter how informal or rudimentary—is an agreement “concerning the matters described in Section 29-3105(A~~a~~).” To the extent the agreement does not provide the *inter se* “rules of the game,” this act “fills in the gaps.” Section 29-3105(B~~b~~).

The result is the same when a person becomes the sole initial member of an LLC, so long as the person has any understanding or intention with regard to the LLC. Any such understanding or intention constitutes an “agreement of all the members of the limited liability company, including a sole member.” Paragraph 17~~13~~.

It may seem oxymoronic to refer an “agreement of . . . a sole member,” but this approach is common in LLC statutes. *See, e.g.*, ARIZ. REV. STAT. ANN. § 29-601 (14)(b) (2012) (defining operating agreement to mean “[i]n the case of a limited liability company that has a single member, any written or oral statement of the member made in good faith purporting to govern the affairs of a limited liability company or the conduct of its business as of the effective time of the statement”); WASH. REV. CODE ANN. § 25.15.005 (5) (2012) (defining limited liability company agreement to include “any written statement of the sole member”).

This re-definition of "agreement" is a function of "path dependence." LLC statutes initially required an LLC to have at least two members, and almost all LLC statutes contemplated an agreement among members as an LLC's key organic document. Because LLC statutes make the operating agreement the principal way to override statutory default rules, the advent of single member LLCs made it necessary to provide that a sole member could make an operating agreement.

This act states no rule as to whether the statute of frauds applies to operating agreements. Case law suggests that the answer is yes. *Olson v. Halvorsen*, 986 A.2d 1150, 1161 (Del. 2009) ("The legislative history of the LLC Act does not demonstrate the General Assembly's intent to place LLC agreements outside of the statute of frauds.") (applying the one-year provision to an alleged oral buy-out agreement), *negated by* 2010 DEL. LAWS, ch. 287 (H.B. 372), §§ 1, 31 (pertaining to statutes of fraud generally).

The Delaware court decision is consistent with partnership cases.

> Partnership agreements, like other contracts, are subject to the Statute of Frauds. A contract of partnership for a term exceeding one year is within the Statute of Frauds and is void unless it is in writing [and signed by the party to be bound]; however, a contract establishing a partnership terminable at the will of any partner is generally held to be capable of performance by its terms within one year of its making and, therefore, to be outside the Statute of Frauds.

Abbott v. Hurst, 643 So. 2d 589, 592 (Ala. 1994) (citations omitted).

Likewise, the land provision of the statute of frauds:

> applies to an oral contract to transfer or convey partnership real property, and the interest of the other partners therein, to one partner as an individual, as well as to a parol contract by one of the parties to convey certain land owned by him individually to the partnership, or to another partner, or to put it into the partnership stock.

Froiseth v. Nowlin, 156 Wash. 314, 316, 287 P. 55, 56 (Wash. 1930) (quoting 27 C.J.S. § 220); *see also E. Piedmont 120 Associates, L.P. v. Sheppard*, 209 Ga. App. 664, 665, 434 S.E.2d 101, 102 (1993) (same, 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).

In contrast, the land provision does not apply to a member's ownership interest in an LLC, no matter how much the LLC owns or deals in real property. Interests in a limited liability company are personal property and reflect no direct interest in the entity's assets. *See* Sections 29-3102(2924), 29-3501. Thus, the real property issues pertaining to the LLC's ownership of land do not "flow through" to the members and membership interests. *See, e.g.*, *Wooten v. Marshall*, 153 F. Supp. 759, 763–64 (S.D. N.Y. 1957) (involving an "oral agreement for a joint venture concerning the purchase, exploitation and eventual disposition of this 160 acre tract" and stating "[t]he real property acquired and dealt with by the venturers takes on the character of personal property as between the partners in the enterprise, and hence is not covered by [the Statute of Frauds]"); *see also Wade v. DeHart*, 1926 WL 2944 (Ohio Com. Pl. 1926), *aff'd sub nom., Wade v. De Hart*, 26 Ohio App. 177, 159 N.E. 838 (1927) (same).

On the question of how far a written (or "in a record") operating agreement can go to prevent oral or implied-in-fact terms, *see* Section 29-3105(Aa)(14)(d), comment. For the effect of a pre-formation

agreement, *see* Section 29-3106(C~~c~~). For the limited liability company's status viz-a-viz the operating agreement, *see* Section 29-3106(A~~a~~).

"Organizer" [(18~~14~~)]—An organizer need not be a prospective member of the limited liability company. Unless the organizer will be the sole initial member of the limited liability company, as a matter of agency law and Section 29-3401(A~~a~~) and (B~~b~~), the organizer is acting on behalf of the person or persons who have agreed to become the initial member or members of the limited liability company. The organizer does not act on behalf of the limited liability company, because a person cannot be an agent of an organization that does not yet exist. RESTATEMENT (THIRD) OF AGENCY § 4.04, cmt. c (2006) (Nonexistent Principals).

"Property" [(21~~16~~)]—This definition encompasses every form of property.

"Transfer" [(28~~23~~)]—The term "transfer" is broadly defined to include all types of conveyances of interests in property. The reference to "transfer by operation of law" is significant in connection with Section 29-3502 (Transfer of Transferable Interest). That section severely restricts a transferee's rights (absent the consent of the members), and this definition makes those restrictions applicable, for example, to transfers ordered by a family court as part of a divorce proceeding and transfers resulting from the death of a member. The restrictions also apply to transfers in the context of a member's bankruptcy, except to the extent that bankruptcy law supersedes this act.

"Transferable interest" [(29~~24~~)]—Absent a contrary provision in the operating agreement or the consent of the members, a "transferable interest" is the only interest in an LLC which can be transferred to a non-member. *See* the comment to Section 29-3502.

This paragraph defines "transferable interest" as an interest "initially owned by a person in the person's capacity as a member," because this act does not contemplate an LLC directly creating interests that comprise only economic rights. *See* Sections 29-3401 (addressing how a person becomes a member), 29-3502 (addressing how a person becomes a transferee).

"Transferee" [(30~~25~~)]—This definition should be read in light of Section 29-3603(A~~a~~)(3), which subject to limited exceptions provides that "any transferable interest owned by the person in the person's capacity as a member immediately before dissociation as a member is owned by the person solely as a transferee."

A.R.S. § 29-3103. KNOWLEDGE; NOTICE.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 103 except for the deletion of a reference to limitations of authority under § 302 of RULLCA (which section was deleted from the Act).

Modified RULLCA Comment
(Rev. 2/23/2024)

This section is substantially slimmer than the corresponding provisions of previous uniform acts pertaining to business organizations: UPA (1997), ULLCA (1996), and ULPA (2001). Each of those acts borrowed heavily from the comparable Uniform Commercial Code provision. This act relies instead on generally applicable principles of agency law, *see* Section 29-3111; therefore, this section is confined mostly to rules specifically tailored to this act.

Several facets of this section warrant particular note. First, ~~and most fundamentally, because this act does not provide for "statutory apparent authority," Section 301,~~ this section contains no special rules for attributing to an LLC information possessed, communicated to, or communicated by a member or manager.

Second, the section contains no generally applicable provisions determining when an organization is charged with knowledge or notice, because those imputation rules: (i) comprise core topics within the law of agency; (ii) are very complicated; (iii) should not have any different content under this act than in other circumstances; and (iv) are the subject of considerable attention in the Restatement (Third) of Agency (2006).

Third, this act does not define "notice" to include "knowledge." Although conceptualizing the latter as giving the former makes logical sense and has a long pedigree, that conceptualization is counter-intuitive for the uninitiated. In ordinary usage, notice has a meaning separate from knowledge. This act follows ordinary usage and therefore contains some references to "knowledge or notice."

Subsection (A~~a~~)(2)—In this context, the most important source of "law other than this chapter~~[act]~~" is the common law of agency.

Subsection (B~~b~~)(1)—The "facts known to the person at the time in question" include facts the person is deemed to know under Subsection (A~~a~~)(2).

Subsection (C~~c~~)—If a person "notifies" another person of a fact, the other person has "reason to know" the fact and therefore has notice under Subsection (B~~b~~)(1). However, a person can have "notice" of a fact without having been "notifie[d]" of the fact.

Section 29-3210(F~~f~~) pertains to delivery of records *by* the filing office.

Subsection (D~~d~~)—This subsection provides constructive notice of facts stated in specified filed public records.

Subsection (D~~d~~)(2)—Under this act, the power to bind a limited liability company to a third party is primarily a matter of agency law and. Section 29-3301~~, cmt~~. The constructive notice provided under this paragraph will be relevant if a third party makes a claim under agency law or under Section 29-3301 that someone who purported to act on behalf of a limited liability company had the apparent authority to do so.

A.R.S. § 29-3104. GOVERNING LAW.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 104.

Modified RULLCA Comment
(Rev. 2/23/2024)

Paragraph (1)—Like any other legal concept, "internal affairs" may be indeterminate at its edges. However, the concept certainly includes interpretation and enforcement of the operating agreement, relations among the members as members, relations between the limited liability company and

a member as a member, relations between a manager-managed limited liability company and a manager, and relations between a manager of a manager-managed limited liability company and the members as members. *Compare* Paragraph 1, *with* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302, cmt. a (1971) (defining "internal affairs" with reference to a corporation as "the relations inter se of the corporation, its shareholders, directors, officers or agents").

"Internal affairs" do not encompass the power *vel non* of a person to bind a limited liability company. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 292(2) (1971) ("The principal will be held bound by the agent's action if he would so be bound under the local law of the state where the agent dealt with the third person, provided at least that the principal had authorized the agent to act on his behalf in that state or had led the third person reasonably to believe that the agent had such authority."); *Id.* § 295(1) ("Whether a partnership is bound by action taken on its behalf by an agent in dealing with a third person is determined by the local law of the state selected by application of the rule of § 292."); RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 345, cmt. c (1934) (Law Governing Effect of Act of Agent or Partner) ("If… the principal or partner sends the agent or other partner into a state to act on his behalf, he assumes the risk of liability not only for authorized but for unauthorized conduct of the agent or partner in accordance with the law of that state."). *See also Farm & Ranch Services, Ltd. v. LT Farm & Ranch, L.L.C.*, 779 F. Supp. 2d 949, 960 (S.D. Iowa 2011).

The operating agreement cannot alter this section. *See* Section 29-3105(C~~c~~)(1). This approach comports with the law of other businesses entities whose formation or legal status depends at least in part on a publicly-filed record. *See, e.g.,* ULPA (2001) (Last Amended 2013) § 104 (stating that the law of the state of formation is the domestic entity's governing law) and ULLCA (2006) (Last Amended 2013) § 104 (same).

However, an operating agreement may lawfully incorporate by reference the provisions of another state's LLC statute. If done correctly, this incorporation makes the foreign statutory language part of the operating agreement, and the incorporated terms (together with the rest of the operating agreement) then govern the members (and those claiming through the members) to the extent not prohibited by this act. *See* Section 29-3105. This approach: (i) does *not* switch the limited liability company's governing law to that of another state; (ii) instead takes the provisions of another state's law and incorporates them by reference into the contract among the members; (iii) raises complex drafting issues – *e.g.*, how to address subsequent changes to the incorporated law (whether occurring by statutory amendment or court decision); and (iv) thus is rarely, if ever, a good idea.

Paragraph (2)—This paragraph obviously encompasses Section 29-3304 (the liability shield) but does not necessarily encompass a claim that a member or manager is liable to a third party for: (i) having purported inaccurately to have the actual authority to bind a limited liability company to the third party; or (ii) having committed a tort against the third party while acting on the limited liability company's behalf or in the course of the company's business. That liability is not by status (*i.e.,* not "as member . . . [or] as manager") but rather results from function or conduct. ~~*Compare* Paragraph 2, *with* Section 301(b) (stating that, although this act does not make a member as member the agent of a limited liability company, other law may make an LLC liable for the conduct of a member).~~

"Internal affairs" and the "liability of a member as a member" are mentioned separately because it can be argued that the liability of members and managers to third parties is not an internal affair. *See, e.g.*, RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 307 (1971) (treating shareholders' liability separately from the internal affairs doctrine). A few cases subsume owner/manager liability into internal affairs, but many do not. *See, e.g.*, *Kalb, Voorhis & Co. v. Am. Fin. Corp.,* 8 F.3d 130, 132 (2nd Cir. 1993) (holding that the corporation's "primary purpose is to insulate shareholders from legal liability" and therefore "the state of incorporation has the greater interest in determining when and if that insulation is to be stripped

away”) (quoting *Soviet Pan Am Travel Effort v. Travel Comm., Inc.*, 756 F. Supp. 126, 131 (S.D.N.Y. 1991) (internal quotation marks omitted).

In any event, most (if not all) LLC statutes follow the rule stated in this paragraph. *See, e.g.,* ~~ARIZ. REV. STAT. ANN. § 29-801(A)(1) (2013) (stating that “[t]he laws of the state or another jurisdiction under which a foreign limited liability company is organized govern its organization and internal affairs and the liability of its members”);~~ GA. CODE ANN. § 14-11-701 (West 2013)(a) (stating that “[t]he laws of the jurisdiction under which a foreign limited liability company is organized govern its organization and internal affairs and the liability of its managers, members, and other owners”); N.Y. LTD. LIAB. CO. LAW § 801(a) (McKinney 2013) (stating that “[t]he laws of the jurisdiction under which a foreign limited liability company is formed govern its organization and internal affairs and the liability of its members and managers”).

Moreover, in the case law, “[t]he general rule is that a plaintiff’s alter ego theory is governed by the law of the state in which the business at issue is organized.” *Rual Trade Ltd. v. Viva Trade L.L.C.*, 549 F. Supp. 2d 1067, 1077 (E.D. Wis. 2008); *see also In re Gulf Fleet Holdings, Inc*., 491 B.R. 747, 787 (Bankr. W.D. La. 2013) (stating both conceptual and policy rationales for choosing the law of the state of formation); *In re Saba Enterprises, Inc.*, 421 B.R. 626, 648–51 (Bankr. S.D.N.Y. 2009) (examining the issue in detail and applying the state of formation rule).

A.R.S. § 29-3105. OPERATING AGREEMENT; SCOPE, FUNCTION AND LIMITATIONS.

Arizona Comment

(Rev. 2/23/2024)

A limited liability company’s operating agreement (which may be written, oral, or implied by conduct or otherwise) is of primary significance to the governance of the company and the rights and obligations of its members. The Act, like the Prior Act, permits an operating agreement to contain any provision that is not a violation of law. However, the Act contains more statutory default rules than the Prior Act. These default rules provide certainty in situations that the parties have failed to address in their operating agreement. By the exercise of the freedom of contract to vary or supersede the default rules, the members may, for example, change the distributions to members, change the rules relating to the duties of managers and members, and change the grounds for dissolution. However, this freedom of contract is subject to common law principles applicable to the enforcement of contracts and to the statutory limitations in Subsections (C) and (D), which describe those provisions of the Act that an operating agreement cannot validly supersede.

A.R.S. § 29-3105 is of particular importance to those drafting or reviewing an operating agreement in two principal ways: (i) if a particular right or obligation is important to the members, and that right or obligation differs from the statutory default rule, the expectations of the members will be frustrated if the operating agreement fails to address and supersede the default rule, and (ii) a provision of an operating agreement attempting to exceed the limitations of Subsections (C) and (D) is not enforceable, which may also frustrate the expectations of the members.

Subsection (A) establishes the primacy of the operating agreement in governing relations among the limited liability company and its members, the rights and duties of its managers, the “activities and affairs” of the company, and amendments to the operating agreement. Subsection (A)(2) was added for continuity with the Prior Act. Subsection (A)(3) was added to address actual conflicts between the Act and the operating agreement, a subject not explicitly addressed by Subsection (B), which applies only to a term about which the Act is silent.

Subsection (A)(3)(b) states that a manager's rights and duties are governed by the operating agreement, subject to the limitations of subsection (C), even though a manager may not be a party to the operating agreement. On its face, this provision leaves a manager vulnerable to terms that are not necessarily known to the manager, and to future amendments that could materially increase a manager's duties or diminish its rights. As a practical matter, however, this risk is minimal in the vast majority of cases where a manager (or its affiliate) is also a member. In the unusual case where a manager is not under common control with one of the members, consideration should be given to putting the manager's rights and obligations into a separate management agreement between the manager and the company, with an integration clause specifying that the management agreement supersedes any conflicting or inconsistent provision in the operating agreement.

Subsection (B) recognizes the Act as comprising mostly default rules – *i.e.,* gap fillers for issues as to which the operating agreement provides no rule.

Subsection (C) lists the few provisions that, if included in an operating agreement, are not enforceable. The provisions of the Act that cannot be modified are often referred to as "mandatory" provisions to distinguish them from the default provisions that can be superseded by the operating agreement.

Subsection (C)(1) renders unenforceable any provision choosing the law of a state other than Arizona to govern the internal affairs of a limited liability company or the liability of a member or manager in his or her capacity as member or manager for a debt, obligation, or liability of a limited liability company formed in Arizona. *See* A.R.S. § 29-3104.

> EXAMPLE 1: Assume the limited liability company laws of State X provide no information rights for members and no liability for a member who receives a distribution while the company is insolvent. A choice of State X law to govern an Arizona limited liability company and its operating agreement would not be effective either to deny a member's information rights under the Act or to relieve a member of liability under A.R.S. § 29-3406.
>
> EXAMPLE 2: The members of an Arizona limited liability company desire to create multiple series within the company to provide internal liability shields between the company's operational divisions. The Act does not permit the creation of multiple series, so the members decide to choose Delaware law to govern the company's affairs because the Delaware Limited Liability Company Act allows the creation of series. The choice of Delaware law would not be effective under Subsection (C)(1) to allow the creation of multiple series because the liability shield between each series relates to the internal affairs of the company. *See also* comment to A.R.S. § 29-3901.

Subsection (C)(5) prohibits an operating agreement from eliminating the contractual obligation of good faith and fair dealing or the duty to refrain from willful or intentional misconduct.

Subsection (C)(6) prohibits an operating agreement from limiting or eliminating a person's liability for any violation of the contractual obligation of good faith and fair dealing or conduct involving willful or intentional misconduct. Subject to those limitations, A.R.S. § 29-3105 allows the operating agreement to modify, limit, and eliminate fiduciary and other managerial duties. For example, subject only to the limitations in A.R.S. §§ 29-3105(C)(5) and (C)(6), the Act allows an operating agreement to eliminate the duty of loyalty and to modify the duty of care, as provided in A.R.S. § 29-3105(D). The duty of care cannot be eliminated entirely because the duty to refrain from willful or intentional misconduct cannot be eliminated.

Subsection (C)(6) differs from RULLCA, which prohibits a provision in an operating agreement that limits or eliminates a person's liability for conduct involving the person's knowing violation of law. Under A.R.S. § 29-3409, the knowing violation of law is *not* a breach of the duty of care or any other statutory duty. *See* comment to A.R.S. § 29-3409. For example, a manager may engage in conduct on behalf of a limited liability company that violates a law that is punishable by a fine on that grounds that paying the fine rather than complying with the law is in the best interests of the company.

Unlike RULLCA, the Act does not apply a test of "not manifestly unreasonable" to determine whether a contractual modification of a manager's or member's duty is valid and enforceable. Unlike the Act, Section 105(c)(6) of RULLCA provides that an operating agreement may prescribe the standards by which the obligation of good faith and fair dealing is to be measured, *if the standards are not "manifestly unreasonable."* Similarly, Section 105(d)(3) of RULLCA provides that *if not "manifestly unreasonable,"* an operating agreement may (i) alter or eliminate the duty of loyalty, (i) identify specific types or categories of activities that do not violate the duty of loyalty, (i) alter the duty of care, but may not authorize conduct involving bad faith, willful or intentional misconduct, or knowing violation of law, and (d) alter or eliminate any other fiduciary duty (*i.e.*, a common law duty other than the duty of loyalty and duty of care).

The "manifestly unreasonable" test was not incorporated into the Act because it represents an extraordinary departure from Arizona's common law and its meaning is too unpredictable. Even without RULLCA's "manifestly unreasonable" test, an Arizona court has significant power and discretion to refuse enforcement of an operating agreement provision based upon existing contract law doctrines, principles of equity, and the contractual obligation of good faith and fair dealing. By omitting the "not manifestly unreasonable" test, the Act gives greater deference to freedom of contract than is provided by RULLCA.

Unlike RULLCA, the Act does not make "bad faith" conduct a mandatory, non-waivable component of the duty of care. In contrast, Section 105(c)(7) of RULLCA prohibits an operating agreement from relieving or exonerating a person from liability for conduct involving "bad faith," and Section 105(d)(3)(C) of RULLCA prohibits authorization of conduct involving "bad faith." The provisions of RULLCA relating to "bad faith" were not incorporated into the Act because the term is ambiguous. Under existing case law, the term has different meanings in different contexts. For example, it is unclear whether the "bad faith" test would apply to conduct motivated by ill will as contrasted with conduct that violates the obligation of good faith and fair dealing.

Subsection (C)(7) renders unenforceable a provision in an operating agreement that "unreasonably restricts" the information rights under A.R.S. § 29-3410. This restriction is substantively the same as Section 105(c)(8) of RULLCA.

Subsection (C)(8) allows the operating agreement greater freedom than does RULLCA to eliminate or modify several causes of dissolution of a limited liability company. Under the Act, most of the causes for judicial dissolution are default rules rather than mandatory rules that cannot be altered or eliminated, with two exceptions. The first exception is under A.R.S. § 29-3701(A)(4)(b) (it is "not reasonably practicable to carry on the company's activities and affairs in conformity with" its articles and operating agreement) and the second is under A.R.S. § 29-3701(A)(5) (administrative dissolution by the Commission). Under the Act, neither of these two grounds may be altered or eliminated in an operating agreement. However, the operating agreement may modify how a disputed claim for dissolution under A.R.S. § 29-3701(A)(4) is resolved. For example, arbitration and forum selection clauses are commonplace in business relationships in general and in operating agreements in particular. The Act also allows the operating agreement to eliminate a member's right to seek a judicial dissolution if: (i) the affairs of the company are unlawful (A.R.S. § 29-3701(A)(4)(a)), (ii) there is a deadlock (A.R.S. § 29-

3701(A)(4)(c)), or (iii) the managers have acted illegally, breached the operating agreement, or wasted assets (Section 29-3701(A)(4)(d)), among other causes. In contrast, RULLCA does not permit the operating agreement the flexibility to modify any of the causes of judicial dissolution.

Subsection (C)(9) renders unenforceable an unreasonable restriction on the right of a member to maintain an action under Article 8, which governs the right of a member to maintain a direct or derivative action against another member, a manager, or the company. This reasonableness test is the same as in RULLCA. However, the Act adds a clause in Subsection (C)(9) that expressly allows an operating agreement to require a member, as a condition to bringing a direct action against a manager or member, to plead and prove an actual or threatened injury that is not solely the result of any injury suffered or threatened to be suffered by the company. This additional clause is not necessary under RULLCA because RULLCA requires proof of a direct injury to support a direct action under Article 8 of RULLCA's default rules. The requirement of proving direct injury is not a default rule under the Act (*see* A.R.S. § 29-3801). Accordingly, under the Act, a requirement to prove direct injury as a condition to bringing a direct action must be set forth in the operating agreement because the default rule does not require it.

Note that regardless of what the operating agreement provides about direct or derivative actions, A.R.S. § 29-3807 provides that the court may treat a direct action as a derivative action and order recovery to be paid to the limited liability company if reasonably necessary to avoid multiplicity of actions, materially adverse effects on the interests of the company's creditors, or an unfair distribution of any recovery among interested persons. The court may also treat a derivative action as a direct action and order recovery to be paid to the plaintiff if the court finds that justice so requires. Subsection (C)(9) does not expressly state whether A.R.S. § 29-3807 may be altered by an operating agreement. The Drafting Subcommittee felt this was not necessary to address because the members cannot restrict the powers of the court.

Subsection (C)(11) prohibits an operating agreement from varying the minimum contents of a plan of merger, interest exchange, conversion, domestication, or division required under Article 10. The operating agreement may modify the voting requirements and other statutory rights in connection with those transactions. *See* A.R.S. § 29-4004. Like RULLCA, the Act does not provide appraisal rights or dissenter's rights for minority members in connection with those transactions, but a plan or operating agreement may require such rights. *See* A.R.S. § 29-4002. Under A.R.S. § 29-3407, a merger, interest exchange, or any such other reorganization of a limited liability company is subject to unanimous approval of the members. If this default rule is modified by the operating agreement, consideration should be given to adding appraisal and dissenter's rights in the operating agreement to protect minority owners.

Subsection (C)(12) states that an operating agreement cannot restrict the rights of persons other than members or managers (*i.e.,* third parties), with only these exceptions: the company, which under A.R.S § 29-3106 is bound by the operating agreement, and transferees and persons dissociated as a member, whose rights against the company and its members can be governed by the operating agreement to the extent provided under A.R.S. § 29-3107(B). For example, rights of creditors who are not members or managers cannot be limited by an operating agreement. *See also* Subsection (C)(13) with respect to creditors' rights.

Subsection (C)(13) renders unenforceable any provision that reduces or eliminates the restrictions on distributions to members under A.R.S. § 29-3405 or the recipient's liability for improper distributions under A.R.S. § 29-3406, if and to the extent that the provisions adversely affect the rights of third parties. Accordingly, the rights of a person who is both a member (or a manager) and a creditor may be subordinated or otherwise modified by the operating agreement. Subsection (C)(13), which is not found in RULLCA, makes explicit what RULLCA implies in its Subsection (C)(12) regarding third party rights

generally. Note that the RULLCA comments to sections 405 and 406 both expressly state that those sections are non-waivable. *See also* comments to A.R.S. §§ 29-3405 and 3406.

Subsection (C)(14) renders unenforceable any provision that varies A.R.S. § 29-3108(C) (which states that a limited liability company may not engage in the business of banking) or A.R.S. §29-3108(D) (which states that a limited liability may not be an insurer, with certain exceptions). RULLCA does not contain a counterpart to (C)(14) because RULLCA does not restrict limited liability companies from engaging in banking or insurance. Note that Subsection (C)(14) does not refer to A.R.S. 29-3108(E), which states that limited liability companies have perpetual duration. Accordingly, perpetual duration is a default rule and can be altered by the operating agreement or the articles. *See also* A.R.S. § 29-3701(A), which allows the operating agreement to state an event that causes dissolution (such as a fixed date for the duration of the limited liability company).

Subsections (D) and (E), which do not appear in RULLCA, specifically authorize and clarify some provisions frequently found in operating agreements.

Subsection (D) describes how fiduciary and other managerial duties may be altered or eliminated, the method by which an act, omission, or transaction may be authorized or ratified, and the method for reimbursing, indemnifying, or limiting (or eliminating) the liability of a member or manager for failure to perform such duties. The provisions permitted by Subsection (D) may be thought of as "safe harbors." Note that all of these safe harbors are subject to the contractual obligation of good faith and fair dealing, and to the duty to refrain from willful or intentional misconduct under Subsections (C)(5) and (C)(6).

Subsection (D)(1) provides that the operating agreement may expand, limit, or eliminate any duty of a member, manager, or other person to another member, manager, or another person that is a party to or is otherwise bound by the operating agreement. For example, unlike RULLCA, the Act permits an operating agreement to eliminate the duty of loyalty.

Note that Subsection (D)(1) specifically allows all duties, including *common law* fiduciary duties, to be expanded, limited, or eliminated. Accordingly, a provision of the operating agreement that eliminates common law fiduciary duties is enforceable under the Act, whereas it may not be enforceable under RULLCA if the elimination of common law duties is determined to be manifestly unreasonable under Subsection 105(d)(3)(D) of RULLCA.

Subsection (D)(2) provides that the operating agreement may limit or eliminate any liability for breach of the operating agreement or breach of duties (under the Act or otherwise provided in the operating agreement) of any member, manager, or other person to the company or to any other member, manager, or other person that is a party to or is otherwise bound by the operating agreement. For example, unlike RULLCA, the Act permits an operating agreement to eliminate any liability for the breach of the duty of loyalty. The term "exculpation" is not used in the Act but the elimination of liability is the equivalent of exculpation. In addition, indemnification of a member or manager against liability for breach of the operating agreement or a duty is also a permissible elimination of liability.

Subsection (D)(3) provides that the operating agreement may specify the method by which a specific act, or a specific category of acts, may be authorized or ratified where the act would otherwise violate any duty. However, as discussed below, a general provision that provides for management by one or more members or managers is not alone sufficient to specify a method for authorization or ratification under this subsection.

Subsections (D)(3) and (D)(4) clarify that a general provision in an operating agreement establishing a minimum threshold of voting power necessary for approval of management or operational

decisions, including a provision requiring approval of management or operational decisions by the holders of membership interests representing a majority or supermajority of the interests in the profits or capital of the limited liability company, is not sufficient in and of itself to limit or eliminate a member's or manager's liability under A.R.S. § 29-3105(D).

> EXAMPLE 3: The sole manager enters into a transaction on behalf of the company in which the manager has a material conflict of interest and the members are not aware of the conflict of interest. Later, the manager decides to ask the members to ratify the transaction after full disclosure of the conflict of interest. The operating agreement provides that "all management decisions relating to the assets and activities of the company shall be determined by a majority in interest of the members." Unfortunately for the manager, this provision describes general management authority and is not sufficiently specific to avoid the Act's default rule requiring unanimous member approval under A.R.S. § 29-3409(N). In contrast, a provision that specifically states that a transaction involving a conflict of interest may be authorized or ratified by a majority in interest of those members who do not have a conflict of interest would be enforceable under Subsection (D).

As previously noted, each of Subsections D(1), D(2), D(3), and D(4) is limited by the phrase, "Subject to Subsection C, paragraphs 5 and 6 of this section," which is a reminder that the contractual obligation of good faith and fair dealing and the duty to refrain from willful or intentional misconduct under A.R.S. Section 20-3409 may never be eliminated by an operating agreement.

Subsection (E) is an express statutory authorization allowing the operating agreement to elect to substitute for the default duties under A.R.S. § § 29-3409 the fiduciary duties of a director, officer, or shareholder of an Arizona corporation and, if the operating agreement so provides, Subsection (E) also will apply the same rules of evidentiary presumptions that apply to the fiduciary duties of a director or shareholder of a corporation under Arizona law. For example, if a business enterprise with multiple entities desires that the fiduciary duty rules be as similar as possible in all affiliated entities, and if the "parent" entity is a corporation, the organization may provide in the operating agreement of a subsidiary limited liability company that the fiduciary duties of the company's managers or members are the same as those applicable to directors of an Arizona corporation, with same rights to indemnity, etc.

Within the limits of the other provisions of A.R.S. § 29-3105(C), the members are free to agree in the operating agreement to any fiduciary duties and thereby to supersede the default fiduciary duties of A.R.S. § 29-3409, and thus Subsection (E) is not strictly required in order to permit members to adopt the corporate standards. However, due to concerns regarding evidentiary presumptions under the business judgement rule, the drafting committee concluded that Subsection (E) was needed to make clear that the evidentiary presumptions of the business judgement rule are incorporated automatically if an operating agreement defines the duties of a manager to be the same as those of a corporate director. The business judgment rule, granting a presumption in favor of validating director action, is a distinguishing feature of corporate law relating to directors, and the rule is codified under Arizona corporate law in a strong statutory presumption in favor of all director action. Without Subsection (E), there could be some doubt as to whether an operating agreement can, without statutory authority, dictate the laws of evidence that would be applied by a court in deciding a case involving manager fiduciary duty. For example, if an operating agreement states that actions of a manager must be presumed valid absent clear and convincing evidence to the contrary, a judge might be reluctant to apply this contractually imposed evidentiary rule without some authority in the statute to do so. Accordingly, Subsection (E) creates this statutory authority, and was added to fulfill the intent of members who elect to replicate by contract in an operating agreement the corporate director standard of conduct for managers and members.

Note that to the extent case law regarding the fiduciary duties of directors differs from case law

on the fiduciary duties of managers and members, and as those two bodies of case law develop in the future, it is possible that there may be uncertainty in translating director duties to duties of managers and members.

If the operating agreement modifies any default rules governing the duties of managers or members, the other provisions of the operating agreement should be consistent with those changes. Particular attention should be paid to the provisions relating to authorizing or ratifying a transaction that would violate such duties, reimbursing a manager or member for his or her expenses, and indemnifying or exculpating a manager or member against liability.

Modified RULLCA Comment
(Rev. 2/23/2024)

Principal Provisions of the Act Concerning the Operating Agreement

The operating agreement is pivotal to a limited liability company, and Sections ~~105~~29-3105 through ~~107~~29-3107 are pivotal to this act. They must be read together, along with Section ~~102(13~~29-3102(17) (defining the operating agreement).

This section performs five essential functions. Subsection (~~a~~A) establishes the primacy of the operating agreement in establishing relations *inter se* the limited liability company, its member or members, and any manager. Subsection (~~b~~B) recognizes this act as comprising mostly default rules— *i.e.,* gap fillers for issues as to which the operating agreement provides no rule. Subsection (~~c~~C) lists the few mandatory provisions of the act. ~~Subsection (d) lists~~Subsections (D) and (E) specifically authorize and clarify some provisions frequently found in operating agreements~~, authorizing some unconditionally and others so long as "not manifestly unreasonable." Subsection (e) delineates in detail both the meaning of "not manifestly unreasonable" and the information relevant to a determining a claim that a provision of an operating agreement is manifestly unreasonable.~~.

Section ~~106~~29-3106 details the effect of an operating agreement on the limited liability company and on persons becoming members of an LLC. Section ~~107~~29-3107 concerns the effect of an operating agreement on third parties.

Role and Inevitability of Operating Agreement

A limited liability company is as much a creature of contract as of statute, *TravelCenters of Am., L.L.C. v. Brog*, CIV.A. 3516-CC, 2008 WL 1746987, at *1 (Del. Ch. Apr. 3, 2008) (stating that "limited liability companies are creatures of contract"); *Gottsacker v. Monnier*, 281 Wis. 2d 361, 370, 697 N.W.2d 436, 440 (2005) (stating that "from the partnership form, the LLC borrows . . . internal governance by contract"), and Section ~~102(13~~29-3102(17) delineates a very broad scope for "operating agreement." As a result, once an LLC comes into existence and has a member, the LLC necessarily has an operating agreement. *See* the comment to Section ~~102(13~~29-3102(17). Accordingly, this act refers to "the operating agreement" rather than "an operating agreement." This phrasing should not, however, be read to require a limited liability company or its members to take any formal action to adopt an operating agreement.

The operating agreement is the exclusive consensual process for modifying this act's various default rules pertaining to relationships *inter se* the members and between the members and the limited liability company. Section ~~105(b~~29-3105(A)(1)(a). The operating agreement also has power over "the rights and duties under this [act] of a person in the capacity of manager," Subsection (~~a)(2~~A)(1)(b), and "the obligations of a limited liability company and its members to a person in the person's capacity as a transferee or person dissociated as a member," Section ~~107(b~~29-3107(B). For the relationship between the

operating agreement and ~~certificate~~articles of ~~formation~~organization, *see* Section ~~107(d~~29-3107(D).

The Operating Agreement and the Fiduciary and Other Duties of Those Who Manage

One of the most complex questions in the law of unincorporated business organizations is the extent to which an agreement among the organization's owners can affect the fiduciary and other duties of those who manage the organization (*e.g.,* members in a member-managed LLC; managers in a manager-managed LLC). ~~As explained in detail in the comment to Subsection (d)(3), this act rejects the notion that a contract can completely transform an inherently fiduciary relationship into a merely arm's length association. Within that limitation, however, this~~This section provides substantial power to the operating agreement to reshape, limit, and eliminate fiduciary and other managerial duties.

Subsection (~~a~~A) recognizes that the operating agreement is the map to the parties' deal and that any claim by a member of managerial misconduct must be assessed first under the relevant terms of the operating agreement. Subsection (~~d~~D) specifically validates arrangements commonly used to reshape managerial duties and limit the consequences of breaching those duties. Subsection (~~c~~C) contains relevant limitations, but those limitations: (i) must be read together with subsection (~~d~~D); and (ii) do not preclude the operating agreement fundamentally redesigning the duties applicable to those who manage the organization. For the act's design of those duties, *see* Sections ~~409~~29-3409 and ~~410~~29-3410.

Subsection (~~a~~A)—This section describes the very broad scope of a limited liability company's operating agreement, which includes all matters constituting "internal affairs." *Compare* Subsection (~~a~~A), *with* Section ~~104~~29-3104(1) (using the phrase "internal affairs" in stating a choice of law rule). This broad grant of authority is subject to the restrictions stated in Subsection (~~c~~C), including the broad restriction stated in Paragraph (~~c)(15~~C)(12) (concerning the rights of third parties under this act).

Subsection (~~a~~A)(1)(a)—This paragraph encompasses all the rights and duties of each member, including rights and duties pertaining to transactions under Article 10.

Subsection (~~a)(2~~A)(1)(b)—Under this paragraph, the operating agreement has the power to affect the rights and duties of managers (including non-member managers). Because the term "[o]perating agreement . . . includes the agreement as amended or restated," Section ~~102(13~~29-3102(17), this paragraph gives the members the ongoing power to define the role of an LLC's managers. Power is not the same as right, however, and exercising the power provided by this paragraph might constitute a breach of a separate contract between the LLC and the manager. A non-member manager might also have rights under Section ~~107(a~~29-3107(A).

Subsection (~~a)(4~~A)(1)(c)—Under this provision, the operating agreement can control both the quantum of consent required (*e.g.,* majority of members) and the means by which the consent is manifested (*e.g.*, prohibiting modifications except when consented to in writing). *See* the comment to Section ~~107(a~~29-3107(A).

If the operating agreement does not address the issue, this act provides the rule. ~~Section 407(b)(4)(C) and 407(c)(3)(C) each require the affirmative vote or consent of all the members.~~ Under Section ~~111~~29-3111 (supplemental principles of law), the parol evidence rule will apply to a written operating agreement when appropriate under contract law.

Subsection (~~b~~B)—To the extent the operating agreement does not determine an *inter se* matter, this act determines the matter. The operating agreement may vary any provision of this act pertaining to *inter se* matters, except as provided in ~~Subsections (c) and (d~~Subsection (C).

Sometimes—but not always—the Comments to this act refer to a variable provision as a "default rule" and a non-waivable provision as "mandatory." These references are merely to draw attention to the default/mandatory distinction in particular contexts and have neither the intent nor the power to affect the default/mandatory status of provisions of this act whose comments lack a comparable reference.

Subsection (~~c~~C)—This subsection lists provisions of ~~this act~~the Act whose respective effects cannot be varied or may be varied subject to a stated limitation. For historical reasons, this subsection uses the words "vary" and "alter" interchangeably. No difference in meaning is intended.

If a person claims that a term of the operating agreement violates this subsection, as a matter of ordinary procedural law the burden of proof is on the person making the claim.

Subsection (~~c~~C)(1)—Section ~~104~~29-3104 states that ~~this act~~the Act provides the law applicable to: (i) the internal affairs of an LLC formed under ~~this act~~the Act; and (ii) the liability of members and managers for obligations of the LLC. The organizers of an LLC make this choice of law by choosing to form an LLC under ~~this act~~the Act. Domestication to another jurisdiction will re-set the choice of law, ~~*see* Sections 1051–56,~~ but the operating agreement cannot*, see* the comment to Section ~~104~~29-3104(1).

Subsection (~~c~~C) contains no parallel prohibition on varying Section ~~901~~29-3901 (stating the governing law for foreign limited liability companies), because a prohibition is unnecessary. As a matter of fundamental contract law, an agreement among members of one limited liability company is powerless to govern the affairs of another limited liability company.

Subsection (~~c~~C)(2)—Under ~~this act~~the Act, a limited liability company is emphatically an entity, and the members lack the power to alter that characteristic.

Subsection (~~c~~C)(3)—This prohibition is arguably implicit in Subsection (~~c)(15~~C)(12) (affecting rights of third parties under this act) but is specifically noted to avoid doubt.

Subsection (~~c~~C)(4)—This provision means that the operating agreement cannot affect the right of an "aggrieved" person to seek the court's help when "a person required by this [act] to sign a record or deliver a record to the ~~[Secretary of State]~~Commission for filing under this ~~[act]~~chapter does not do so." Section ~~204(a~~29-3204(A).

~~**Subsection (c)(5)**—This limitation is less powerful than might first appear, because Subsection (d) specifically authorizes substantial alterations to the duties of loyalty and care, including restricting and substantially eliminating those duties~~.

Subsection (~~c~~C)(~~6~~5)—Section 409(~~d~~D) refers to the "contractual obligation of good faith and fair dealing," which contract law implies in every contract. The operating agreement cannot eliminate this obligation, neither in whole (i.e., generally) nor in part (i.e., as applicable to specified situations). The following examples illustrate conduct that may be undertaken consistent with the contractual obligation of good faith and fair dealing.

~~However, an operating agreement may "prescribe the standards . . . by which the performance of the obligation is to be measured."~~

> EXAMPLE: The operating agreement of a manager-managed LLC gives the manager the discretion to cause the LLC to enter into contracts with affiliates of the manager (so-called "Conflict Transactions"). The agreement further provides: "When causing the Company to enter into a Conflict Transaction, the manager complies with Section 409(d) of [this act] if a

disinterested person, knowledgeable in the subject matter, states in writing that the terms and conditions of the Conflict Transaction are equivalent to the terms and conditions that would be agreed to by persons at arm's length in comparable circumstances." ~~This provision "prescribe[s] the standards by which the performance of the [Section 409(d)] obligation is to be measured."~~

EXAMPLE: Same facts as the previous example, except that, during the performance of a Conflict Transaction, the manager causes the LLC to waive material protections under the applicable contract. The standard stated in the previous example is inapposite to this conduct. Section 409(~~d~~D) therefore applies to the conduct without any direct contractual delineation. (However, other terms of the agreement may be relevant to determining whether the conduct violates Section 409(~~d~~D). *See* the comment to Section 409(~~d~~D).)

EXAMPLE: The operating agreement of a manager-managed LLC gives the manager "sole discretion" to make various decisions. The agreement further provides: "Whenever this agreement requires or permits a manager to make a decision that has the potential to benefit one class of members to the detriment of another class, the manager complies with Section 409(d) of [this act] if the manager makes the decision with:

a. the honest belief that the decision:
    i. serves the best interests of the LLC; or
    ii. at least does not injure or otherwise disserve those interests; and
b. the reasonable belief that the decision breaches no member's rights under this agreement."

~~This provision "prescribe[s] the standards by which the performance of the [Section 409(d)] obligation is to be measured." *Compare* Section 105(c)(6), *with Nemec v. Shrader*, 991 A.2d 1120 (Del. 2010) (considering such a situation in the context of the right to call preferred stock and deciding by a 3-2 vote that exercising the call did not breach the implied covenant of good faith and fair dealing).~~

~~An operating agreement that seeks to prescribe standards for measuring the contractual obligation of good faith and fair dealing under Section 409(d) should expressly refer to the obligation. *See Gerber v. Enter. Prods. Hldgs., L.L.C.*, 67 A.3d 400, 418 (Del. 2013) (distinguishing between the implied contractual covenant and an express contractual obligation of "good faith" as stated in a limited partnership agreement).~~

For an explanation of the function and role of the covenant of good faith and fair dealing, see Section ~~409(d), comment. For the rules delimiting the "not manifestly unreasonable" requirement, see Subsection (e).~~29-3409(D), comment.

Subsection<u>s</u> (~~e~~C)(5~~7~~) <u>and (C)(6)</u>—These restrictions are ubiquitous in the law of business entities and, in conjunction with other provisions of this section, control the otherwise very broad power of an operating agreement to affect fiduciary and other duties. The restrictions are central to the raft of exculpatory provisions that sprung up in corporate statutes in response to *Smith v. Van Gorkum*, 488 A.2d 858 (Del. 1985), *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009). Delaware led the response with DEL. CODE ANN. tit. 8, § 102(b)(7), and a number of LLC statutes have similar provisions. *E.g.*, GA. CODE ANN. § 14-11-305(4)(A) (2011). For an extreme example, *see* VA. CODE ANN. § 13.1-1025 (B) (2012). In this context, "conduct" includes both acts and omissions. BLACK'S LAW DICTIONARY (9th ed. 2009) (defining conduct as "[p]ersonal behavior, whether by action or inaction").

~~The term "bad faith" has multiple meanings, and the context determines which meaning applies. In the context of the duty of loyalty, "bad faith" includes conduct motivated by ill will or other intent purposely to harm another person. The concept also includes conduct from which a person derives an~~

~~improper personal benefit. *See, e.g., Mroz v. Hoaloha Na Eha, Inc.*, 410 F. Supp. 2d 919, 936–37 (D. Haw. 2005) (denying a motion to dismiss a claim that "the Majority Partners" were personally liable for the partnership's wrongful termination of the plaintiff; quoting the complaint as alleging that "the Majority Partners, individually and as a group, acted with malice and/or ill will, and/or with an intent to serve their own personal interests and/or without an intent to serve company interests, and/or outside of the scope of their authority and/or without justification"); *BOGNC, L.L.C. v. Cornelius NC Self Storage L.L.C.*, 10 CVS 19072, 2013 WL 1867065, at *9 (N.C. Super. [Business Court] May 1, 2013) (noting that "no . . . [exculpatory] provision may limit a manager's liability for acts known to be in conflict with the interests of the limited liability company, or for acts from which the manager derived an improper personal benefit") (citing N.C. GEN. STAT. § 57C–3–32(b)); *Lasica v. Savers Grp. of Minn., L.L.C.*, A12-0092, 2012 WL 3553246, at *2 (Minn. Ct. App. Aug. 20, 2012) (noting that an "individual seeking indemnification [under statute providing for indemnification)] must have acted in good faith and must not have received an improper personal benefit") (citing MINN. STAT. § 322B.699, subdivs. 2(a)(2), (3) (2010)).~~

~~In the context of the duty of care, the concept of bad faith comes primarily from corporate law and means an extreme breach of the duty (*i.e.*, "the failure to exercise "*honest judgment* in the lawful and legitimate furtherance of corporate purposes." *Deblinger v. Sani-Pine Products Co., Inc.*, 107 A.D.3d 659, 661, 967 N.Y.S.2d 394 (2013) (quoting Auerbach v. Bennett, 47 N.Y.2d 619, 629, 393 N.E.2d 994 (1979) (emphasis added) (internal quotation marks omitted).~~

~~Thus, when a plaintiff alleges bad faith as pertaining to the duty of care, "[t]he burden . . . is to show irrationality: a plaintiff must demonstrate that no reasonable business person could possibly authorize the action in good faith. Put positively, the decision must go so far beyond the bounds of reasonable business judgment that its only explanation is bad faith." *In re Tower Air, Inc.*, 416 F.3d 229, 238 (3d Cir. 2005) (discussing then prevailing Delaware law) (citation omited); *see also KDW Restructuring & Liquidation Servs. LLC v. Greenfield*, 874 F. Supp. 2d 213, 226 (S.D.N.Y. 2012) (referring to a lack of "a rationale corporate purpose" and "a disregard for the duty to examine all available information—*information that was readily at hand*") (emphasis added).~~
~~With regard to both the duty of loyalty and the duty of care, "bad faith" is entirely distinct from the meaning of "good faith" in the contractual covenant of good faith and fair dealing~~. ~~*See* the comment to Section 409(d).~~
Subsection (~~e)(7) pertains to indirect as well as direct efforts to "relieve or exonerate" and thus~~D)(2) limits how far an operating agreement can go in providing for indemnification. *See* Section ~~408(b~~29-3408(B) (stating a default rule for indemnification).~~Also, in accordance with this paragraph, an exculpatory provision cannot shield against a member's claim of oppression. *See* Section 701(a)(4)(C).~~

Although this paragraph does not expressly address contracts between an LLC and a member or manager, the stated constraints must also apply to such contracts. If not, those constraints are effectively meaningless.

> EXAMPLE: A manager-managed LLC enters into a management contract with its sole manager, and the contract provides the manager exoneration for liability to the LLC even for willful and intentional misconduct. Most likely, contract law will treat the provision as against public policy and therefore unenforceable. RESTATEMENT (SECOND) OF CONTRACTS § 195(1) (1981) ("A term exempting a party from tort liability for harm caused intentionally or recklessly is unenforceable on grounds of public policy."). If not, a court should hold the provision unenforceable to avoid evisceration of Subsection (~~e)(7~~C)(6). (Or, the court could invoke the policy expressed in Subsection (~~e)(7~~C)(6) as grounds for holding the provision unenforceable under contract law.)

Subsection (~~e~~C)(~~8~~7)—Although phrased as a restriction, this provision grants substantial power

to the operating agreement.

> EXAMPLE: A law firm operates as a limited liability company, and the operating agreement provides that a "Compensation Committee" periodically decides each member's compensation. The agreement also states that only members who are on the Compensation Committee may have access to the Committee's compensation decisions pertaining to other members. This restriction is reasonable.

The act also empowers the LLC "as a matter within the ordinary course of its activities and affairs [to] impose reasonable restrictions and conditions on access to and use of information" obtained under Section ~~410~~29-3410. *See* Section ~~410(h~~29-3410(K).

In determining whether a restriction is reasonable, a court might consider: (i) the danger or other problem the restriction seeks to avoid; (ii) the purpose for which the information is sought; and (iii) whether, in light of both the problem and the purpose, the restriction is reasonably tailored. In addition, a restriction that is reasonable viz-a-viz a non-managing member in a manager-managed LLC ~~-~~might be unreasonable viz-a-viz a managing member or in the context of a member-managed LLC.

Subsection (~~c~~C)(~~9~~8)—The operating agreement may not change one of the stated grounds for judicial dissolution ~~but may determine~~(it is "not reasonably practicable to carry on the ~~forum in which a claim for dissolution under Section 701(a)(4) is determined. For example, arbitration~~company's activities and ~~forum selection clauses are commonplace in business relationships in general~~affairs in conformity with" its articles and ~~in~~ operating ~~agreements in particular.~~agreement).

~~The approach of this paragraph differs from the law of Delaware. *Huatuco v. Satellite Healthcare*, CV 8465-VCG, 2013 WL 6460898, at *1, n.2 (Del. Ch. Dec. 9, 2013) (stating that "the right to judicial dissolution is a default right which the parties may eschew by contract" but reserving the question of "[w]hether the parties may, by contract, divest this Court of its authority to order a dissolution in all circumstances, even where it appears manifest that equity so requires—leaving, for instance, irreconcilable members locked away together forever like some alternative entity version of Sartre's *Huis Clos*").~~

~~**Subsection (c)(10)**—The cited provisions comprise the non-waivable aspects of winding up a dissolved limited liability company. The other provisions of Section 702 are default rules.~~

Subsection (~~c~~C)(~~11~~9)—Article 8 delineates a member's rights to bring direct and derivative actions. It would be unreasonable to frustrate these rights but not unreasonable to channel their exercise. For example, the operating agreement might select a forum, require pre-suit mediation, provide for arbitration of both direct and derivative claims, or override Section ~~802~~29-3802 and require "universal demand" in all derivative cases. Similarly, it is not unreasonable to provide for liquidated damages consonant with the law of contracts. In contrast, it would be unreasonable for an operating agreement to both: (i) require a would-be derivative plaintiff to make demand regardless of futility; and (ii) bar taking the claim to court no matter how long the management group ponders the demand.

Subsection (~~c~~C)(1~~2~~0)—An operating agreement may not alter the act's rules for a special litigation committee but may preclude entirely the use of such a committee.

~~**Subsection (c)(13)**—Section 1023(a)(1), 1033(a)(1), 1043(a)(1), and 1053(a)(1) each requires the consent or the affirmative vote of all members. The operating agreement may modify these requirements. In contrast, under the sections stated in this subsection:~~

- ~~each member is protected from being merged, exchanged, converted, or domesticated "into" the status of a partner in a general partnership that is not a limited liability partnership (or a comparable "unshielded" position in some other organization) without the member having *directly* consented to either:~~
    - ~~the merger, interest exchange, conversion, or domestication; or~~
    - ~~an operating agreement provision that permits such transactions to occur with less than unanimous consent of the members; and~~
- ~~merely consenting to an operating agreement provision that permits amendment of the agreement with less than unanimous consent of the members does not qualify as the requisite direct consent.~~

Subsection (~~e~~C)(11~~4~~)—Because these plans are the basic "deal documents" for each of the organic transactions contemplated in Article 10, the operating agreement may not vary the contents of these plans.

Subsection (~~e~~C)(12~~5~~)—This limitation pertains only to "the rights under this [act] of" third parties other than members and managers. Moreover, the limitation is subject to two substantial exceptions: Section ~~106~~29-3106 (pertaining to the operating agreement's relationship to the limited liability company itself and to persons becoming members) and Section ~~107(b~~29-3107(B) (pertaining to the operating agreement's power over the rights of transferees).

~~**Subsection (d)**—The operating agreement has plenipotentiary power over the matters described in Subsection (a), except as specifically limited by Subsections (c) and (d)(3). However, for the convenience of practitioners and the courts. Paragraphs 1 and 2 list various terms often found in operating agreements. No negative inference should be drawn about terms not listed; the listing is provided "without limiting other terms that may be included in an operating agreement."~~

~~Paragraph 3 lists terms subject to the "not manifestly unreasonable" standard. Subsection (e) delineates that standard. The same standard applies to terms of an operating agreement which seek to "prescribe the standards . . . by which the performance of the [Section 409(d)] obligation [of good faith and fair dealing] is to be measured." Subsection (c)(6).~~

~~**Subsection (d)(1)(A)**—An arrangement *not* involving "one or more disinterested and independent persons" acting "after full disclosure of all material facts" would "alter . . . the aspects of the duty of loyalty stated in Section 409(b) and (i)" and would therefore be subject to the "not manifestly unreasonable standard" of Subsection (d)(3)(A).~~

~~For the meaning of "material" as applied to information, see Section 409(f), comment.~~

~~**Subsection (d)(1)(B)**—Section 405(a)(2) prohibits distributions:~~
- ~~*not merely* when, after the distribution, "the company's total assets would be less than the sum of its total liabilities,"~~
- ~~*but also* when, after the distribution, the assets would less than the total liabilities "plus the amount that would be needed, if the company were to be dissolved and wound up at the time of the distribution, to satisfy the preferential rights upon dissolution and winding up of members and transferees whose preferential rights are superior to those of persons receiving the distribution."~~

~~The second part of the solvency test pertains to preferential rights to distributions, is thus a matter *inter se* the members and any transferees, and is therefore subject to change in the operating agreement.~~

~~In contrast, the first part of the solvency test protects third parties—creditors of the LLC—and~~

therefore cannot be changed by the operating agreement. Subsection (c)(15). Likewise, the operating agreement cannot change the solvency test stated in Section 405(a)(1) (providing that "the company would not be able to pay its debts as they become due in the ordinary course of the company's activities and affairs").

Subsection (d)(2) – This provision is limited to member-managed limited liability companies on the premise that: (i) managers are collectively responsible; and (ii) managers may properly delegate a duty but the delegation does not discharge the duty. However, in a manager-managed LLC (as well as in a member-managed LLC), subject to Subsection (d)(3) the operating agreement may alter or even eliminate fiduciary duties.

> EXAMPLE: ABC LLC ("ABC") is a member-managed LLC. ABC has two entirely separate lines of business, the Alpha business and the Beta business. Under ABC's operating agreement:
>
> - Member 1's responsibilities pertain exclusively to the Alpha business, while responsibility for:
>   - the Beta business is allocated exclusively to Member 2; and
>   - ABC's overall operations is allocated exclusively to Member 3.
> - Member 2's responsibilities pertain exclusively to the Beta business, while responsibility for:
>   - the Alpha business is allocated exclusively to Member 1; and
>   - ABC's overall operations is allocated exclusively to Member 3.
> - Member 1 has no fiduciary duties pertaining to the Beta business.
> - Member 2 has no fiduciary duties pertaining to the Alpha business.
>
> The elimination of Member 1's fiduciary duties with regard to the Beta business and Member 2's fiduciary duties with regard to the Alpha business are enforceable, without regard to the "manifestly unreasonable" standard of Subsection (d)(3).

Subsection (d)(3) – This act rejects the ultra-contractarian notion that fiduciary duty within a business organization is merely a set of default rules and seeks instead to balance the virtues of "freedom of contract" against the dangers that inescapably exist when some persons have power over the interests of others. *Cf.* Leo E. Strine, Jr. J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, ELGAR HANDBOOK ON ALTERNATIVE ENTITIES (Eds. Mark Lowenstein and Robert Hillman), forthcoming 2014,, Edward Elgar Publishing 2014) (noting that an "argument often made in favor of [Delaware] alternative entity statutes is that they allow for the elimination of fiduciary duties and the establishment of a purely contractual relationship between entity managers and investors" and stating that "[a]s judges who have seen our fair share of alternative entity disputes, we do not immediately grasp why this would be seen as a compelling advantage"); available at SSRN: http://ssrn.com/abstract=2481039, at 9-10 (footnote omitted).

Under this act, a properly drafted operating agreement may substantially alter and even eliminate fiduciary duties. However, two important limitations exist.

First, arrangements subject to this subsection may not be "manifestly unreasonable." *See* Subsection (e) (delineating this standard).

Second, the operating agreement may not transform the relationship *inter se* members, managers, and the LLC into an entirely arm's length arrangement. For example, displacement of fiduciary duties is effective only to the extent that the displacement is stated clearly and with particularity. This rule is fundamental in the jurisprudence of fiduciary duty. *See, e.g.*, *Paige Capital Mgmt, L.L.C. v. Lerner*

Master Fund, L.L.C., Civ. A. No. 5502-CS, 2011 WL 3505355, at *31 (Del. Ch. Aug. 8, 2011) (Del. Ch. 2011) (stating that, even under a statute that "permits the waiver of fiduciary duties . . . such waivers must be set forth clearly"); *Kelly v. Blum*, Civ. A. No. 4516-VCP, 2010 WL 629850, at *10, n.70 (Del. Ch. Feb. 24, 2010) ("Having been granted great contractual freedom by the LLC Act, drafters of or parties to an LLC agreement should be expected to provide . . . clear and unambiguous provisions when they desire to expand, restrict or eliminate the operation of traditional fiduciary duties"). It would therefore be manifestly unreasonable for an operating agreement to negate this rule.

Although Subsection (d)(3) does not expressly address contracts between an LLC and a member or manager, the stated constraints must also apply to such contracts. If not, those constraints are effectively meaningless.

> EXAMPLE: A manager-managed LLC enters into a management contract with its sole manager, and the contract provides that the duties of loyalty stated in Section 409(b) and (i) are entirely eliminated. If the operating agreement were to so provide, the provision would be subject to the "manifestly unreasonable standard." Section 105(d)(3)(A). Absent the authorization provided by Section 105(d)(3)(A), the management contract's attempt to waive fiduciary duties may be unenforceable as a matter of public policy and contract law. *See Neubauer v. Goldfarb*, 108 Cal. App. 4th 47, 57, 133 Cal. Rptr. 2d 218 (2003) (stating that "waiver of corporate directors' and majority shareholders' fiduciary duties to minority shareholders in private close corporations is against public policy and a contract provision in a buy-sell agreement purporting to effect such a waiver is void"). If not, a court should hold the provision unenforceable nonetheless so as to avoid eviscerating Subsection (d)(3).

Subsection (d)(3)(A) – Subject to the "not manifestly unreasonable" standard, this paragraph empowers the operating agreement to eliminate *all* aspects of the duty of loyalty listed in Section 409(b). The obligation of good faith and fair dealing, Section 409(d), would remain. See Subsection (c)(6). As to any other, uncodified aspects of the duty of loyalty, see Subsection (d)(3)(D) (empowering the operating agreement to "alter or eliminate any other fiduciary duty").

> EXAMPLE: Joint Venture LLC ("JV") is a manager-managed limited liability company, with two members, Kappa, Inc. ("Kappa") and Lambda, LLC ("Lambda"). The operating agreement provides that:
>
> - JV is managed by a "board of managers" consisting of one person appointed by Kappa and one person appointed by Lambda;
> - each appointee:
>   - owes fiduciary and any other duties exclusively to the member that made the appointment; and
>   - owes no duties to the other member and the limited liability company.
>
> The "not manifestly unreasonable" standard applies to these provisions under Subsection (d)(3)(A) and (D), and the provisions are not manifestly unreasonable. Note that the provisions do not affect the duties of Kappa and Lambda to:
>
> - the limited liability company, under applicable case law (pertaining to the obligations of owners of an entity who control the entity indirectly); and
> - each other, under applicable case law and Section 701(a)(4)(C)(ii) (providing for judicial dissolution when "the managers or those members in control of the company . . . have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the [member seeking dissolution").
>
> EXAMPLE: ABC LLC ("ABC") is a manager-managed limited liability company with three

managers and two entirely separate lines of business, the Alpha business and the Beta business. Under ABC's operating agreement:

- Manager 1's responsibilities pertain exclusively to the Alpha business; responsibility for:
    - the Beta business is allocated exclusively to Manager 2; and
    - ABC's overall operations is allocated exclusively to Manager 3.
- Manager 2's responsibilities pertain exclusively to the Beta business; responsibility for:
    - the Alpha business is allocated exclusively to Manager 1; and
    - ABC's overall operations is allocated exclusively to Manager 3.
- Manager 1 has no fiduciary duties pertaining to the Beta business.
- Manager 2 has no fiduciary duties pertaining to the Alpha business.

The "not manifestly unreasonable" standard applies to these provisions under Subsection (d)(3)(A) and (D), and the provisions are not manifestly unreasonable.

Subsection (d)(3)(B) Under this paragraph, an operating agreement might provide that an affiliate of a manager of a manager-managed LLC will provide compensated services to the LLC at a price not exceeding market price, or that the manager may pursue opportunities that otherwise would be company opportunities. Such arrangements are commonplace and permissible.

Subsection (d)(3)(C) In this context, "conduct" includes both acts and omissions. BLACK'S LAW DICTIONARY (9th ed. 2009) (defining conduct as "[p]ersonal behavior, whether by action or inaction"). Subject to the "not manifestly unreasonable" standard and the bedrock requirements stated here and in Subsection (c)(7), the operating agreement can reduce the duty of care substantially. In particular, the operating agreement can eliminate the aspects of the duty of care pertaining to gross negligence and recklessness.

This provision replicates in a particular context the general rule stated in Subsection (c)(7). For the meaning of "bad faith" in the context of the duty of care, see Subsection (c)(7), comment.

Subsection (e) The "not manifestly unreasonable" concept became part of uniform business entity statutes when UPA (1997) imported the concept from the Uniform Commercial Code. (In the current version of the Uniform Commercial Code, the concept appears in Section 1-302(b).)

This subsection provides rules for applying the concept, specifying:

- who decides the issue of "manifestly unreasonable"
    - "the court . . . as a matter of law," Subsection (e);
- the framework for determining the issue
    - determination to be made "in light of the purposes, activities, and affairs of the limited liability company," Subsection (e)(2);
- the temporal setting for determining the issue
    - "determination [to be made] as of the time the challenged term became part of the operating agreement," Subsection (e)(1); and
- what information is admissible for determining the issue
    - "only circumstances existing" when "the challenged term became part of the operating agreement," Subsection (e)(1).

The subsection also provides a very demanding standard for persons claiming that a term of an operating agreement is "manifestly unreasonable." "The court . . . may invalidate the term only if, in light of the purposes, activities, and affairs of the limited liability company, it is *readily apparent* that: (A) the

objective of the term is unreasonable; or (B) the term is an unreasonable means to achieve the term's objective." Subsection (e)(2) (emphasis added).

Subsection (e) is fundamental to this act, because: (i) this act generally defers to the agreement among the members; and (ii) Subsection (e) safeguards the operating agreement in at least four ways:

- Determining manifest unreasonableness *inter se* owners of an organization is a different task than doing so in a commercial context, where concepts like "usages of trade" are available to inform the analysis. Each business organization must be understood in its own terms and context.
- If loosely applied, the concept of "manifestly unreasonable" would permit a court to rewrite the members' agreement, which would destroy the balance this act seeks to establish between freedom of contract and fiduciary duty.
- Case law has not adequately delineated the concept. *See, e.g.*, *In re Brobeck, Phleger & Harrison L.L.P.*, 408 B.R. 318, 335 (Bankr. N.D. Cal. 2009) ("RUPA [UPA (1997)] does not define what is 'manifestly unreasonable' and the parties have not cited, nor can the court locate, a decision that defines the term. Absent case law or even a dictionary definition, the court must rely on its common sense to recognize something as manifestly unreasonable.").
- In the context of statutes permitting stock transfer restrictions unless "manifestly unreasonable," courts have often ignored the word "manifestly." *See, e.g.*, *Brandt v. Somerville*, 692 N.W.2d 144, 152 (N.D. 2005) (stating that "in close corporations, a majority of courts have sustained restrictions that are determined to be reasonable in light of the relevant circumstances"); *Roof Depot, Inc. v. Ohman*, 638 N.W.2d 782, 786 (Minn. Ct. App. 2002) (stating that "the restrictions [on share transfer] are not 'manifestly unreasonable' because they are reasonable means to ensure that the management and control of the business remains in the group of investors or with people well known to them"); *Castriota v. Castriota*, 633 A.2d 1024, 1027–28 (App. Div. 1993) ("We are obliged to apply the statute in a manner consonant with its essential purpose to permit reasonable restrictions upon alienation.").

Subsection (e)(1) – The significance of the phrase "as of the time the term as challenged became part of the operating agreement" is best shown by example.

EXAMPLE: When a particular manager-managed LLC comes into existence, its business plan is quite unusual and its success depends on the willingness of a particular individual to serve as the LLC's sole manager. This individual has a rare combination of skills, experiences, and contacts, which are particularly appropriate for the LLC's start-up. In order to induce the individual to accept the position of sole manager, the members are willing to have the operating agreement significantly limit the manager's fiduciary duties. Several years later, when the LLC's operations have turned prosaic and the manager's talents and background are not nearly so crucial, a member challenges the fiduciary duty limitations as manifestly unreasonable. The relevant time under Subsection (e)(1) is when the LLC began. Subsequent developments are not relevant, except as they might inferentially bear on the circumstances in existence at the relevant time.

EXAMPLE: As initially adopted, an operating agreement identifies a category of decisions ordinarily subject to the duty of loyalty and provides that "the manager's sole, reasonable discretion" satisfies the duty. A year later, the agreement is amended to delete the word "reasonable." Later, a member claims that, without the word "reasonable," the provision is manifestly unreasonable. The relevant time under Subsection (e)(1) is when the agreement was amended, not when the agreement was initially adopted.

Subsection (e)(2) – If a person claims that a term of the operating agreement is manifestly

~~unreasonable under Subsections (c)(6) or (d)(3), as a matter of ordinary procedural law the person making the claim has the burden of proof.~~

A.R.S. § 29-3106. OPERATING AGREEMENTS; EFFECT ON LIMITED LIABILITY COMPANY AND PERSONS BECOMING MEMBERS; PREFORMATION AGREEMENTS.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 106.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (A~~a~~)—This subsection resolves twin questions that have troubled some courts – namely, whether an unincorporated entity that has not signed its foundational agreement nonetheless is bound by and may enforce the agreement. The questions have been particularly troubling in the context of agreements to arbitrate. *See, e.g., Elkjer v. Scheef & Stone, L.L.P.*, 3:13-CV-1655-K, --- F. Supp.2d ----, 2014 WL 1255844 at *5-6 (N.D. Tex. Mar. 27, 2014) (concluding that a limited liability partnership "is a party to the Partnership Agreement," even though the partnership itself never signed or otherwise assented to the agreement; enforcing arbitration provision to the benefit of the LLP). *Contra Trover v. 419 OCR, Inc.*, 397 Ill. App. 3d 403, 409, 921 N.E.2d 1249, 1255 (2010) (finding that "neither FODG [an LLC] nor the Golf Club [a related LLC] was a party to the operating agreements and that they are therefore not bound by the arbitration clauses therein").

Developments pertaining to the Virginia LLC Act further illustrate the difficulties. In *Mission Residential, L.L.C. v. Triple Net Properties, L.L.C.*, 654 S.E.2d 888, 891 (2008), the Virginia Supreme Court held that a member's derivative claim was not subject to the arbitration provision in the operating agreement, because: (i) the LLC was "the real party in interest"; (ii) the LLC had not signed the operating agreement; and (iii) requiring the claim to be arbitrated would "ignore[] the separate existence of Holdings [the LLC]." The Virginia legislature promptly disagreed and amended the LLC act to state: "A limited liability company is bound by its operating agreement whether or not the limited liability company executes the operating agreement." VA. CODE ANN. § 13.1–1023.A.1 (2012). The legislature left open the question of a limited liability company's power to enforce an operating agreement that the company has not executed.

This subsection answers the twin questions, categorically and in the affirmative.

This subsection does not consider whether a limited liability company is an indispensable party to a suit concerning the operating agreement. That question is one of procedural law, and the answer can determine whether federal diversity jurisdiction exists.

Subsection (B~~b~~)—Given the possibility of oral and implied-in-fact terms in the operating agreement, a person becoming a member of an existing limited liability company should take precautions to ascertain fully the contents of the operating agreement. *See* the comment to Section 29-3105(A~~a~~)(14)(c).

Subsection (C~~c~~)—The second sentence refers to "assent to terms" rather than "make an agreement" because, under venerable principles of contract law, an agreement presupposes at least two parties, and Section 29-3102(17~~13~~) specifically contemplates an operating agreement in a single member LLC.

A pre-formation arrangement is not an operating agreement. An operating agreement presupposes at least one member, and, under this act, the earliest a person can become a member is upon the formation of the limited liability company. *See* Section 29-3401.

A.R.S. § 29-3107. OPERATING AGREEMENT; AMENDMENT; EFFECT ON THIRD PARTIES AND RELATIONSHIP TO RECORDS ON BEHALF OF LIMITED LIABILITY COMPANY.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 107 with two exceptions. First, the reference to a court order under RULLCA § 503 was excluded from this section because A.R.S. § 29-3503 (the corresponding section of the Act) does not incorporate RULLCA's authorization of judicial orders to effectuate the collection of distributions pursuant to a charging order.

The second departure from RULLCA § 107 relates to subsection (B), which allows the members to amend the operating agreement in a manner that alters their (or the company's) obligations and liabilities to a transferee or a previously dissociated member. While the members should have the ability to amend the operating agreement from time to time without always having to obtain the consent of a transferee or a dissociated member, the Drafting Subcommittee was concerned that future amendments might be abused to eliminate or diminish unfairly a transferee's future distributions or the fiduciary duties or other obligations owed by members and the company to transferees or dissociated members. Accordingly, this section adds a restriction, not found in RULLCA § 107, that any such amendment must not violate the members' and managers' contractual obligations of good faith and fair dealing under subsections (D) and (L) of A.R.S. § 29-3409. *See* the Modified RULLCA Comment to A.R.S. § 29-3409 for an explanation of how the contractual obligation of good faith and fair dealing differs from the duty of good faith in the corporate or other contexts.

The requirement that members must act in accordance with their contractual obligations of good faith and fair dealing when amending the operating agreement is supported by (i) the contractual nature of their relationship to each other and the company (as explained in the Modified RULLCA Comment to A.R.S § 29-3105) and (ii) the requirement that members exercise their rights and discharge their obligations under the Act and under the operating agreement consistently with their contractual obligations of good faith and fair dealing pursuant to A.R.S. § 29-3409(D). Although RULLCA's language in § 107(B), because of the failure to reference the contractual obligation of good faith and fair dealing might be interpreted to say that amendments to the operating agreement are outside the scope of the members' contractual obligations under RULLCA § 409(D),the Drafting Subcommittee's decision to add a reference to A.R.S. § 29-3409(D) in A.R.S. § 29-3107(B) leaves no doubt that, under the Act, a transferee may contest the effectiveness of an amendment that violates the contractual obligation of good faith and fair dealing.

Although subsection (B) is not identified in A.R.S. § 29-3105(C) as a mandatory, non-waiveable provision of the Act, subsection (C)(5) of A.R.S. § 29-3105 prohibits the elimination of the contractual obligation of good faith and fair dealing in the operating agreement. Accordingly, the operating agreement may not eliminate this contractual obligation in connection with any amendment to the operating agreement. In other respects, however, the remaining provisions of subsection (B) are default rules subject to variation in the operating agreement.

As described in the Arizona Comment to A.R.S. § 29-3502(B), the rights of transferees and dissociated members are extremely limited under the Act's default rules. For that reason, the members

may include in their operating agreement one or more protective rights for the benefit of their respective heirs and transferees. For example, the operating agreement may (i) obligate the company to dissolve and wind up its affairs on a specified date, (ii) extend the managers' and members' fiduciary duties to transferees, (iii) obligate the company to make minimum distributions to transferees, (iv) obligate the company to obtain a transferee's consent to the admission of a new member or the appointment of a new manager, or (v) obligate the company to provide the same information to transferees as to members. After a member dissociates or transfers his or her interest to a transferee, the remaining members might be tempted to amend the operating agreement to eliminate one or more of these protections. Subsection (B)(1) comes into play in these situations. It says that any such amendment will be effective if it does not violate the members' obligations of good faith and fair dealing. If the amendment violates the obligation, the amendment will not be effective.

The application of the contractual obligation of good faith and fair dealing depends upon the facts and circumstances of each case, including the motivation of the parties. The cost of litigating this issue can be significant and the outcome is often unpredictable. To avoid these costs and risks, the members may protect the rights of their heirs and transferees against the risks of subsequent amendments by requiring each transferee's consent as a condition of the effectiveness of any future amendment relating to specified rights of transferees. Any such transferee consent requirement will supersede the default rule in subsection (B)(1) regardless of whether the amendment violates the contractual obligation of good faith and fair dealing.

> EXAMPLE 1: The initial operating agreement of a limited liability company provides that the company must dissolve no later than a specified date, whereupon the members must cause the sale of the company's assets and wind up the company within a reasonable time. After the death and dissociation of one of the members, the remaining members amend the operating agreement to defer for two years the company's obligation to dissolve and wind up its affairs. The heirs and transferees of the deceased member are unhappy that their interests in the company will not be liquidated at the time specified in the initial operating agreement, but the issue of whether the amendment violates the contractual obligation of good faith and fair dealing is uncertain. However, if the initial operating agreement had provided that any amendment to defer the deadline for dissolution would be subject to transferee consent, such a provision would override the default rule under subsection (B)(1) without regard to the issue of good faith and fair dealing. Subsection (B)(2) is also a default rule. Accordingly, if the operating agreement expressly permits amendments that increase the obligations or liabilities of dissociated members and transferees, those amendments will be effective so long as they do not violate the contractual obligation of good faith and fair dealing.

> EXAMPLE 2: The initial operating agreement of a limited liability company provides that, if the company should require additional capital to accomplish its purpose, future additional contributions may be required from the members (and any transferees) in the amounts and at the times specified in a future amendment to be approved by all of the members, so long as the required contributions are proportionate to the members' and transferees' respective interests in the company. Absent evidence that the company does not actually need additional capital or that the members are motivated by a desire to eliminate the interest of a transferee or dissociated member in a manner not contemplated by the initial agreement, such an amendment is probably consistent with the contractual obligation of good faith and fair dealing and therefore (notwithstanding the default rule in subsection (B)(2)) is enforceable against a transferee and a dissociated member.

Under the common law of assignment of contract rights, it might be argued that the distribution rights of a transferee and a dissociated member (who has the rights of a transferee under A.R.S. § 29-

3603(A)(3)) are essentially the same as an assignee's rights to payment under a contract, and that an amendment to the operating agreement after notification to the company of a transferee's rights should not be effective to defend against the transferee's right to receive future distributions under the terms of the operating agreement in effect prior to the amendment. The Restatement of Contracts (Second) § 336(2) states that the right of an assignee is subject to any defense of an obligor (here, the limited liability company) that accrues before, but not after, the obligor has notice of the assignment, except "as provided by statute." Given this exception for contrary statutes, subsection (B)(1) probably displaces the common law governing the assignment of contract rights.

Modified RULLCA Comment

(Rev. 2/23/2024)

Subsection (A~~a~~)—This subsection, derived from DEL. CODE ANN. tit. 6, § 18-302(e), permits the operating agreement to: (i) accord a non-member veto rights over amendments to the agreement; and (ii) establish other preconditions for amendments. An amendment made in derogation of a veto right or precondition is ineffective.

Veto rights are likely to be sought by lenders but may also be attractive to non-member managers.

> EXAMPLE: A non-member manager enters into a management contract with an LLC, and that agreement provides in part that the LLC may remove the manager without cause only with the consent of members holding 2/3 of the profits interests. The operating agreement contains a parallel provision (the "operating agreement's quantum provision"), but the non-member manager is not a party to the operating agreement. Later, the LLC members amend the operating agreement's quantum provision to reduce the quantum to a simple majority of profits interests and thereafter purport to remove the manager without cause. Although the LLC has undoubtedly breached its contract with the manager and subjected itself to a damage claim, the LLC has the *power* under Section 29-3105(A~~a~~)(1~~2~~)(b) to effect the removal—unless the operating agreement provides the manager a veto right over changes in the operating agreement's quantum provision.

This subsection does not refer to member veto rights because, unless otherwise provided in the operating agreement, the consent of each member is necessary to effect an amendment. *See* Section 29-3407(B~~b~~)(4)(b~~B~~), (C~~c~~)(4~~3~~)(b~~B~~).

Because "[a]n operating agreement may specify that its amendment requires . . . the satisfaction of a condition," an operating agreement can require that any amendment be made through a writing or a record signed by each member. *See* Section 29-3105(A~~a~~)(14)(d) (empowering the operating agreement to determine "the means and conditions for amending the operating agreement").

Subsection (B~~b~~)—The law of unincorporated business organizations is only beginning to grapple in a modern way with the tension between the rights of an organization's owners to carry on their activities as they see fit (or have agreed) and the rights of transferees of the organization's economic interests. Such transferees can include the heirs of business founders as well as former owners who are "locked in" as transferees of their own interests. *See* Section 29-3603(A~~a~~)(3).

If the law categorically favors the owners, there is a serious risk of expropriation and other abuse. On the other hand, if the law grants former owners and other transferees the right to seek judicial protection, that specter can "freeze the deal" as of the moment an owner leaves the enterprise or a third party obtains an economic interest.

There is little case law in this area, and almost all of it pertains to limited partnerships rather than

LLCs. The partnership case law clearly favors the remaining owners over former owners and other transferees. *See, e.g.*, *Bauer v. Blomfield Co./Holden Joint Venture*, 849 P.2d 1365, 1367, n.2 (Alaska 1993) (holding that a mere assignee "was not entitled to complain about a decision made with the consent of all the partners" and stating "[w]e are unwilling to hold that partners owe a duty of good faith and fair dealing to assignees of a partner's interest"); *Bynum v. Frisby*, 73 Nev. 145, 149-50, 311 P.2d 972, 975 (1957) ("[A]n assignment of a partnership interest from one partner to a stranger does not bring that stranger into fiduciary relationship with the remaining partners nor require them to resort to dissolution in order to prevent such a relationship from arising. The stranger remains a stranger entitled only to share in the partnership's worth and to demand an accounting upon dissolution.") (applying UPA (1914) § 27, pertaining to rights of an assignee). *See generally* Daniel S. Kleinberger, *The Plight of the Bare Naked Assignee*, 42 SUFFOLK L. REV. 587 (2009).

This subsection does not follow~~s~~ *Bauer* insofar as that case holds that members owe no duty or obligation of good faith and fair dealing to an existing transferee or former member when they amend the operating agreement. The rights of ~~and other cases by expressly subjecting~~ transferees (including a person dissociated as a member) will be governed by ~~to~~ operating agreement amendments made after the transfer or dissociation, except amendments that increase obligations on transferees or that affect the company's (or its members') obligations to the transferee to the extent that such amendments violate the members' obligations of good faith and fair dealing. For example, an amendment might extend the duration of a limited liability company but may not institute a new capital call obligation on transferees.

The question of whether, in extreme and sufficiently harsh circumstances, transferees might be able to claim some type of duty or obligation to protect against expropriation awaits development in the case law. An unreported LLC case suggests the answer might be yes, but the decision rests primarily on the wording of the LLC's operating agreement. In *Kohannim v. Katoli*, 08-11-00155-CV, 2013 WL 3943078, at *10-11 (Tex. App. July 24, 2013), the court: (i) noted that the LLC's "Regulations provide[] for the distribution of 'available cash' to members quarterly provided that the available cash is not needed for a reasonable working capital reserve"; (ii) also noted that "Jacob [the defendant member] paid himself $100,000 for management services that were not performed and failed to make any profit distributions to Mike [former member and ex-spouse of the plaintiff Parvaneh] or Parvaneh [ex-spouse of Mike, who became Mike's transferee as part of their divorce proceeding] even though more than $250,000 in undistributed profit had accumulated in the company's accounts since the mortgage on the property had been paid off in February 2007"; and (iii) concluded that "more than a scintilla of evidence supports the trial court's finding that Jacob failed to make profit distributions to Parvaneh." In essence, the court upheld a finding that Jacob had breached (or caused the LLC to breach) a contractual obligation to make distributions. But the court went further: "We also agree with the trial court's conclusion that the established facts demonstrated Jacob engaged in wrongful conduct and exhibited a lack of fair dealing in the company's affairs to the prejudice of Parvaneh." *Id.* at *11.

For the very limited rights of transferees, *see* Section 29-3502 and, in particular, the Arizona Comment A.R.S. § 29-3502(B).

Subsection (B~~b~~)(1)—This provision is inapposite when "a member or transferee becomes entitled to receive a distribution." Section 29-3404(D~~d~~). In that circumstance:

- "the member or transferee has the status of . . . a creditor of the limited liability company with respect to the distribution," *Id.*; and
- the relevant obligation is not owed to "a person in the person's capacity as a transferee or person dissociated as a member," Subsection (B~~b~~)(1), but rather to the person in the person's capacity as a creditor.

Subsection (C~~c~~)—This provision precludes using the certificate of organization to make an end run around the strictures of Section 29-3105(C~~c~~) and (D~~d~~)~~(3)~~.

Subsection (D~~d~~)—It will be possible, albeit improvident, for a limited liability company's operating agreement to be inconsistent with the articles ~~certificate~~ of organization or other public filings pertaining to the company. For those circumstances, this subsection provides rules for determining which source of information prevails:

- For members, managers and transferees, the operating agreement is paramount.
- Third parties may invoke the public record upon a showing of reasonable reliance, which presupposes actual knowledge – *i.e.*, deemed knowledge under Section 29-3103(D~~d~~) does not suffice.

The mere fact that a term is present in a publicly filed record and not in the operating agreement, or *vice versa*, does not automatically establish a conflict. This subsection does not expressly cover a situation in which: (i) one of the specified filed records contains information in addition to, but not inconsistent with, the operating agreement; and (ii) a person, other than a member or transferee, reasonably relies on the additional information. However, the policy reflected in this subsection seems equally applicable to that situation. Moreover, to argue that the operating agreement prevails over the filed record is to argue that the additional term does conflict with the operating agreement, at least in effect.

Section 29-3105(A~~a~~)(1~~4~~)(d) might also be relevant to the subject matter of this subsection. Absent a contrary provision in the operating agreement, language in an LLC's articles ~~certificate~~ of organization or other record delivered to the filing office for filing on behalf of the LLC might be evidence of the members' agreement and might thereby constitute or at least imply a term of the operating agreement.

This subsection does not apply to records delivered to the filing office for filing on behalf of a person other than a limited liability company.

A.R.S. § 29-3108. NATURE, PURPOSE AND DURATION OF LIMITED LIABILITY COMPANY.

Arizona Comment

(Rev. 2/23/2024)

Under the Prior Act, a limited liability company was prohibited from engaging in the business of banking and (with limited exceptions) from being an insurer as defined in A.R.S. § 20-1562. These restrictions on the permitted activities of a limited liability company were included in this section to preserve established public policy in Arizona. In other respects, this section is substantively the same as RULLCA § 108.

Modified RULLCA Comment

(Rev. 2/23/2024)

Subsection (A~~a~~)—The "separate entity" characteristic is fundamental to a limited liability company and is inextricably connected to both the liability shield, Section 29-3304, and the inability of creditors of a member or transferee to reach the assets of the limited liability company absent a "reverse pierce" or a claim of fraudulent transfer. *See, e.g.*, *Litchfield Asset Mgmt Corp. v. Howell*, 799 A2d 298 (Conn. Ct. App. 2002) (applying an "outside reverse pierce" to allow judgment creditor of member to reach assets of LLC) (overruled on other grounds by *Robinson v. Coughlin*, 830 A2d 1114 (Conn. 2003));

Egle v. Egle, 817 So. 2d 136, 140 (La. Ct. App. 2002) (allowing plaintiff to proceed with claims that transfers made by her ex-spouse inter alia to an LLC were sham transactions).

Subsection (B~~b~~)—Although some LLC statutes continue to require a business purpose, this act follows the current trend and takes a more expansive approach. The phrase "any lawful purpose, regardless of whether for profit" encompasses even charitable activities, but this act does not include any comprehensive protections pertaining to charitable assets and purposes. ~~Section 1004(b) does contain a "nondiversion" provision, but the provision applies only to the organic transactions contemplated by Article 10.~~ Comprehensive protections must be (and typically are) found in other law, although sometimes that "other law" appears within a state's non-profit corporation statute. *See, e.g.,* MINN. STAT. § 317A.811 (2012) (providing restrictions on charitable organizations that seek to "dissolve, merge, or consolidate, or to transfer all or substantially all of their assets" but imposing those restrictions only on "corporations," which are elsewhere defined as corporations incorporated under the non-profit corporation act).

Subsection (E~~e~~)—The word "perpetual" is a misnomer, albeit one commonplace in LLC statutes. In this context, "perpetual" means merely that the act: (i) does not require a definite term; and (ii) creates no nexus between the dissociation of a member and the dissolution of the entity.

Moreover, the public record pertaining to a limited liability company will not necessarily reveal whether the company actually has a perpetual duration or has in fact dissolved, because: (i) this act, like all LLC statutes, provides several consent-based methods to dissolve a limited liability company; and (ii) none of those methods require ~~involve~~ a public filing. For example, dissolution and winding up of a limited liability company may result from a term specified in the operating agreement or the affirmative vote or consent of certain ~~all~~ members. *See* Sections 29-3701 (events causing dissolution) and 29-3702 (winding up required upon dissolution). An operating agreement is not a publicly filed document, and a member vote to dissolve a limited liability company is not a public event. A dissolved limited liability company ~~partnership~~ may deliver to the filing office for filing a notice of winding up~~statement of dissolution~~, Section 29-3702(B~~b~~)(2)(a~~A~~), and later must file articles ~~a statement~~ of termination, Section 29-3702(H~~b~~)~~(2)(F)~~.~~, or both, but the filing of such statements is permissive rather than mandatory, *id.*~~

~~Likewise, the public record will not reveal when (or even whether) a limited liability company has come into existence. *See* Section 201(d) ("A limited liability company is formed when the company's certificate of becomes effective and at least one person becomes a member.").~~

A.R.S. § 29-3109. POWERS.

Arizona Comment
(Rev. 2/23/2024)

This section is the same as RULLCA § 109.

Modified RULLCA Comment
(Rev. 2/23/2024)

Continuing the approach initiated in ULPA (2001) § 105, this act omits as unnecessary any detailed list of specific powers.

The operating agreement cannot vary a limited liability company's capacity to sue and be sued. Section 29-3105(C~~c~~)(2). An LLC's standing to enforce the operating agreement is a separate matter, which is covered by Section 29-3106(A~~a~~) (stating, as a default rule, that the limited liability company "may enforce the operating agreement").

A.R.S. § 29-3110. APPLICATION TO EXISTING RELATIONSHIPS.

Arizona Comment
(Rev. 2/23/2024)

This section contains most (but not all) of the transition rules governing the Act and differs from RULLCA in several important ways.

Section 5 of SB 1353 provides that the legislation (of which the Act is a part) is effective "from and after August 31, 2019". Consistent with that date, subsection (A)(1) of this section states that the Act applies to every limited liability company that is formed, converted, or domesticated on or after September 1, 2019, and to every foreign limited liability company that is registered in Arizona after September 1, 2019. This section departs from RULLCA by expressly making the Act apply to a limited liability company formed before September 1, 2019, if it is converted or domesticated on or after September 1, 2019.

Subsection (A)(2) allows the members of a limited liability company formed, converted, or domesticated before September 1, 2019, to elect to be governed by the Act.

Subsection (B) states that the Act applies to all foreign and domestic limited liability companies (whenever formed or registered) on or after September 1, 2020, which is sometimes referred to as the "all-inclusive date". However, this rule is subject to two important exceptions.

Subsection (D) sets forth the first exception. It provides that the Act does not affect the enforceability of any term of an operating agreement entered into while the Prior Act was in effect, so long as the term was enforceable under the law at that time. This exception to the all-inclusive date is not in RULLCA. Its purpose is to relieve a pre-existing limited liability company from the burden of having to review (and possibly amend) its operating agreement for conformity with the provisions of A.R.S. § 29-3105(C) and (D).

> EXAMPLE 1: Member A contributes all of the start-up capital for a limited liability company formed before September 1, 2019. Under the terms of the operating agreement signed on the date of formation, Member B is entitled to a share of the profits and has exclusive rights as sole manager. The operating agreement further provides that the managers and members have no fiduciary duties to each other or to the company. A dispute arises as to whether Member B has committed intentional misconduct in managing the company's affairs after September 1, 2020 (the all-inclusive date). Were it not for the transition rule in subsection (D), the blanket waiver of all fiduciary duties would not be enforceable under A.R.S. § 29-3105(C)(5). However, pursuant to A.R.S. § 29-3110(D), the enforceability of the waiver of fiduciary duties will be determined under the Prior Act and the common law in effect at the time the operating agreement was signed, issues that are unsettled under the case law existing on the date of this comment.

The second exception to the all-inclusive date arises under Section 6 of SB 1353, which provides (in part) that SB 1353 does not affect actions commenced, proceedings brought, or rights accrued before its effective date of September 1, 2019. This rule is the same as RULLCA § 1103. However, Section 6 of SB 1353 adds a second rule, not found in RULLCA, that addresses the one-year period between the Act's initial effective date (September 1, 2019) and the all-inclusive date (September 1, 2020). For a limited liability company formed before the initial effective date, the rights and obligations of the members and the managers with respect to events and activities during that one-year period will be determined in accordance with the Prior Act, common law, and terms of the operating agreement in effect at the time of

those events and activities. The Drafting Subcommittee added this supplementary rule to make explicit what is implied under RULLCA.

> EXAMPLE 2: Member A commences a lawsuit in 2021 against Member B for the latter's failure to disclose a conflict of interest with respect to a transaction approved by the members on July 1, 2020. The limited liability company was formed before September 1, 2019, under the terms of an operating agreement that was silent on the members' disclosure duties and other fiduciary duties. Were it not for the transition rule in SB 1353, Member B's failure to disclose the conflict of interest would violate its duties under A.R.S. § 29-3409(B)(4). However, even though the lawsuit was commenced after the all-inclusive date, section 6 of SB 1353 requires that Member B's disclosure duties be determined under the Prior Act and common law as of July 1, 2020, an issue that is unsettled under case law existing on the date of this comment.

Subsection (C) provides convenient transition rules with respect to the Prior Act's terminology that was changed by the Act. Under the Prior Act, a limited liability company was required to disclose its "known place of business" in its filed articles of organization (or its address in its application for registration in the case of a foreign limited liability company.) Under the Act, a limited liability company must disclose its mailing address, which is referred to as its "principal address" in order to avoid any implication that company must maintain a physical business location. To avoid the need for existing limited liability companies to amend their filings with the Commission, subsection (C) states that the known place of business of a company formed before September 1, 2019, will be treated as its principal address for purposes of applying the Act's requirements, and the address of a foreign company registered before September 1, 2019, will be treated as its principal address. This transition rule will relieve almost all companies formed or registered under the Prior Act from the need to amend their filings with the Commission. The only exception arises if the company's address in previous filings is not a mailing address.

Under RULLCA § 110(C), similar transition rules are provided to reflect RULLCA's new terminology and management rules that were not adopted in the Act, so RULLCA's transition rules were also excluded from subsection (C) of this section.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (Ce)—When a pre-existing limited liability company becomes subject to this act, the company ceases to be governed by the predecessor act, including whatever requirements that act might have imposed for the contents of the articles of organization, except as otherwise provided in subsections (C) and (D) of this section and in section 6 of SB 1353.

A.R.S. § 29-3111. SUPPLEMENTAL PRINCIPLES OF LAW AND EQUITY.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 111.

The brevity of this section masks its importance in the formation and operation of a limited liability company. The primary source for determining the rights and obligations of the members and managers is the operating agreement, and the enforceability of the operating agreement rests upon the common law of contracts as well as the specific limitations or A.R.S. § 29-3105(C) and (D). Relevant equitable principles and contract rules include those relating to mistake, misrepresentation, duress, undue

influence, public policy, specific performance, forfeiture, contract interpretation, and good faith and fair dealing.

The common law of agency will be relevant in determining the rights and obligations of the limited liability company and its members and managers in situations where a member or manager acts as agent for the company, except to the extent the common law conflicts with rights and duties specifically addressed by the Act. *See, e.g.,* the Arizona Comment to A.R.S. § 29-3409 regarding the duty of a member or manager under the law of agency to act within the scope of his or her authority when dealing with third parties as an agent of the company.

Although the definition of "operating agreement" in A.R.S. § 29-3102 includes oral agreements, the statute of frauds (A.R.S. § 44-101) may be applicable to the enforcement of operating agreements. *See Olson v. Halvorsen,* 986 A.2d 1150 (Del 2009). This issue is not expressly addressed in the Act or in RULLCA. However, the Modified RULLCA Comment to A.R.S. § 29-3102 suggests that enforcement of the operating agreement is subject to the statute of frauds. In light of the uncertainty regarding if and how the statute of frauds applies to operating agreements, the better practice is to put all material terms of the operating agreement into a record that has been signed by each of the members.

Modified RULLCA Comment
(Rev. 2/23/2024)

For this act, the common law rules of contract and agency are among the most important supplemental "principles of law." With regard to transactions under Article 10 of this Act and the Arizona Entity Restructuring Act (Chapter 6 of Title 29), noteworthy principles include the rights of creditors following leveraged buyouts, spinoffs, asset purchases, or other similar transactions; and creditors' rights under other laws.

A.R.S. § 29-3112. PERMITTED NAMES.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 112 with several exceptions.

The mandatory words or abbreviations required under subsection (A) to appear in the name of a limited liability company exclude "Ltd" and "Co".

Subsection (E) prohibits a limited liability company's name from including specified words and phrases in conformity with the prohibitions contained in the Prior Act. These rules replace the provisions in subsection (e) of RULLCA § 112, which were deleted from the Act. As a result, the Act does not permit a limited liability company to distinguish its name from that of another type of entity merely with the words or abbreviations indicating that it is a limited liability company, even if the other entity consents.

The Act adds subsection (G) to require a foreign series to use the word "series" in its name when registering to do business in Arizona.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section adopts the “distinguishable on the records” test for name availability and rejects the “deceptively similar” test widely used in the past.

For additional name requirements for foreign limited liability companies, *see* Sections 29-3906.

A.R.S. § 29-3113. RESERVATION OF NAME.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 113.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section does not provide for the renewal of a name reservation for successive 120-day periods. A new reservation may be filed upon the expiration of a reservation, but by requiring a new filing this section creates the possibility that another party may timely submit a reservation for the same name. It was considered appropriate to allow for that possibility so that the procedure in this section cannot be used to block a name indefinitely. *Compare* Section 29-3113, *with* Section 29-3114(Dd) (authorizing a renewable registration of certain names).

A.R.S. § 29-3114. REGISTRATION OF NAME BY A FOREIGN LIMITED LIABILITY COMPANY.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 114.

Modified RULLCA Comment
(Rev. 2/23/2024)

Unlike the reservation of a name under Section 29-3113, a registration of a name under this section may be renewed for successive periods thus permitting a name to be protected for a period longer than the initial registration period. Use of the procedure in this section is limited, however, to the names of foreign limited liability companies that are not registered to do business in the state. The purpose of this section is to permit a foreign entity to make sure its name will be available if the entity should choose to register in the state in the future.

A.R.S. § 29-3115. STATUTORY AGENT.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 115 except for three changes.

In addition to changing “registered agent” to “statutory agent”, subsection (A) requires the agent to either sign the document making the appointment or to deliver to the Commission a separate signed record accepting the appointment.

Subsection (B) requires that the agent be an individual, a domestic corporation or limited liability company, or a foreign corporation or limited liability company registered to do business in Arizona. Also, the agent need not have a place of business in Arizona if he or she has a place of residence in Arizona.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section is limited to prescribing the duties of a statutory ~~registered~~ agent under this act. The operating agreement cannot vary this section. Section 29-3105(C~~c~~)(3)(a~~A~~). However, an agent may undertake other responsibilities to a represented limited liability company or foreign limited liability company, such as by contract or course of dealing, but those duties will be determined under other law.

A.R.S. § 29-3116. STATEMENT OF CHANGE.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 116 except that the Act expands the categories of information that may be updated by a statement of change in lieu of an amendment to the articles of organization. RULLCA allows a statement of change to be used only to change the identity or address of the statutory agent. Under this section of the Act, the statement of change may also be used to change the company's principal address or the address of one or more of the members and managers. Note that a statement of change may not be used to change the identity of a member or manager.

If the newly appointed statutory agent does not sign the statement of change, the appointment is not effective until the new agent signs and delivers to the Commission a signed record accepting the appointment.

Modified RULLCA Comment
(Rev. 2/23/2024)

A change in the identity of the statutory ~~registered~~ agent of a LLC or foreign LLC or a change of the office address of a company's statutory ~~registered~~ agent are usually routine matters that do not affect the rights of the members of the represented LLC. This section permits those changes to be made without: (i) amendment of an LLC's articles ~~certificate~~ of organization; (ii) formal approval by an LLC's managers (if any); and (iii) any approval by an LLC's members. For the statutory ~~registered~~ agent's power to resign, *see* Section 29-3117. For the statutory ~~registered~~ agent's power to change its name, address, or both, *see* Section 29-3118.

Subsection (C~~c~~)—This subsection affirms ~~avoids~~ the need to file with a statement of change consent of the new statutory ~~registered~~ agent being designated.

Subsection (D~~d~~)—This subsection makes clear that the procedures in this section are not exclusive. A common way in which a limited liability company changes its statutory ~~registered~~ agent is to include the change in an amendment of its articles ~~certificate~~ of organization ~~or in its annual/biennial report. *See* Section 212(e)~~.

A.R.S. § 29-3117. RESIGNATION OF STATUTORY AGENT.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 117.

Modified RULLCA Comment
(Rev. 2/23/2024)

Resignation under this section may be accomplished solely by action of the statutory ~~registered~~ agent and does not require the cooperation or consent of the represented LLC or foreign LLC. Whether a resignation violates a contract between the statutory ~~registered~~ agent and the company is beyond the scope of this act, and Subsection (D~~d~~) preserves whatever claims a represented LLC may have against its statutory ~~registered~~ agent for a wrongful termination. Even if a resignation were to violate such a contract, the resignation would still be effective if the provisions of this section were followed.

Subsection (B~~b~~)—This subsection delays the effectiveness of a statement of resignation for thirty-one days to allow the notice of the resignation that must be sent under Subsection (C~~c~~) to reach the represented LLC or registered foreign LLC and to allow the represented LLC to arrange for a substitute statutory ~~registered~~ agent.

Subsection (E~~e~~)—This subsection makes clear that a statutory ~~registered~~ agent may resign with respect to LLC or registered foreign LLC that is not in good standing and supersedes the contrary administrative practice in some states of refusing to accept any filings with respect to an entity that is not in good standing until the problem with the entity's standing is cured.

A.R.S. § 29-3118. CHANGE OF NAME OR ADDRESS BY STATUTORY AGENT.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 118.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section permits a statutory ~~registered~~ agent to change the name and address of the agent that appears in the statutory ~~registered~~ agent filing of an LLC or foreign LLC represented by the agent. This act does not provide for commercial statutory ~~registered~~ agents. *Cf.* UBOC (2011) (Last Amended 2013) §§ 1-405, 1-406, 1-409. As a result, a statutory ~~registered~~ agent will need to make a separate filing under this section for each LLC and foreign LLC represented by the agent, unless, if authorized by rule or administrative policy, the filing office establishes procedures for a bulk filing with one filing listing the names of all the statutory ~~registered~~ agent's represented entities.

A.R.S. § 29-3119. SERVICE OF PROCESS, NOTICE OR DEMAND.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 119 except for the deletion of the reference to annual reports in subsection (B).

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (B~~b~~)—This subsection offers three alternative methods for establishing the date service is effected, a date important for determining the time within which an LLC or registered foreign LLC must respond to the process, notice, or demand served. Under Subsection (B~~b~~)(1), service is effected on the date of receipt by the company of the mail or commercial delivery. Under Subsection (B~~b~~)(2), service is effected on the date shown on the return receipt, if signed on behalf of the company. Under Subsection (B~~b~~)(3), service is effected five days after it is deposited with the Postal Service or with a similar commercial delivery service, if correctly addressed and with correct postage or payment. Service is effective at the earliest of the three listed circumstances.

However, for the party effecting service there are difficulties of proof under the first two circumstances. Under Subsection (B~~b~~)(1) the exact date of the receipt by the LLC or foreign LLC of mail or commercial delivery is peculiarly within the knowledge of the company. Under Subsection (B~~b~~)(2) the return receipt must be signed on behalf of the company. That requirement is designed to assure that the service is actually received by the company, but the signature on the return receipt may not always show unambiguously that the signer was acting for the company and was authorized to do so. As a practical matter, therefore, parties effecting service under Subsection (B~~b~~) may find it most convenient to rely on subsection (B)(3) and to maintain their own records so that the date of deposit in the mails or with a commercial delivery service can easily be established.

Subsection (C~~c~~)—This subsection provides a means for serving process on an LLC or foreign LLC that cannot be served under Subsection (A~~a~~) or (B~~b~~). Some LLC statutes require or permit service of process in that circumstance be made on the filing office

Subsection (E~~e~~)—*See, e.g.*, Fed. R. Civ. P. 4(h)(1)(B) (authorizing service on "a domestic or foreign corporation, or a partnership or other unincorporated association that is subject to suit under a common name" to be made on "an officer, a managing or general agent, or any other agent authorized by appointment or by law to receive service of process").

A.R.S. § 29-3120. DELIVERY OF RECORD.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 120.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (A~~a~~)—Permissible means of delivery are not limited to those listed in this subsection, because this subsection by its terms is a non-exclusive list. Conventional commercial practice includes the

use of private delivery or courier services. What constitutes conventional commercial practice may change over time.

Subsection (B~~b~~)—This section lists permissible means of delivery but, except for delivery to the filing office, does not determine when delivery occurs. Delivery to the filing office is effective only upon actual receipt.

A.R.S. § 29-3121. RESERVATION OF POWER TO AMEND OR REPEAL.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 121.

Modified RULLCA Comment
(Rev. 2/23/2024)

Provisions similar to this section have their genesis in *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat) 518 (1819), which held that the United States Constitution prohibited the application of newly enacted statutes to existing corporations while suggesting the efficacy of a reservation of power similar to this section. This section is a generalized form of the type of provision found in many entity organic laws, the purpose of which is to avoid any possible argument that an entity has contractual or vested rights in any specific statutory provision of its organic law and to ensure that the state may in the future modify its entity statutes as it deems appropriate and require existing entities to comply with the statutes as modified.

This section applies to changes in mandatory provisions of this act; the section does not pertain to changes in default rules.

> EXAMPLE: Having enacted this act, State A later amends Section 401(c)(3) (affirmative vote or consent of all members required for a person for a person to become a member) to reduce, as a default rule, the necessary quantum of consent to consent from members owning in the aggregate at least two-third of the interests in current profits owned by members at the time of the consent. XYZ, LLC is a limited liability company formed under State A's act before the amendment. XYZ's operating agreement is silent on this issue, leaving in place the act's default rule. Whether the act's amended default rule applies depends on whether the members initially: (i) agreed (whether expressly or implicitly) to accept the then-applicable default rule requiring unanimous consent; (ii) agreed (whether expressly or implicitly) to adopt whatever rule the act provided; or (iii) never considered the issue. In short, the change in a default rule occasions an inquiry into the members' express or implied agreement as to the role of the default rule in their mutual understanding. In the first instance, the old rule would continue in effect. In the second and third instances, the new rule would apply.

A.R.S. § 29-3122. POWERS OF COMMISSION.

Arizona Comment
(Rev. 2/23/2024)

This section does not appear in RULLCA and is intended to continue in effect the provisions of A.R.S. § 29-611 of the Prior Act.

A.R.S. § 29-3123. TAXATION.

Arizona Comment
(Rev. 2/23/2024)

This section does not appear in RULLCA and is intended to preserve the Arizona tax treatment of limited liability companies under A.R.S. § 29-857 of the Prior Act.

ARTICLE 2
FORMATION; ARTICLES OF ORGANIZATION AND OTHER FILINGS

A.R.S. § 29-3201. FORMATION OF LIMITED LIABILITY COMPANY; ARTICLES OF ORGANIZATION.

Arizona Comment
(Rev. 2/23/2024)

This section preserves prior Arizona law. The document to be filed with the Commission continues to be called articles of organization rather than a certificate of organization as under RULLCA. Articles of organization must contain the same information that was required by the Prior Act, including the company's name and principal address, the name and address of the statutory agent, the designation of whether the company is manager-managed or member-managed, the names and addresses of all managers, and the names and addresses of all members, if a member-managed company, or members with a 20 percent or greater "interest in the capital or profits" of the company, if a manager-managed company. Pursuant to Subsection (D), the company is formed when the articles of organization become effective under A.R.S. § 29-3207.

The members' respective "interests in profits" means their respective rights to share in distributions that exceed the repayment of their contributions on dissolution and winding up of the company. *See* the definition of "majority in interest" in A.R.S. § 29-3102(12) and the Arizona Comment to A.R.S. § 29-3407. Neither the Act nor the Prior Act defines an "interest in capital" or describes how it is to be calculated. It could be interpreted to be based upon the members' respective capital contributions or their contributions that have not previously been returned. Alternatively, the members' interests in capital might be based upon their respective capital account balances maintained for income tax purposes. The better practice is to include in the articles the name of each member that satisfies the 20 percent threshold under either of these interpretations. *See* A.R.S. § 29-3202(B) and the related Arizona Comment regarding the need to amend the articles when there is a change in managers or members.

Subsection (D) states that a limited liability company is formed when its articles of organization become effective and A.R.S. § 29-3401(A) requires that a company have at least one member at the time of its formation. As a result, the Act (in keeping with the Prior Act and unlike the laws of certain other states, such as Delaware) does not authorize the formation what is sometimes referred to as a "shelf" limited liability company – that is, a limited liability company that does not have any members. *See* the Arizona Comment to A.R.S. § 29-3401 for an explanation of how a person becomes a member and the consequences for a false statement regarding the existence of a member at the time the articles of organization are filed.

This section also differs significantly from RULLCA in that under RULLCA, the decision whether the company is manager-managed or member-managed, and the identity of the members and managers are all left to the operating agreement and are not public records. Similar to the mandatory disclosure of officers and shareholders in the annual report of a corporation under the Arizona corporate code, the Prior Act required identification of the managers and certain members in the articles of organization or articles of amendment of a limited liability company. The Drafting Subcommittee concluded that the RULLCA approach would be a drastic change to the established Arizona practice of making the names of the managers and members public that would be contrary to public policy, and so prior law was retained in the Act.

The articles of organization must include the company's "principal address," rather than a "known place of business" as under the Prior Act. This change acknowledges that companies may

exclusively conduct business online, without a physical place of business. A mailing address (including a P.O. box) is sufficient for the principal address.

Subsections (E), (F), and (G) are identical to the Prior Act and do not appear in RULLCA. Subsection (G) requires that a notice of the filing of the articles be published in a newspaper of general circulation in the county of the statutory agent's street address for three consecutive publications, unless the Commission is required to input the information contained in the notice into its database because the statutory agent's street address is located in a county with a population more than 800,000. As of the date of this comment, Maricopa County and Pima County have populations greater than 800,000, so a company whose statutory agent's street address is located in either of those counties does not have to publish a notice of the filing of its articles. The notice must contain all of the information that is required to be set forth in the articles under subsection (B), but need not contain any information in the articles that is optional under subsection (C). Note that the company's principal address does not affect the publication requirements; the location of the statutory agent's street address determines whether publication is required.

Modified RULLCA Comment
(Rev. 2/23/2024)

For a limited liability company to be formed (*i.e.*, to come into existence), two conditions must be met: (i) ~~a certificate of~~articles of organization must become effective; and (ii) at least one person must be~~come~~ a member.

By definition, the earliest a person can become a member is when the ~~certificate~~ articles of organization take~~s~~ effect. *See* A.R.S. § 29-3102(15)~~Section 102(11)~~ (defining "member" as a person that "has become a member of a limited liability company"). ~~However, a certificate of organization can take effect long before any person becomes a member, and the act does not require any public filing to indicate that a person has become a member. . Therefore, the public record will not reflect when (and even whether) a limited liability company has come into existence. . *See also* the comment to Section 211.~~

~~**Subsection (b)** – Consistent with the modern trend, this act requires only the most "bare bones" of disclosure.~~

~~Unlike many LLC statutes, this act does not require that the certificate of organization state whether the limited liability company is manager-managed or member-managed. . Placing that information in a public record pertains primarily to "statutory apparent authority," which this act has eschewed. . *See* the comment to Section 301(a). . Under this act, the manager-managed and member-managed characterizations pertain principally to *inter se* relations, and the act therefore looks to the operating agreement to make the characterization. . *See* Sections 102(10) and (12); Section 407(a).~~

Subsection (C~~c~~) – This provision permits the ~~certificate~~ articles of organization to contain information beyond that required in Subsection (B~~b~~). . An LLC should have good reason, however, before choosing to include additional information. . Such information: (i) is available to the public (including competitors); (ii) increases the chances of a conflict between the ~~certificate~~articles of organization and the operating agreement, *see* A.R.S. § 29-3107(D)~~Section 107(d)~~; (iii) permits the argument that the additional information is part of the operating agreement, *see* the comment to A.R.S. § 29-3102(17)~~Section 102(13)~~ (stating that "[u]nless the operating agreement itself provides otherwise . . . an operating agreement may comprise a number of separate documents (or records), however denominated"); and (iv) can be confusing to the extent the information appears to delineate the power of persons to act for the LLC. . ~~(Subsection (c) states explicitly that information in a certificate of formation "is not effective as a statement of authority.")~~. . In any event, placing additional information in the

~~certificate~~ articles of organization~~formation~~ does not enable an LLC to "end run" the provisions of A.R.S. § 29-3105(C)~~Section 105(c)~~ (limiting the power of the operating agreement to vary specified provisions of this act).

~~**Subsection (d)** – ULLCA (2006) flirted with the concept of a "shelf" LLC – *i.e.*, a limited liability company duly formed without having at least one member upon formation~~. . ~~As the Prefatory Note to ULLCA (2006) explains:~~

> ~~[T]he Act: (i) permits an organizer to file a certificate of organization without a person "waiting in the wings" to become a member upon formation; but (ii) provides that the LLC is not formed until and unless at least one person becomes a member and the organizer makes a second filing stating that the LLC has at least one member.~~

~~Prefatory Note, *The Ability to "Pre-File" a Certificate of Organization*.~~

A.R.S. § 29-3401(A)~~Subsection (d) clearly~~ precludes a "shelf" LLC, which is consistent with ULPA (2001) (Last Amended 2013) Section 201(d) (providing that a limited partnership is formed when the certificate of limited partnership becomes effective, at least two persons have become partners, at least one person has become a general partner, and at least one person has become a limited partner).

A.R.S. § 29-3202. AMENDMENT OR RESTATEMENT OF ARTICLES OF ORGANIZATION.

Arizona Comment
(Rev. 2/23/2024)

This section is significantly different from RULLCA because the Act requires that articles of organization contain information that RULLCA does not require in certificates of organization. For example, A.R.S. § 29-3201(B)(4) requires a company to state in its articles of organization whether it is manager-managed or member-managed. As a consequence, this section requires the company to file an amendment to its articles in order to change its management structure, while under RULLCA the company accomplishes that change in management structure through an amendment to the operating agreement.

Subsection (B) requires that articles of organization be amended if any statement therein was false or erroneous when made. In addition, the articles of organization of a member-managed limited liability company must be amended within thirty days after any change in its members and the articles of organization of a manager-managed company must be amended within thirty days after any change in its managers or in the members who own a twenty percent or greater interest in its capital or profits. *See* Comment to A.R.S. § 29-3201 regarding the meaning of "interest in capital or profits."

Subsection (C) provides that the articles of organization must be amended, or, alternatively, a statement of change must be filed, within 30 days following a change to the name or address of the statutory agent, the company's principal address, or the address of any of the company's members or managers.

Subsection (G) is substantively the same as in subsection (G) of RULLCA. It requires a member of a member-managed company or a manager of a manager-managed company to cause the filing of articles of amendment (or a statement of change, if applicable) whenever he or she learns that any information in the then-currently filed articles was inaccurate when the articles were filed, or has become inaccurate because of changed circumstances.

Subsection (H) differs from RULLCA by requiring the publication of amendments (other than those amendments listed in Subsection (I)) in a newspaper of general circulation in the county of the statutory agent's street address for three consecutive publications, unless the Commission is required to input the information contained in the amendment into its database because the statutory agent's street address is in a county with a population of more than 800,000. As of the date of this comment, Maricopa County and Pima County have populations of at least 800,000, so a company whose statutory agent's street address is located in either of these counties does not have to publish its amendments. Note that the county of the company's principal address does not affect this rule. Thus, a company with a principal address in Yuma County that maintains a statutory agent with a street address in Maricopa County does not have to publish its amendments. This subsection reflects public policy embodied in the Prior Act.

Subsection (I) exempts from the publication requirement any amendment that consists only of one or more of the following matters: names or addresses of members or managers, name or street address of a statutory agent, or the company's principal address. This exemption applies irrespective of the company's principal address and the street address of its statutory agent.

Companies incur consequences for failing to timely file amendments or otherwise correct inaccuracies in its filed records. Subsection (J) (which is not found in RULLCA) provides that a Company that has not amended its articles of organization as required by this section may not maintain an action on or on account of a contract or transaction made in the name of the company in any court of this state until it has amended its articles as required by this section. *See* also A.R.S. § 29-3205 (statutory liability of the members or managers and the company for inaccurate information in filed record).

Under the default rules of the Act, the only amendment to articles of organization that requires member approval is a change in management structure. *See* A.R.S. §§ 29-3407(B)(4)(c), 29-3407(C)(4)(c). However, under the definition of an "operating agreement" in A.R.S. § 29-3102(17), the articles of organization may contain matters that constitute a part of the members' operating agreement. In the unusual circumstance that the members have made the company's articles a part of their operating agreement, an amendment to those sections of the articles of organization that constitute an operating agreement would require unanimous member approval under the Act's default rules regarding amendments to the operating agreement.

Some transactions may require majority or unanimous approval of the members under the Act's default rules or under the terms of the operating agreement. Any such transaction that has received the necessary member approval, such as admission of a new member, does not require a separate member approval of an amendment to the articles of organization reflecting that transaction. For example, if both members approve a change in the managers, the members do not need to separately approve an amendment to the articles of organization showing the change. Any manager, or any other person authorized by the company, may sign the amendment and submit it to the Commission for filing.

Modified RULLCA Comment

(Rev. 2/23/2024)

Like other provisions of the act requiring records to be delivered to the filing officer for filing, this section is not subject to change by the operating agreement. *See* A.R.S. § 29-3105(C)(3) ~~Section 105(c)(3)~~. ~~Except for Subsection (d), this section is essentially mechanical.~~

Subsection (G~~d~~) – This subsection imposes an obligation directly on the members and managers rather than on the limited liability company. A member's or manager's failure to meet the obligation exposes the member or manager to liability to third parties under A.R.S. § 29-3205(A)~~Section 205(a)(2)~~ and might constitute a breach of the member or manager's duties under A.R.S. § 29-3409(A) and

(I)Section 409(c) and (i). In addition, an aggrieved person may seek a remedy under A.R.S. § 29-3204Sections 204 (Signing and Filing Pursuant to Judicial Order) and A.R.S. § 29-3205 (Liability for Inaccurate Information in Filed Record).

A.R.S. § 29-3203. SIGNING OF RECORDS TO BE DELIVERED FOR FILING TO THE COMMISSION.

Arizona Comment

(Rev. 2/23/2024)

This section is substantively the same as RULLCA Section 203 except that Subsection (A)(1) expressly provides that foreign companies and foreign series are also subject to the requirements of subsection (A)(1).

Subsection (A)(1) expressly provides that a record submitted to the Commission by a limited liability company must be signed on behalf of the company by any person authorized to do so, and subsection (B) expressly states that a record delivered to the Commission for filing may be signed by an agent. Nevertheless, the Commission on multiple occasions has rejected a record if it is not signed by a person who is named in the Commission's records (or in the record currently being filed) as a member or manager of the company. Furthermore, it has been reported that the Commission sometimes has rejected a record because the name of the signer was not an exact match of a member's or manager's name in the Commission's records. The Commission's requirement that a record be signed by a member or manager of the submitting company is not only contrary to subsections (A)(1) and (B) of this section, but is inconsistent with the Commission's "ministerial" duty under A.R.S. § 29-3210(A) to file every record delivered to it that satisfies the Act's requirements. *See* the Modified RULLCA Comment to this section for additional explanation of the filing office's restricted review of records submitted for filing.

To avoid possible delay in the filing of articles of amendment and conflicts with Commission staff, the better practice is to arrange for a member or manager to sign amendments if that is practicable.

Modified RULLCA Comment

(Rev. 2/23/2024)

Subsection (aA) – Section A.R.S. § 29-3102(25) 102(21) defines "sign" broadly, including "an electronic symbol, sound, or process."

Subsection (aA)(1) – From the perspective of the Commissionfiling office, it is not necessary that a record delivered for filing on behalf of a limited liability company be signed by a member or, in the case of a manager-managed LLC, a manager. The operating agreement can impose such a requirement as an *inter se* matter, but the requirement would not affect this provision. *See* A.R.S. § 29-3105(C)(3)(b) Section 105(c)(3)(B) (stating that the operating agreement may not "vary any requirement, procedure, or other provision of this [act] pertaining to … the Commission[Secretary of State], including provisions pertaining to records authorized or required to be delivered to the Commission[Secretary of State] for filing under this [act]").

The Commission filing office will not check whether a person who purports to be authorized to sign a record on behalf of an LLC actually has that authority, even if a statement of authority pertaining to the matter is in effect. Indeed, even if the Commission filing office somehow "knows" of a statement limiting authority, the office lacks the authority to reject a record on that basis. *See* the comment Modified RULLCA Comment to A.R.S. § 29-3206(A) Section 206(a) (stating the requirements for filing and noting that the Commissionfiling office's review is ministerial and limited to information pertaining to the stated

requirements) ~~and the comment to Section 302(c) (explaining why such a statement of authority does not affect the filing office)~~.

Subsection (b) – The ~~filing~~ Commission will not check the bona fides of a person purporting to have signed a record in a representative capacity. This subsection expressly authorizes taking action through an agent so as to provide context for Subsection (C~~c~~) and for the avoidance of doubt. No negative inference should be drawn about using agents to take other action under this act.

Subsection (c) – As a matter of agency law, a person who signs in a representative capacity gives a "warranty of authority." RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006) (Agent's Implied Warranty of Authority). This subsection has criminal and civil law implications.

A.R.S. § 29-3204. SIGNING AND FILING PURSUANT TO JUDICIAL ORDER.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA Section 204.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section gives the court the flexibility to order either that a record be signed or that the record be filed by the filing office unsigned. The latter circumstance may arise, for example, in a situation where the person who should sign the record is not subject to the jurisdiction of the court. This section also makes clear that the court may order a person with control over a record that has been signed to deliver the record to the filing office for filing.

A.R.S. § 29-3205. LIABILITY FOR INACCURATE INFORMATION IN FILED RECORD.

Arizona Comment
(Rev. 2/23/2024)

This section is substantially more important in Arizona than in states that adopted the RULLCA approach to articles of organization, because of the Arizona requirements that the names and addresses of members and managers must be included in articles of organization and must be kept current by amendments to the articles of organization filed with the Commission.

Subsections (A), (B), and (C) are substantively the same as RULLCA Section 205, except that liability under subsection (C) is qualified by the knowledge of the individual who signs a record filed with the Commission.

Subsections (D) and (E) are not contained in RULLCA. Subsection (D) grants to the limited liability company itself and to its members the right to collect damages from a person who knowingly executes an inaccurate record. It differs from the provisions of subsection (A) in that, under subsection (D), the claimant must be either the limited liability company or a member and the claimant is not required to have relied on the inaccurate information to collect damages. Subsection (E) entitles the prevailing party in an action under this section to recover its costs and reasonable attorneys' fees.

This section is a default rule that can be changed to the extent permitted by A.R.S. § 29-3105. For example, the application of this section to the liability of a manager to members for violating subsection

(A)(2), such as failing to assure that the articles of organization are amended as required under A.R.S. § 29-3202, is a default rule and the operating agreement could exculpate the manager from liability to members for such violations. However, note than A.R.S. § 29-3105(C)(5) prohibits the operating agreement from limiting or eliminating a person's liability for wilful or intentional misconduct and A.R.S. § 105(C)(12) largely prohibits the operating agreement from restricting the rights of third parties. A general disclaimer of any duty of care, without reference to this section 29-3205, is probably insufficient.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (A~~a~~) – This subsection relates to liability to third parties for inaccurate information in a filed record. Subsection (A)(1) ~~Paragraph 1~~ requires actual knowledge because the paragraph can inculpate a person who is neither a member of a member-managed limited liability company nor a manager of a manager-managed limited liability company. Under Subsection (A)(2)(b),~~Paragraph 2(B)~~, notice suffices, because: (i) the provision applies only to members of a member-managed LLC and managers of a manager-managed LLC; (ii) by status these persons have overall management authority; and (iii) therefore it is reasonable to impose liability when a person either knows or "has reason to know … from all the facts known to the person at the time in question." A.R.S. § 29-3103(B)(1) ~~Section 103(b)(1)~~ (defining notice). For the same reason, Subsection (A)(1) ~~Paragraph 1~~ applies only to "information [known] to be inaccurate at the time the record was signed," while Subsection (A)(2) ~~Paragraph 2~~ applies whenever a "member or manager knew or had notice of the inaccuracy for a reasonably sufficient time before the information was relied upon so that, before the reliance, the member or manager reasonably could have [taken corrective action]." Subsection (A)(2)(b).~~Paragraph (2)(B).~~

Subsection (A~~a~~)(2) – Although this act establishes the avoidance of gross negligence as the standard of care for those who manage a limited liability company, this provision encompasses liability to third parties. Accordingly, the standard here is more demanding. The phrases "reasonably sufficient time" and "reasonably could have" indicate a standard of ordinary care. "[N]otice of the inaccuracy" involves "reason to know." A.R.S. § 29-3103(B)(1)~~Section 103(b)(1)~~.

Subsection (B~~b~~) – A.R.S. § 29-3105(D)(2) ~~Section 105(d)(2)~~ authorizes the operating agreement to establish an analogous rule *inter se* the members. This subsection goes where the operating agreement cannot reach and affects the rights of third parties.

Subsection (C~~c~~) – This subsection provides criminal liability. The elements of perjury are a matter for the criminal law of the jurisdiction.

A.R.S. § 29-3206. FILING REQUIREMENTS.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA Section 206. The section does, however, preserve the Prior Act in that the Commission is authorized only to collect fees and penalties required to be paid under this Act when filing a document, rather than the RULLCA authorization for the filing authority to collect taxes, fees, and penalties under other laws as well. The Drafting Subcommittee determined that document filings required by the Act should not empower the Commission to effectively act as a collection agency for other state governmental agencies.

Modified RULLCA Comment
(Rev. 2/23/2024)

The Commission~~filing office~~'s duty under this section is ministerial, A.R.S. § 29-3210(A)~~Section 210(a)~~, and the office's assessment of a record delivered for filing is limited to conformity with this section. The filing office *must* file a record delivered for filing if the record contains the information required by this act and is accompanied by the required filing fee. The filing office is authorized to provide forms but not require their use, and, as a result, may not reject records delivered for filing on the basis of form (except to the very limited extent permitted by Subsections (D~~d~~) and (F~~f~~)).

In view of the very limited discretion granted to the filing office under this section and ~~Section~~ A.R.S. § 29-3210(A~~a~~), "[t]he filing of or refusal to file~~…~~ a record does not … create a presumption that the information contained in the record is correct or incorrect.~~….~~" A.R.S. § 29-3210(E) ~~Section 210(c)~~.

Subsection (A~~a~~) – The first requisite for having a record filed is to cause the record actually to be received by the filing office. A.R.S. § 29-3120(B) ~~Section 120(b)~~ reiterates this point.

Subsection (~~a~~A)(2) – A record delivered for filing must be in typewritten or printed form unless the filing office permits delivery by electronic transmission. The types of electronic transmission that may be used will be determined by the filing office and is intended to include the evolving methods of electronic delivery, including facsimile transmissions, electronic transmissions between computers, and filings through delivery of storage media.

Subsection (A~~a~~)(3) – The text of an entity filing must be in the English language, except to the limited extent permitted by this paragraph.

Subsection (A~~a~~)(4) – To be filed a record must be signed by the appropriate person. *See* A.R.S. § 29-3102(24)~~Section 102(21)~~ (defining "sign" and manner in which a record may be "signed"). Who is an appropriate person is determined under Section 203, but the filing office will not check to determine whether a person purportedly authorized to sign is in fact authorized. *See* the comment to A.R.S. § 29-3203(A)-(C)~~Section 203(a)–(c)~~.

The requirement in some state statutes that records delivered for filing on behalf of an entity must be acknowledged or verified as a condition for filing has been rejected. These requirements serve little purpose in connection with entity filings. On the other hand, many organizations, like lenders or title companies, may desire that specific records include acknowledgements, verifications, or seals; Subsection (A~~a~~)(4) does not prohibit the addition of these forms of execution and their use does not affect the eligibility of the record for filing.

Subsection (B~~b~~) – Under this subsection, a confidentiality obligation does not affect the filing office's duty to file, and the filing office is authorized but not required to redact. This act does not affect any confidentiality-related obligations the filing office may have under other law.

A.R.S. § 29-3207. EFFECTIVE DATE AND TIME.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA section 207 with one exception. Subsection (B) addresses the possibility that the Commission may not complete its review and "file" a document until a date subsequent to its delivery to the Commission. In that situation, the effective date and time of

the document is the date and time it was delivered to the Commission if: (1) the Commission subsequently determines it conforms to the filing requirements, or (2) within 30 days after the Commission notifies the filer that the document is not in compliance, the filer brings the document into compliance. In either event, the document will be filed by the Commission with an effective date that is the date the document was first delivered to the Commission. Subsection (A) also provides for a delayed effective date if the delayed date is specified in the document and is not later than 90 days after delivery to the Commission.

Subsection (A) is substantively the same as RULLCA, except for the reference to delivery rather than filing. Subsection (B) is not found in RULLCA and is substantially the same as the Prior Act.

Modified RULLCA Comment
(Rev. 2/23/2024)

Records accepted for filing become effective at the date and time of filing as recorded by the filing office, or at another specified time on that date, unless a permissible delayed effective date is stated in the record.

A.R.S. § 29-3210(B)~~Section 210(b)~~ requires the filing office to maintain some means of recording the date and time of delivery of a record and requires that office to record that date and time as the date and time of filing. That provision gives express statutory authority to the common practice of most filing offices of ignoring processing time and treating a record as filed as of the date and time it is delivered for filing even though it may not be reviewed and accepted for filing until several days after delivery. That section contemplates that time of delivery, as well as the date, will be routinely recorded.

Subsection (A)(1)~~Paragraph (1)~~ – In the absence of provision for a delayed effective date, a record delivered for filing becomes effective on the date and time of filing by the filing office. Since under A.R.S. § 29-210(B)~~210(b)~~ the date and time of filing is the recorded date and time of delivery of the record to the filing office (which under A.R.S. § 29-210(B)~~Section 210(b)~~ is the date and time of actual receipt), together these provisions eliminate any doubt about situations involving same-day transactions in which a record, for example, a statement of merger, is delivered for filing on the morning of the day the merger is to become effective.

Subsection (A)(3)~~Paragraph (3)~~ – This paragraph does not authorize or contemplate the retroactive establishment of an effective date before the date of filing.

Subsection (A)(3) and (4)~~Paragraphs (3) and (4)~~ – A record that states an effective date beyond the 90-day limit is not a record that "satisfies this chapter~~[act]~~," A.R.S. § 29-3210(A)~~Section 210(a)~~, and will properly be rejected by the filing office.

A.R.S. § 29-3208. WITHDRAWAL OF FILED RECORD BEFORE EFFECTIVENESS

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA Section 208.

Modified RULLCA Comment
(Rev. 2/23/2024)

Only records that have not yet taken effect may be withdrawn under this section. If a record has

taken effect, it may be corrected under A.R.S. § 29-3209 ~~Section 209~~ if the requirements of that section are satisfied. Otherwise, the record must be amended in accordance with this A~~a~~ct or, if the record is ~~a~~ articles~~certificate~~ of organization, the resulting limited liability company may be dissolved and terminated in accordance with Article 7.

Subsection (B~~b~~)(1) – This provision is subject to A.R.S. § 29-3203(B) ~~Section 203(b)~~ ("Whenever this chapter~~[act]~~ requires a particular individual to sign a record and the individual is deceased or incompetent, the record may be signed by a legal representative of the individual.").

A.R.S. § 29-3209. CORRECTING FILED RECORD.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA Section 209.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section permits making corrections in filed records without re-submitting the entire record.

Subsection (A~~a~~)(1) and (2) – A filed record may be corrected because it contains an inaccuracy or because it was defectively signed (including defects in optional forms of execution that do not affect the eligibility of the original record for filing).

Subsection (A~~a~~)(3) – In addition, a filed record may be corrected if its electronic transmission was defective – *i.e.*, where an electronic delivery is made but, due to a defect in transmission, the filed record is later discovered to be inconsistent with the record intended to be filed. If no delivery is made because of a defect in transmission, a statement of correction may not be used to effect a retroactive filing. Therefore, a limited liability company making an electronic delivery should take steps to confirm that the transmission was received by the filing office.

Subsection (C~~c~~) – A provision in a filed record setting an effective date may be corrected under this section, but the corrected effective date must comply with ARS § 29-3207~~Section 207~~, which limits delayed effective dates to within ninety days after filing. A corrected effective date is thus measured from the date of the original filing of the record being corrected, *i.e.*, it cannot be before the date of filing of the record or more than ninety days thereafter.

Subsection (D~~d~~) – The correction relates back to the original effective date of the record being corrected, except as to persons relying on the original entity filing and adversely affected by the correction. As to these persons, the effective date of the statement of correction is the date the statement is filed.

A.R.S. § 29-3210. DUTY OF COMMISSION TO FILE; REFUSAL TO FILE; DELIVERY OF RECORD BY COMMISSION.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA Section 210, with two exceptions. In accordance with prior Arizona law, subsection (B) allows the Commission to deliver an

acknowledgement of filing rather than to return the document itself after filing, and subsection (C) relieves the Commission of the 15-day deadline to return a rejected filing.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (aA) – Under this subsection the Commission filing office is required to file a record if it "satisfies this chapter[act]." The purpose of this language is to limit the discretion of the filing office to a ministerial role in reviewing the contents of records. If the record submitted is in the form prescribed, contains the information required by this act, and the appropriate filing fee is tendered, the filing office must file the record. Consistent with this approach, this subsection states explicitly that the filing duty of the filing office is ministerial. *See also* Subsection (Ee) (pertaining to presumptions not created).

Subsection (Bb) – This subsection provides that when the filing office files a record, the filing office records it as filed on the date and time of delivery to the filing office, retains the original record for the office's records, and delivers a copy of the record to the person who delivered the record for filing with an acknowledgement of the date and time of filing. In the case of a statement of denial, Section 303, the filing office will also send a copy of the record and acknowledgment to the limited liability company.

IIn the case of a record transmitted electronically to the filing office, that office may make delivery by electronic transmission. The copy returned will be the exact or conformed copy if one has been required by the filing office, or will be a copy made by the filing office if an exact or conformed copy was not required.

Under this subsection the acceptance of a filing is evidenced merely by the filing office's delivery of a copy of the record with an acknowledgment of the date and time of filing. The act does not provide for the filing office to issue a formal certificate of filing. A copy of the filed record together with an acknowledgment of the date and time of filing should sufficiently indicate that the filing has been accepted for filing and been filed.

Subsection (Cc) – Because of the simplification of formal filing requirements and the limited discretion granted to the filing office by this act, it is probable that rejection of records delivered to the filing office for filing will occur only rarely. This subsection provides that if the filing Commission does reject a record delivered for filing, the filing Commission must return the record to the person that submitted the filing within fifteen days together with a brief written explanation of the reason for rejection. In the case of a record delivered by electronic transmission, rejection of the record may be made electronically by the filing office or by a mailing to the person that submitted the record.

Subsection (Ee) – This subsection provides that the filing of a record by the filing office does not affect the validity or invalidity of any provision contained in the record and does not create any presumption with respect to any information in the record. Likewise, the refusal of the filing office to file a record creates no presumption that any of the information in the record is incorrect. Persons adversely affected by a statement in a filed record may contest the statement in a proceeding appropriate for that purpose, including a damage action under A.R.S. § 29-3205Section 205.

A.R.S. § 29-3211. CERTIFICATE OF GOOD STANDING OR REGISTRATION.

Arizona Comment
(Rev. 2/23/2024)

This section preserves prior Arizona law and practice for requesting Certificates of Good Standing and Certificates of Registration, as well as the contents of such certificates, which differs from RULLCA Section 211. Because A.R.S. § 29-3903 permits the registration in Arizona of a series of a foreign LLC, this section also permits a Certificate of Registration to be issued by the Commission to a registered foreign series.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section establishes a procedure by which anyone may obtain a conclusive certificate from the Commission ~~filing office~~ that, among other things, the records of the filing office either (i) do not indicate that a particular domestic limited liability company has ceased to exist subject to A.R.S. § 29-3702(I); or (ii) indicate that a particular foreign limited liability company is registered to do business in the state. The certificate will probably be a standardized form. The Commission~~filing office~~ is to make those determinations from public records only and is neither expected nor permitted to make a more extensive investigation.

~~Thus, the certificate of good standing will state whether a certificate has been filed and become effective but not that the limited liability company has been formed~~. ~~For two reasons, a~~A certificate concerning a domestic limited liability company can never conclusively indicate whether the ~~LLC has actually been formed and, if formed, whether the~~ LLC has been dissolved. ~~Formation depends in part on the occurrence of an act "not of record." *See* Section 201(d) ("A limited liability company is formed when the company's certificate of organization becomes effective and at least one person becomes a member.")~~. ~~Similarly, causes of dissolution are typically "not of record." *See* Section 701~~. However, ~~A~~a dissolved limited liability company may deliver for filing a notice of winding up~~statement of dissolution~~, Section A.R.S. § 29-3702(B)(2)(a)~~702(b)(2)(A)~~, and the filing of such a statement would preclude the issuance of a certificate of good standing, ARS § 29-3211(B)(1)(c)~~Subsection (b)(2)(D)(i)~~. ~~However~~ Note that a notice of winding up~~statement of dissolution~~ is permissive.~~; so too is a statement of termination. *See* Section 702(b)(2)(F).~~

Subsection (B~~b~~)(1~~4~~)(c~~B~~) – This provision refers only to fees, taxes, interest, and penalties collected by the Commission.~~filing office~~. ~~In some states other agencies may report to the filing office that franchise or other taxes have been paid; in those states, this information may be included in the certificate~~. ~~In states where this procedure does not unduly delay the issuance of certificates, this section may be revised appropriately~~. ~~Subsection (b)(4)(B) limits the scope of the statement in the certificate that all fees, taxes, interest, and penalties have been paid to those where nonpayment affects the existence or authorization to do business of the entity.~~

A.R.S. § 29-3212. INTERROGATORIES BY THE COMMISSION; INFORMATION DISCLOSED BY INTERROGATORIES.

Arizona Comment
(Rev. 2/23/2024)

RULLCA Section 212 provides for the filing of annual reports by all domestic and foreign LLCs. The Drafting Subcommittee determined the better approach was to preserve the prior Arizona law, which

did not require any annual filings by domestic or foreign limited liability companies. All of RULLCA's prescribed contents of an annual report are required by the Act to be disclosed and continuously updated by a limited liability company in its articles of organization, articles of amendment, or statements of change. Accordingly, RULLCA's annual report requirements were deleted in their entirety from this section.

In place of the RULLCA language, A.R.S. § 29-3212 is now identical to the Prior Act at A.R.S. § 29-612, providing that the Commission may propound interrogatories to LLCs. This is authority the Commission has had with corporations for many years and has had with LLCs since 2000. The interrogatories must be reasonably necessary and proper for the Commission to ascertain whether a company has complied with all applicable provisions of law. It may refer information obtained disclosing violations to the Attorney General for appropriate action. It may also use the information, or the failure of a company to answer the interrogatories, as cause for commencing proceedings to administratively dissolve a domestic LLC under A.R.S. § 29-3708 or to terminate the registration of a foreign LLC or series under A.R.S. § 29-3910.

Each domestic and registered foreign limited liability company should make sure that its principal address and statutory agent name and address are always up to date on the Commission's records to avoid administrative dissolution for failure to respond to the Commission's interrogatories.

Modified RULLCA Comment
(Rev. 2/23/2024)

~~In some states, an annual or biennial report by a limited liability company or registered foreign limited liability company will be a new requirement.~~

~~**Subsection (a)(4) and (5)** – The requirement that the report include the name of at least one member of a member-managed LLC and one manager of a manager-managed LLC will be a new requirement in some states~~. ~~There has been increasing pressure from law enforcement agencies for access to more information about the ownership and control of legal entities~~. ~~This requirement will enable law enforcement to contact a person with some knowledge about the affairs of the limited liability company~~. ~~Members of the public will also have that ability.~~

A.R.S. § 29-3213. FEES; FILING SERVICES; DEFINITION.

Arizona Comment
(Rev. 2/23/2024)

This is a new section that does not exist in RULLCA. A.R.S. § 29-3213 preserves prior Arizona law, which was contained in the Prior Act at A.R.S. § 29-851. There is no equivalent section in RULLCA. This section sets forth the fee schedule for filing documents with the Commission, including an additional fee for expedited filing, and permits filers to have money on deposit accounts with the Commission for future filings.

ARTICLE 3
RELATIONS OF MEMBERS AND MANAGERS TO PERSONS DEALING WITH LIMITED LIABILITY COMPANY

A.R.S. § 29-3301. AGENCY POWER OF MEMBER AND MANAGER.

Arizona Comment
(Rev. 2/23/2024)

This section represents a substantive departure from RULLCA Section 301 and preserves the agency rules applicable to managers and members under the Prior Act. The Drafting Subcommittee determined that the business and legal communities in Arizona had come to rely on the agency rules under the Prior Act and that the elimination of these rules would undercut reasonable commercial expectations

RULLCA section 301 states simply that no member is an agent of the company by reason of being a member, and that a member's agency authority to bind the company is determined under other law. In contrast, the Prior Act conferred limited agency authority on each member in a member-managed company, and on each manager in a manager-managed company, to act for the company "for the purpose of carrying on its business in the usual way." A.R.S. § 29-654.

A.R.S. § 29-3301 preserves prior law with two minor changes. It refers not only to the business of the limited liability company but also to its activities and affairs, to avoid any implication that the agency rules apply only to profit-motivated business activities. A.R.S. § 29-3301 also substitutes the phrase "in the ordinary course" for the phrase "in the usual way," to match the evolving phraseology in the Uniform Partnership Act and Arizona partnership law. A.R.S. § 29-654 of the Prior Act was derived from section 9 of the 1914 Uniform Partnership Act (enacted in Arizona as A.R.S. § 29-209), which employed the phrase "in the usual way." Subsequently, section 301 of the 1994 revision of the Uniform Partnership Act (enacted as A.R.S. § 29-1022 in 1996) substituted the phrase "in the ordinary course" for "in the usual way."

The agency rules in § 29-3301 of the Act are default rules as they relate to the internal rights and obligations of the members and managers. Any limitation on or expansion of their agency authority contained in an operating agreement will bind the members and managers as among themselves. However, § 29-3105(C)(12) of the Act precludes an operating agreement from restricting the rights of persons who are not members or managers. Accordingly, the right of a third party to rely upon the agency power of a manager or member under § 29-3301 cannot be restricted under the terms of an operating agreement.

> EXAMPLE 1: All of the members sign an operating agreement providing that member A has no agency authority to act for the member-managed limited liability company in the ordinary course of business or otherwise. Member A nevertheless signs a contract on behalf of the company that is within the ordinary course of its business. The other party to the contract may enforce its rights under the contract against the company. The other members may recover damages from member A for breach of the operating agreement.
>
> EXAMPLE 2: Same as Example 1, except that member A's lack of authority is set forth in the company's articles of organization as well as the operating agreement. The articles do not impart constructive notice to third parties, so the other party to the contract may enforce the contract against the company. However, if evidence exists to prove that the third party had actual knowledge of the contents of the articles of organization before signing the contract, such

knowledge would defeat the third party's right of reliance under subsection (A)(2).

The authority of members, managers, and other persons may be created, terminated, limited, or enlarged pursuant to the management rules under A.R.S. § 29-3407 or the terms of the operating agreement. The common law of agency supplements the provisions of A.R.S. § 29-3301 to determine the actual, apparent, and implied authority of a member, manager, or other person to bind the limited liability company in transactions with third parties. Because the Act departs from RULLCA regarding the statutory authority of members and managers, only those portions of the RULLCA Comment to § 303 relating to the law of agency remain relevant to the Act.

Subsection (B)(1) expressly recognizes that a member in a manager-managed LLC may sometimes act as an agent of the company if and to the extent authorized by the manager or by the provisions of the operating agreement. This statutory recognition is intended as a continuation and clarification of the law under the Prior Act, not a substantive change. A member who acts as an agent of a manager-managed LLC should bear in mind that an agency relationship may give rise to fiduciary duties to the LLC under the common law of agency and A.R.S. § 29-3409(Q).

Note that reimbursement and indemnification rights under A.R.S. § 29-3408 are conferred only on managers in a manager-managed LLC and on members in a member-managed LLC. Accordingly, a member who is authorized (by the manager or the operating agreement) to act for a manager-managed LLC must rely upon the common law of agency or the operating agreement to obtain reimbursement or indemnification.

See A.R.S. § 29-3409 and the related Arizona Comment and Modified RULLCA Comment regarding the duties that arise from a manager's or member's agency power and authority.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (~~a~~A) – Most LLC statutes, including the original ULLCA (1996), provide for what might be termed "statutory apparent authority" for members in a member-managed limited liability company and managers in a manager-managed limited liability company. This approach codifies the common law notion of apparent authority by position and dates back at least to the original Uniform Partnership Act. UPA (1914) § 9 provided that "the act of every partner … for apparently carrying on in the usual way the business of the partnership … binds the partnership," and that formulation has been essentially followed by UPA (1997) § 301, ULLCA (1996) § 301, ULPA (2001) § 402, and myriad state LLC statutes.

~~This act rejects the statutory apparent authority approach, for reasons summarized in a "Progress Report on the Revised Uniform Limited Liability Company Act," published in the March 2006 issue of the newsletter of the ABA Committee on Partnerships and Unincorporated Business Organizations:~~

> ~~The concept [of statutory apparent authority] still makes sense both for general and limited partnerships. A third party dealing with either type of partnership can know by the formal name of the entity and by a person's status as general or limited partner whether the person has the power to bind the entity.~~
>
> ~~Most LLC statutes have attempted to use the same approach but with a fundamentally important (and problematic) distinction. An LLC's status as member-managed or manager-managed determines whether members or managers have the statutory power to bind. But an LLC's status as member- or manager-managed is not apparent from the~~

LLC's name. A third party must check the public record, which may reveal that the LLC is manager-managed, which in turn means a member as member has no power to bind the LLC. As a result, a provision that originated in 1914 as a protection for third parties can, in the LLC context, easily function as a trap for the unwary. The problem is exacerbated by the almost infinite variety of management structures permissible in and used by LLCs.

The new Act cuts through this problem by simply eliminating statutory apparent authority.

PUBOGRAM, Vol. XXIII, no. 2 at 9-10.

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 corporationsAct are remain subject to the samecommon law principles of agency for attributing to the entity the conduct of those who act or purport to act on the entity's behalf. *See* RESTATEMENT (THIRD) AGENCY §§ 1.03, cmt. c (manifestations of authority by organizations); 2.01, cmt. e (actual authority); 2.03, cmts. (c) – (e) (apparent authority) (2006). Section 407 provides the default rules on the actual authority of those who manage an LLC.

This subsection does not address the power to bind of a manager in a manager-managed LLC, although this act does consider a manager's management responsibilities. *See* Section 407(c) (allocating management authority, subject to the operating agreement). For a discussion of how agency law will approach the actual and apparent authority of managers, *see* Section 407(c), comment.

Subsection (b) – As the "flip side" to Subsection (a), this subsection expressly preserves the power of other law to hold an LLC directly or vicariously liable on account of conduct by a person who happens to be a member.

For example, given the proper set of circumstances: (i) a member might have actual or apparent authority to bind an LLC to a contract; (ii) the doctrine of *respondeat superior* might make an LLC liable for the tortious conduct of a member (*i.e.*, in some circumstances a member acts analogously to a "servant" or "employee" of the LLC); and (iii) an LLC might be liable for negligently supervising a member who is acting on behalf of the LLC. A person's status as a member does not weigh against these or any other relevant theories of law.

Moreover, subsection (a) does not prevent member status from being relevant to one or more elements of an "other law" theory. *See* Section 111. The most likely "other law" theory is the agency doctrine of apparent authority. Of course, if a member lacking actual authority binds an LLC through conduct within the member's apparent authority, the LLC has a claim against the member. RESTATEMENT

~~(THIRD) OF AGENCY § 8.09 (2006) (Duty to Act Only Within Scope of Actual Authority and to Comply with Principal's Lawful Instructions)~~. ~~In contrast, if the member lacked even the power to bind the LLC, the member him, her, or itself will be liable to the vendor as a matter of agency law~~. ~~RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006) (Agent's Implied Warranty of Authority).~~

For example, the common law of agency will determine the apparent authority of a member to bind a ~~member~~manager-managed LLC. In that analysis what the particular third party knows or has reason to know about the management structure and business practices of the particular LLC will always be relevant. RESTATEMENT (THIRD) OF AGENCY § 3.03, cmt. b (2006) ("A principal may also make a manifestation by placing an agent in a defined position in an organization … . Third parties who interact with the principal through the agent will naturally and reasonably assume that the agent has authority to do acts consistent with the agent's position … unless they have notice of facts suggesting that this may not be so.")

Of course, if a member lacking actual authority binds an LLC through conduct within the member's apparent authority, the LLC has a claim against the member. RESTATEMENT (THIRD) OF AGENCY § 8.09 (2006) (Duty to Act Only Within Scope of Actual Authority and to Comply with Principal's Lawful Instructions). In contrast, if the member lacked even the power to bind the LLC, the member him, her, or itself will be liable to the vendor as a matter of agency law. RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006) (Agent's Implied Warranty of Authority).

Under ~~Section 301(a~~A.R.S. § 29-3301(B), however, the mere fact that a person is a member of a ~~member~~manager-managed limited liability company cannot *by itself* establish apparent authority by position. A course of dealing, however, may easily change the analysis:

> EXAMPLE: David is a one of two members of DS, LLC, a ~~member~~manager-managed LLC. David orders paper clips on behalf of the LLC, signing the purchase agreement, "David, as a member of DS, LLC." Absent further facts, David has no apparent authority to bind the LLC. However, the vendor accepts the order, sends an invoice to the LLC's address, and in due course receives a check drawn on the LLC's bank account. When David next places an order with the vendor, the LLC's payment of the first order is a manifestation that the vendor may use in asserting that David had apparent authority to place the second order. A successful apparent authority claim also presupposes that: (i) the vendor believed that David was authorized; and (ii) the belief was reasonable. RESTATEMENT (THIRD) OF AGENCY § 3.03 (2006) (Creation of Apparent Authority).

In general, a member's actual authority to act for ~~an~~a manager-managed LLC will depend fundamentally on the operating agreement~~.~~ or the manager's decision under A.R.S. § 29-3407(C) to authorize the member to act for the LLC. *See* the ~~comment~~ Arizona and Modified RULLCA Comments to ~~Section 407(b).~~A.R.S. § 29-3407.

A.R.S. § 29-3302. RESERVED.

Arizona Comment
(Rev. 2/23/2024)

Section 302 of RULLCA sets forth rules for the filing of "Statements of Authority" whereby the agency authority of specified managers or members may be limited, enlarged or terminated with respect to transactions in real estate and any other matter. The rules are complicated and contain many exceptions. The Prior Act contained no similar provisions.

The Drafting Subcommittee determined, based upon 25 years of experience with existing law, that Arizona LLCs have been able to enter into major financial transactions (including the transfer and encumbrance of real property) without the need for filing or recording statements of authority, and that the basic authority default rules under A.R.S. § 29-3301 are sufficient to enable a member or manager to conduct ordinary course transactions on behalf of the company. Furthermore, because the Arizona Corporation Commission files documents in a ministerial capacity without verifying the authority of the signer, the Drafting Subcommittee believed that Statements of Authority were susceptible to fraudulent use. Accordingly, section 302 of RULLCA was omitted from the Act.

Modified RULLCA Comment
(Rev. 2/23/2024)

~~This section is derived from and builds on UPA (1997) § 303, which was refined in ULLCA (2006) and further refined in the Harmonization Project. This section is conceptually divided into two realms: statements pertaining to the power to transfer interests in the LLC's real property and statements pertaining to other matters~~. ~~In the latter realm, statements are filed only in the records of the filing office and operate only to the extent the statements are actually known and relied on by a third party~~. ~~Section 302(d) and (e).~~

~~As to interests in real property, in contrast, this section: (i) requires double-filing—with the filing office and in the appropriate land records; and (ii) provides for constructive knowledge of statements limiting authority~~. ~~Thus, a properly filed and recorded statement can protect the limited liability company, Section 302(g), and, in order for a statement pertaining to real property to be a sword in the hands of a third party, the statement must have been both filed and properly recorded. Section 302(f)~~. ~~Experience suggests that statements of authority will most often be used in connection with transactions in real estate.~~

~~By its terms, this section applies only to domestic limited liability companies~~. ~~A foreign LLC cannot make use of this section even as to real property located in this state~~. ~~The section refers throughout to "limited liability company," which this act defines as a domestic limited liability company~~. ~~*See* Section 102(8) ("'Limited liability company'… means an entity formed under this [act] or which becomes subject to this [act]")~~. ~~*Cf. Fannie Mae v. Heather Apartments Ltd. P'ship*, A13-0562, 2013 WL 6223564 at *6 (Minn. Ct. App. Dec. 2, 2013) (considering the remedies available to a judgment creditor with respect to the judgment debtor's interest in a Cook Islands LLC; rejecting the debtor's argument that the creditor's "only remedy is to obtain a charging order under" [the Minnesota LLC statute]; explaining that "this argument fails because that statute only applies to Minnesota limited liability companies" which the Minnesota LLC statute "defines … as 'a limited liability company, other than a foreign limited liability company, *organized or governed by this chapter*'") (emphasis added; statutory citations omitted).~~

~~**Subsection (a)(2)** – This paragraph permits a statement to designate authority by position (or office) rather than by specific person, thus avoiding the need to file anew whenever a new person assumes the position or the office~~. ~~This type of a statement will enable LLCs to provide evidence of ongoing power to enter into transactions without having to disclose to third parties the entirety of the operating agreement.~~

~~**Subsection (a)(2)(A) and (a)(3)(A)** – The authority to "sign" an instrument includes the authority to commit the partnership to the transfer reflected in the agreement~~. ~~*See* Subsection (f) (referring not merely to signing but also to "an effective statement of authority that grants authority to transfer real property").~~

~~Here and elsewhere in the section, the phrase "real property" includes all interests in real property, such as mortgages, easements, etc.~~

Subsection (c) – This subsection expresses a very important limitation – *i.e.*, that this section's rules do not operate viz-a-viz members. For members, the operating agreement is controlling. Section 107(d). However, like any other record delivered for filing on behalf of an LLC, a statement of authority might be some evidence of the contents of the operating agreement. *See* the comment to Section 107(d).

Another important limitation exists. The filing office is not affected by a statement of authority that purports to delineate the authority of persons to sign documents to be delivered for filing of behalf of a limited liability company. The act does define "[p]erson" to include a "government or governmental subdivision, agency, or instrumentality," Section 102(15), but "a limitation on the authority of a person or a position contained in an effective statement of authority is not by itself evidence of knowledge or notice of the limitation by any person." Subsection (d).

Moreover, even if an employee of the filing office happened to see that a statement of authority purported to delineate the authority of persons to sign records to be delivered on behalf of an LLC, that information would not pertain to a "fact [that] is material to the agent's duties to the principal" and therefore would not be attributed to the filing office. RESTATEMENT (THIRD) OF AGENCY § 5.03 (2006).

Subsection (d) – The phrase "by itself" is important, because the existence of a limitation of authority could be evidence if, for example, the person in question reviewed the public record at a time when the limitation was of record.

Subsection (e)(1) – What happens if a statement of authority conflicts with the contents of an LLC's certificate of organization? The contents of the certificate are not statements of authority, Section 201(c), so the information in the certificate does not directly figure into the operation of this section. However, if the person claiming to rely on a statement of authority had read the certificate's conflicting information before giving value, that fact might be evidence that person gave value with "knowledge to the contrary" of the statement.

Subsection (e)(2) – This paragraph by its terms does not affect a claim of lingering apparent authority. A person could: (i) assert knowledge of a statement of authority as the statement existed before a cancellation or restrictive amendment; and (ii) characterize the original statement as a manifestation of authority traceable to the limited liability company. RESTATEMENT (THIRD) OF AGENCY § 3.03, cmt. b (2006) ("Apparent authority is present only when a third party's belief is traceable to manifestations of the principal.").

However, for apparent authority to exist, the purported agent must *reasonably* appear to be authorized. RESTATEMENT (THIRD) OF AGENCY § 2.03 (2006) (stating that apparent authority can only exist when "a third party reasonably believes the actor has authority to act on behalf of the principal"). Given the possibility of cancellation or restrictive amendment, it might not be reasonable for a person to know of a statement of authority, let time pass, and then rely on the statement without re-checking the public record.

Subsections (f) through (h) – These subsections: (i) pertain to transactions in real property; (ii) provide a mechanism by which authority to transfer an LLC's real property can be made to appear in the real estate records; and (iii) thus address the principal concerns (raised by real estate lawyers) that led the drafters of UPA (1997) to provide for statements of authority.

Subsection (f) – This subsection provides a sword for a vendee of real property. If the vendee has "give[n] value in reliance on the grant without knowledge to the contrary," the statement of authority protects the vendee against claims that contradict the grant.

~~**Subsection (f)(1) and (2)** – As a claim of lingering apparent authority, *see* the comment to Section (e)(2)~~. ~~The analysis stated there applies even more strongly in the context of customary practices involving land transfers.~~

~~**Subsection (g)** – This subsection provides a shield for the limited liability company as alleged vendor~~. ~~If a vendee's claim contradicts the stated limitation, constructive knowledge ("deemed to know") defeats the claim even if the vendee gave value and lacked actual knowledge.~~

~~**Subsection (h)** – This subsection integrates statements of dissolution and termination, Section 702, into the operation of this section.~~

~~The effect of a statement of dissolution depends on the circumstances~~.

~~EXAMPLE: ABC, LLC has in effect a properly filed and recorded statement of authority authorizing ABC's CEO to transfer real estate owned by the LLC~~. ~~The proper filing and recording by ABC of a statement of dissolution cancels the statement of authority~~. ~~Subsequently, Buyer gives value in return for a deed signed by the CEO on behalf of ABC~~. ~~Due to Subsections (h) and (f)(1), Subsection (f) does not protect Buyer. Moreover, under Subsections (g) and (h), Buyer is "deemed to know" of the dissolution~~. ~~Whether that deemed knowledge functions to deprive the CEO of authority to bind ABC depends on agency law and additional facts~~. ~~For example, the CEO might have had actual or apparent authority to transfer the real estate despite the dissolution of the LLC~~.

~~If properly filed with the filing office and properly recorded in the office for land records, a statement of termination eliminates the power of any person to transfer real property owned in the name of the LLC~~. ~~No one can have the authority to act for a non-existent entity. *Cf.* RESTATEMENT (THIRD) OF AGENCY § 4.04(1)(a) (2006) (precluding ratification by a principal that did not exist at the time of the unauthorized act).~~

~~**Subsection (i)** – This provision permits an LLC to use statements of authority during winding up~~. ~~As an additional protection for third parties, a statement must be "designated as a post-dissolution statement of authority" to be effective under this provision.~~

~~**Subsection (k)** – Presumably, when real property is involved, a person who obtains the filing of a statement of denial under Section 303 will cause a certified copy of the statement to be "recorded by certified copy for purposes of subsection (f)(1)" [undercutting constructive notice as to authority to transfer real property]~~. ~~However, nothing in this subsection prevents the limited liability company from causing a certified copy to appear in the land records; due the section's use of the passive voice ("may be recorded"), the act does not delimit who has the authority to act under this subsection.~~

A.R.S. § 29-3303. RESERVED.

Arizona Comment
(Rev. 2/23/2024)

Section 303 of RULLCA provides for the public filing of a "Statement of Denial" by a person who was named as an authorized agent of a limited liability in a previously filed "Statement of Authority" under RULLCA § 302. Section 303 of RULLCA was omitted from the Act because § 302 of RULLCA was omitted (for the reasons explained in the Arizona Comment to A.R.S. § 29-3302)

Modified RULLCA Comment
(Rev. 2/23/2024)

~~A person whose powers are delineated in the public record by another person should have the right to dissent from that delineation~~. ~~This section takes an "all or nothing" approach; a person may not deny in part and confirm in part~~. ~~For the effect of a statement of denial, *see* Section 302(k).~~

A.R.S. § 29-3304. LIABILITY OF MEMBERS AND MANAGERS.

Arizona Comment
(Rev. 2/23/2024)

Section 29-3304 of the Act is the same as section 304 of RULLCA, except for the addition of the phrase "or for the acts or omissions of any other member, manager, agent or employee of the company." The Drafting Subcommittee added this phrase to remove any possibility that a member or manager might be vicariously liable for acts or omissions of another member, manager, agent or employee of the company. The addition of this phrase does not affect the basic principle that each member and manager remains personally liable for his or her own wrongful conduct, including liability arising under the common law of agency for an act beyond the scope of a member's or manager's authority, under contract law for a breach of the operating agreement, or under tort law for fraud or other tortious conduct (such as negligent supervision of another member, manager, agent, or employee where the duty to supervise exists).

Subsection (A) is substantially similar to A.R.S. § 29-651 of the Prior Act.

Modified RULLCA Comment
(Rev. 2/23/2024)

Derivation – ULLCA (2006) derived this section from UPA (1997) § 306, which was also the source for ULPA (2001) § 404. The Harmonization Project brought the two partnership acts and the limited liability company act into accord to the extent the three acts overlap.

Subsection (~~a~~A) – This subsection provides a corporate-like liability shield to members and managers, protecting them against ~~(and only against)~~ the debts, obligations and liabilities of the limited liability company – *i.e.*, against a member's or manager's alleged vicarious liability for the obligations of the entity. The shield "applies regardless of the dissolution of the company" and thus continues in effect through the completion of winding up (*i.e.*, termination). The shield applies regardless of the law giving rise to a claim against a limited liability company.

Shield Applicable Regardless of the Identity of the Plaintiff

What makes the shield relevant is the nature of the claim. If the complaint seeks to hold a member vicariously liability for the LLC's obligations, the shield applies. If not, not. Thus, there is no distinction between a claim arising from an LLC's debt to a commercial creditor, a member's claim that the LLC has failed to return a contribution as required by the operating agreement, and a claim by a former member that the LLC has failed to follow through on a buy-out agreement. *See Rappaport v. Gelfand*, 197 Cal. App.4th 1213, 1230-1232, 129 Cal. Rptr. 3d 670, 682-84 (Cal. App. 2 Dist. 2011) (involving a claim by a former partner). *Accord Ederer v. Gursky*, 9 N.Y.3d 514, 526, 881 N.E.2d 204, 212-213 (N.Y. 2007) (Smith, J., dissenting).

Shield Inapposite for Claims Arising from a Member's or Manager's Own Conduct

Because the member or manager liability at issue is solely vicarious, the shield is irrelevant to claims seeking to hold a member or manager directly liable on account of the member's or manager's own conduct. Put another way, "[t]here is no question" that "the member-manager of a limited liability company who causes his business to breach common law and statutory duties may be held independently liable for his personal torts." *Dep't of Agric. v. Appletree Mktg., L.L.C.*, 485 Mich. 1, 4, 18, 779 N.W.2d 237, 239, 247 (2010).

A few judges have failed to understand this point. *See Puleo v. Topel*, 368 Ill. App. 3d 63, 68-69, 856 N.E.2d 1152, 1157 (Ill. App. Ct. 2006) (basing its holding on a legislative amendment that "removed … language which explicitly provided that a member or manager of an LLC could be held personally liable for his or her own actions or for the actions of the LLC to the same extent as a shareholder or director of a corporation could be held personally liable").

This mistaken view: (i) ignores the actual words of LLC shield provisions (which protect members and managers only against liability for obligations *of* an LLC and make no reference to direct obligations of a member or manager); and (ii) flouts public policy (which recoils from the idea of immunizing a person's misconduct solely because the person acts on behalf of an organization). Moreover, the mistaken view is contrary to the overwhelming weight of the case law. *See, e.g., Mbahaba v. Morgan*, 163 N.H. 561, 565, 44 A.3d 472, 476 (2012) ("When … a member or manager commits or participates in the commission of a tort, whether or not he acts on behalf of his LLC, he is liable to third persons injured thereby."); *Sturm v. Harb Dev., LLC*, 298 Conn. 124, 138, 2 A.3d 859, 870 (2010) (holding that the liability shield of an LLC is subject to "the common-law tort exception … [for] individual claims against LLC members); *Allen v. Dackman*, 413 Md. 132, 154, 991 A.2d 1216, 1229 (2010) ("An LLC member is liable for torts he or she personally commits, inspires, or participates in because he or she personally committed a wrong, not 'solely' because he or she is a member of the LLC."); *Weber v. U.S. Sterling Sec., Inc.*, 282 Conn. 722, 732–34, 924 A2d 816, 824–25 (2007) (stating that the Delaware LLC Act "does not preclude individual liability for members of a limited liability company if that liability is not based simply on the member's affiliation with the company" and holding, in particular, that the Act "does not bar the defendants' liability for tortious conduct").

> EXAMPLE: A manager personally guarantees a debt of a limited liability company. Subsection (~~a~~A) is irrelevant to the manager's liability as guarantor.

> EXAMPLE: A member purports to bind a limited liability company while lacking any statutory or agency law power to do so. The limited liability company is not bound, but the member is liable for having breached the "warranty of authority" (an agency law doctrine). Subsection (~~a~~A) does not apply. The liability is not *for* a debt, obligation, or other liability of the [limited liability] company, but rather is the member's own, direct liability. Indeed, the liability exists because the limited liability company is *not* indebted, obligated or liable. RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006).

> EXAMPLE: A manager of a limited liability company defames a third party in circumstances that render the limited liability company vicariously liable under agency law. Under Subsection (~~a~~A), the third party cannot hold the manager accountable for the *company's* liability, but that protection is immaterial. The manager is the tortfeasor and in that role is directly liable to the third party.

> EXAMPLE: A limited liability company provides professional services, and one of its members commits malpractice. The liability shield is irrelevant to the member's direct liability in tort. However, if the member's malpractice liability is attributed to the LLC under agency law

principles, the liability shield will protect the other members of the LLC against a claim that they must make good on the LLC's liability.

EXAMPLE: A single member limited liability company enters into a contract to build a home, and the member performs substantial amounts of the work. The homeowner sues both the LLC and the member for allegedly defective work, but the complaint sounds in contract rather than in tort. The LLC may be liable, but the member is not. *See Ogea v. Merritt* --- So.3d ----, 2013 WL 6439355 at *24-25 (La. 2013).

Subsection (~~a~~A) ~~pertains only to claims based on the LLC's liability and~~ is irrelevant to claims by a limited liability company against a member or manager and *vice versa*. *E.g.*, ~~Sections 408~~A.R.S. § 29-3408 (pertaining to a limited liability company's obligation to indemnify a member or manager), ~~409~~§ 29-3409 (pertaining to management duties) and ~~801~~§ 29-3801 (pertaining to a member's rights to bring a direct claim against a limited liability company).

Shield Inapposite to Role Liability Claims

Provisions of regulatory law may impose liability on a member or manager due to a role the person plays in the LLC. *See, e.g., Food Team Intern., Ltd. v. Unilink, LLC*, 872 F. Supp. 2d 405, 424 (E.D Pa. 2012) (holding several individuals "subject to secondary individual liability under PACA [Perishable Agricultural Commodities Act]" because their roles within the LLC enabled them to control the relevant assets) (citing *Bear Mountain Orchards, Inc. v. Mich–Kim, Inc.*, 623 F.3d 163, 172 (3d Cir. 2010)).

The Shield and Dissolution.

The rule stated here is inherent in the nature of LLC dissolution. "[D]issolution does not end a limited liability company's existence but rather changes the purpose of that existence." Section 701, cmt. "A dissolved limited liability company shall wind up its activities and affairs and … continues after dissolution … for the purpose of winding up." ~~Section 702(a).~~A.R.S. § 29-3702(A). Put another way: dissolution and winding up are part of the life cycle of a limited liability company – sometimes the most complicated part. There is no logical reason to remove the shield during the last part of an LLC's life cycle.

This subsection makes this point expressly, because it is possible to misinterpret some outlying LLP cases as holding to the contrary. *See, e.g., Carolina Cas. Ins. Co. v. L.M. Ross Law Grp., LLP*, 151 Cal. Rptr. 3d 628, 635 (2012) (affirming the trial court's decision to hold an LLP's named partner liable for a judgment against his limited ability partnership; noting that "[c]entral to the decision to amend the judgment to add Ross [the named partner] as a judgment debtor … is the trial court's finding that Ross Law Group dissolved"; recognizing, however, that, before the partnership incurred the liability, Ross had signed and filed with the California Secretary of State a form stating that the law firm had "cease[d] to be a registered limited liability partnership and is hereby filing this notice with the California Secretary of State that [it] is no longer a registered limited partnership") (quotation marks omitted).

The Shield and Termination

This subsection does not expressly provide that, when a limited liability company's existence terminates, the liability shield remains in place as to any debt, obligation, or other liability of the LLC incurred before the termination. However, the point follows ineluctably from Subsection ~~304(a~~(A), which provides that the shield applies to any "debt, obligation, or other liability of a limited liability company." A debt, obligation or other liability of an LLC does not disappear merely because the LLC has terminated.

Moreover, any other result would: (i) create huge holes in the shield; (ii) put the law of unincorporated businesses at odds with the law of corporations; (iii) render surplus this act's distribution recapture provision, ~~Section 406~~A.R.S. § 29-3406; and (iv) render nonsensical the otherwise logical extension of the equitable trust fund theory to limited liability companies. *Cf. Velasquez v. Franz*, 589 A.2d 143, 146 (N.J. 1991) (explaining that "the trust-fund doctrine… renders shareholders who receive distributed assets of the corporation liable as 'trustees' for claims of the corporation's creditors").

Dangers of Indemnification Provisions Inter Se the Members

Despite the phrase "by way of contribution or otherwise," the LLC shield has no effect on contribution or indemnification requirements running directly from member to member or from members to a manager. These obligations are not obligations of the LLC but rather personal to each member. Indirectly they pose a risk to the shield as to liability arising from the misconduct of a member or manager.

> EXAMPLE: A law firm operates as a professional limited liability company. One practice area (the "Practice Area") brings in large fees but also exposes its practitioners (the "Practitioners") to liability risks substantially higher than the risks faced by other lawyers in the firm. Fees in the Practice Area are episodic, so it makes sense for the Practitioners to share profits with the rest of the firm, where returns are lower but more regular.
>
> The firm carries liability insurance, and the operating agreement provides broad indemnification rights to all the firm's lawyers. However, the Practitioners are mindful that the LLC liability shield sets a practical limit to the firm's indemnification obligations and that policies of insurance have limits. The Practitioners obtain a provision in the operating agreement by which each member of the LLC makes a personal promise of indemnification (subject to a cap).
>
> The tortious conduct of one of the Practitioners (the "Tortfeasor") results in a substantial judgment against the Tortfeasor and, per ~~Section 305(a~~A.R.S. § 29-3304(A), against the LLC. For unrelated reasons, the LLC has become insolvent and its liability coverage is "maxed out." The Tortfeasor's right to indemnification from fellow members is an asset of the Tortfeasor. The judgment creditor can levy on that asset, thereby defeating the liability shield in effect if not in form.

Subsection (~~b~~B) – This subsection pertains to the equitable doctrine of "piercing the veil" – *i.e.*, conflating an entity and its owners to hold one liable for the obligations of the other. The doctrine of "piercing the corporate veil" is well-established, and courts regularly (and sometimes almost reflexively) apply that doctrine to limited liability companies. In the corporate realm, "disregard of corporate formalities" is a key factor in the piercing analysis. In the realm of LLCs, that factor is inappropriate, because informality of organization and operation is both common and desired. *See, e.g., In re Packer*, Bankruptcy No. 13–41304, 2014 WL 5100095 (Bankr. E.D. Tex. Oct. 10, 2014) (noting the informality of LLC governance, recognizing that "the disregard of corporate formalities … [is] one of the key factors in [corporate] veil-piercing determinations"; but holding that "'it makes no sense to imperil the shield simply because the members do not undergo meaningless formalities such as formal meetings'") (citing Carter G. Bishop & Daniel S. Kleinberger, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 6.03 at *3 (Thomson Reuters Tax and Accounting 2014)).

The formalities at issue are the process formalities of governance – both those few created by this act and however few or many might be created by the operating agreement.

> EXAMPLE: The operating agreement of a three-member, member-managed limited liability

company requires formal monthly meetings of the members. Each of the members works in the LLC's business, and they consult each other regularly. They have forgotten or ignore the requirement of monthly meetings. Under Subsection (~~b~~B), that fact is irrelevant to a piercing claim.

In contrast, this subsection is inapposite to another key piercing factor – disregard of the separateness between entity and owner. *E.g., Vanderford Co. v. Knudson*, 165 P.3d 261, 271 (Idaho 2007) (noting that managing member and "his accountant testified that the LLC's checking account was so confusing that the accountant could not be sure whose money was in the account at what times"); *Utzler v. Braca*, 972 A.2d 743 (Conn. App. 2009) (holding that veil piercing was appropriate under alter-ego theory when owner deposited LLC funds into a commingled bank account from which he made withdrawals for personal needs and unrelated projects).

EXAMPLE: The sole owner of a limited liability company uses a car titled in the company's name for personal purposes and writes checks on the company's account to pay for personal expenses. These facts are relevant to a piercing claim; they pertain to economic separateness, not Subsection (~~b~~B) formalities.

This subsection also is inapposite to a member's claim of ~~oppression~~breach of the operating agreement or duty of loyalty under ~~Section 701(a~~A.R.S. § 29-3701(A)(4)(~~C~~c)(ii). In some circumstances, disregard of agreed-upon formalities can be a "freeze out" mechanism. Likewise, this subsection has no relevance to a member's claim that the disregard of agreed-upon formalities is a breach of the operating agreement.

This subsection addresses claims to "impos[e] liability on a member or manager for a debt, obligation, or other liability of the company" – *i.e.*, for what is sometimes termed a "direct pierce." Whether the same approach should apply to claims for a "reverse pierce" is a question for the courts. *See Comm'r of Envtl. Prot. v. State Five Indus. Park, Inc.*, 304 Conn. 128, 140, 37 A.3d 724, 732-33 (2012) (stating that "[a]lthough some courts have adopted reverse veil piercing with little distinction as a logical corollary of traditional veil piercing, because the two share the same equitable goals, others wisely have recognized important differences between them").

ARTICLE 4
RELATIONS OF MEMBERS TO EACH OTHER AND TO LIMITED LIABILITY COMPANY

A.R.S. § 29-3401. BECOMING A MEMBER; TRANSFERABLE INTEREST; OWNERSHIP OF INTEREST IN LIMITED LIABILITY COMPANY.

Arizona Comment
(Rev. 2/23/2024)

A.R.S. § 29-3401 of the Act departs from § 401 of RULLCA in several important ways.

Subsection (A) requires that a limited liability company have at least one member at the time of its formation, in keeping with the Prior Act. If it has only one member at formation, the member must be identified in the filed articles of organization and must agree to be a member. The member's agreement is an important element of member status, as it prevents an organization from conferring (or imposing) member status upon a person without the person's awareness and consent. Note that A.R.S.§ 29-3201(E) expressly allows parent and subsidiary limited liability companies to be formed at the same time.

In the unusual circumstance where none of the persons named as members in the initial articles of organization has agreed to become a member (or has come into existence) at the time the Commission files the articles, that inaccurate statement in the articles will not adversely affect the existence of the limited liability company. A.R.S. § 29-3201(F) expressly provides that the Commission's filing of the articles is "conclusive proof … that the limited liability company has been legally organized and formed under this chapter." However, the inaccurate information in the filed articles regarding the existence of a member (like any other inaccurate information) may give rise to liability on the part of the company and its managers or members to any person who suffers loss by reliance on the inaccurate information under A.R.S. § 29-3205.

The Drafting Subcommittee considered and then rejected the approach taken by some other states (such as Delaware) which allow the creation of so-called "shelf" limited liability companies without any statutory requirement for at least one member who has agreed to become a member. Many troublesome issues may arise if a manager (inadvertently or intentionally) engages in a transaction in the name of the "shelf" company before it has a member, such as (i) whether a manager will be liable for the company's debts incurred before it has a member; (ii) whether the company must file income tax returns for the period before it has a member; and (iii) whether the company, before it has a member, will be treated as a *de facto* legal entity for purposes of owning property or any other purpose.

Subsection (B) states the requirements for becoming a member where the company has more than one member at the time of formation. Essentially, the members at that time must be in agreement regarding the persons who are members, and the agreement need not be evidenced by a signed record. Under the Prior Act, A.R.S. § 29-731(A) required that members at the time of formation be identified in one of three alternative documents: the initial articles of organization, an operating agreement signed by the members, or a written statement certified by each manager identified in the initial articles of organization. Under the Act, even an oral agreement will suffice to determine the identities of the members at the time of formation.

Subsection (C) prescribes four alternative methods whereby a person may be admitted as a member after formation of a limited liability company, and is the same as subsection (c) of RULLCA § 401. These requirements apply to every person who was not a member at the time of formation of the limited liability company, including each transferee of a transferable interest who desires to acquire the voting and other management rights of a member. The four methods are:

(1) pursuant to the terms of the operating agreement;

(2) with the consent of all members and the agreement of the person being admitted as a member;

(3) as the result of a merger or other restructuring transaction under Article 10;

(4) by consent of transferees after the dissociation of the last remaining member pursuant to A.R.S. § 29-3701(A)(3).

Although not referenced in subsection (C), a court may have equitable powers to compel the admission of a new member in extraordinary circumstances, including to avoid dissolution of a limited liability company pursuant to A.R.S. § 29-3701(B). However, the party seeking that remedy should bear a heavy burden to overcome the general policy (evident in subsection (C)) that members should have the right to choose with whom they must share the management rights of members.

Subsection (D) is the same as in RULLCA and provides that a person may become a member without holding or acquiring a transferable (i.e., economic) interest or promising to contribute capital to the company. Pursuant to A.R.S. § 29-3105(A), the operating agreement may limit the management participation rights of such a member (sometimes referred to as a “special” member). The certainty afforded by subsection (D) can be very useful, for example, if the company’s lender desires member status to obtain a veto right over specified business transactions (such as secondary debt financing). Also, the ability to issue a transferable interest without requiring a contribution is useful in attracting and retaining a key employee through the issuance of an interest in future profits.

Members may desire to provide for a “springing” member in their operating agreement, *i.e.,* a person who is not a member at the time the operating agreement is entered into but who automatically becomes a member at a specified later date or upon the occurrence of a specified contingency. Subsections (C) and (D) enable the members to do that without requiring the springing member to hold distribution rights or to make a contribution at the time of admission. To be effective, the operating agreement should either name the springing member or prescribe the method or procedure for determining his or her identity. On or before the effective date for the admission of a springing member, he or she should sign a counterpart of the operating agreement or a separate agreement to be admitted as a member and to be bound by its terms.

> EXAMPLE 1: A lender does not want its subsidiary to be a member on the date of the loan, but it desires to have veto rights over certain transactions (*e.g.,* a bankruptcy filing) in the event of a loan default. To satisfy the lender, the operating agreement provides that the lender’s named subsidiary automatically becomes a member upon a loan default and also requires unanimous member approval of the specified transactions of concern to the member.

> EXAMPLE 2: A.R.S. § 29-3701(A)(3) requires a limited liability company to dissolve and wind up its affairs if it ceases to have any members. To avoid the risk of dissolution if all of the members unexpectedly die or otherwise disassociate as members, the operating agreement provides for the automatic admission of a named springing member if the company fails to have at least one member.

Subsections (A) through (D) are default rules that may be modified by an operating agreement except insofar as those rules relate to the required contents of articles of organization. *See* A.R.S. § 29-3105(C)(3).

A basic principle underlying subsections (A) through (D) is that the determination of who is and who is not a member of a multiple member company is determined by agreement, not by the filed articles of organization. The articles of organization are intended to disclose the identities of members and managers on which third parties may rely. *See* A.R.S. § 29-3205. Should a discrepancy arise between the filed articles and the members' agreement regarding who is a member, the members' agreement will control as among the members and their transferees. Accordingly, if a dispute exists regarding who is or is not a member, no advantage can be gained by a party's filing of an amendment to the articles of organization.

Subsections (E) through (O) set forth the rules regarding the creation and termination of interests held by joint tenancies, tenancies in common, and community property, with or without rights of survivorship, and the relative rights and obligations of the co-owners. These provisions were incorporated into the Act from A.R.S. § 29-732.01 of the Prior Act (originally drafted by representatives of the Probate & Trust and Business Law Sections of the Arizona Bar) with minor wording changes to conform to the terminology of the Act. RULLCA contains no comparable provisions.

Modified RULLCA Comment
(Rev. 2/23/2024)

Most LLC statutes address in separate provisions: (i) how an LLC obtains its initial member or members; and (ii) how additional persons might later become members. This act follows that approach.

Subsections (~~a~~A) and (~~b~~B) – These subsections make explicit the agency relationship between the person acting as organizer and the initial member or members.

Subsection (~~c~~C)(3) – A limited liability company being in part a creature of contract, consent is determined on an objective basis (*i.e.,* contract law's "reasonable person" standard). Depending on the terms of an LLC's operating agreement, the members' manifestation of consent might involve detailed formalities, entirely informal activities, or anything in between. Moreover, the operating agreement might reduce the quantum of consent necessary or shift the consent right to a manager.

A limited liability company being a voluntary association, a person cannot become a member without manifesting consent or agreement to do so. That consent also is judged objectively.

Under ~~Section 106(b~~A.R.S. § 29-3106(B), "[a] person that becomes a member of a limited liability company is deemed to assent to the operating agreement," and the agreement binds the member regardless of whether the member has actually indicated assent in any way.

Subsection (~~d~~D)(1) – To accommodate business practices and also because a limited liability company need not have a business purpose, this provision permits so-called "non-economic members."

A.R.S. § 29-3402. FORM OF CONTRIBUTION.

Arizona Comment
(Rev. 2/23/2024)

This section is identical to section 402 of RULLCA and is substantially similar to the definition of "capital contribution" in A.R.S. § 29-601 of the Prior Act.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section is intentionally quite broad, encompassing past, present, and promised benefits. Comparable language exists in most, if not all, LLC statutes, and case law recognizes the intended broadness of this approach. *See, e.g.*, *Belgard v. Manchac Technologies, LLC*, 92 So.3d 660, 664 (La.App. 3 Cir. 2012) (stating that "the creation of an obligation to establish a $1.8 million line of credit was valid consideration for the transfer of 24% of the membership interest in Manchac"); *In re Eight of Swords, LLC*, 96 A.D.3d 839, 840, 946 N.Y.S.2d 248, 249 (N.Y.A.D. 2 Dept. 2012) (referring to "the petitioner's contributions to the LLC, which overwhelmingly consisted of services rendered to the LLC in the form of preparing and filing start-up documentation and performing activities associated with the renovation of the business's premises").

~~This act does not contain~~A.R.S. § 29-3403(A) contains a statute of frauds specifically applicable to promised contributions. Generally applicable statutes of fraud also might apply, however. For example, a promise to contribute land to the LLC would be subject to the statute of frauds pertaining to land transfers. Likewise, a promise that by its terms requires performance that extends beyond one year from the making of the contract would be subject to the one-year provision of the statute of frauds. *See* the Modified RULLCA Comment~~comment~~ to ~~Section 102(13).~~A.R.S. § 29-3102(17) relating to the definition of "operating agreement."

A.R.S. § 29-3403. LIABILITY FOR CONTRIBUTIONS.

Arizona Comment
(Rev. 2/23/2024)

This section is the same as section 403 of RULLCA, except that subsection (A) requires that a member's contribution obligation, to be enforceable against the member, must be set forth in a record signed by the member or, in the case of a successor member, must be set forth either in an operating agreement contained in a signed record or actually known by the successor member. This requirement reflects the same policy considerations underlying the statute of frauds and conforms to A.R.S. § 29-702(A) in the Prior Act. The Arizona corporate code also requires that a stock subscription agreement be set forth in a signed instrument to be enforceable. A.R.S. § 10-620(E).

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (~~a~~A) – Under common law principles of impracticability, an individual's death or incapacity will sometimes discharge a duty to render performance. RESTATEMENT (SECOND) OF CONTRACTS §§ 261 (Discharge by Supervening Impracticability), 262 (Death or Incapacity of Person Necessary For Performance). This subsection overrides those principles. Moreover, the reference to "perform personally" is not limited to individuals but rather may refer to any legal person (including an entity) that has a non-delegable duty.

Subsection (~~b~~B) – This subsection is a statutory liquidated damage provision, exercisable at the option of the limited liability company, with the damage amount set according to the value of the promised, non-monetary contribution.

> EXAMPLE: In order to become a member, a person promises to contribute to the limited liability company various assets "free and clear," which the operating agreement values at $150,000. In return for the person's promise, and in light of the agreed value, the limited liability company

admits the person as a member with a right to receive 25% of the LLC's distributions.

However, the promised assets are subject to a security agreement, and, before the member can contribute the assets, the secured party forecloses on the security interest and sells the assets at a public sale for $75,000. Even if the $75,000 reflects the actual fair market value of the assets, under this subsection the limited liability company has a claim against the member for "money equal to the value of the part of the contribution which has not been made" – *i.e.,* $150,000.

EXAMPLE: Same facts as the previous example, except that the public sale brings $225,000. The limited liability company is neither obliged to invoke this subsection nor limited to the $150,000. The LLC may instead sue for breach of the promise to make the contribution, asserting the $225,000 figure as evidence of the actual loss suffered as a result of the breach.

Subsection (~~c~~C) – The unanimity requirement expressed in the first sentence might indirectly benefit creditors, but the requirement is nonetheless a default rule and therefore may be varied by operating agreement. The right of each member to consent is not a "right[] under this [act] of a person other than a member or manager." *See* ~~Section 105(c)(15~~A.R.S.§ 29-3105(C)(12) (preventing the operating agreement from affecting such rights). In contrast, the creditor right stated in the second sentence fits squarely within ~~Section 105(c)(15~~A.R.S. § 29-3105(C)12) and therefore may not be varied by the operating agreement.

A.R.S. § 29-3404. SHARING OF AND RIGHT TO DISTRIBUTIONS BEFORE DISSOLUTION.

Arizona Comment
(Rev. 2/23/2024)

This section is the same as section 404 of RULLCA.

Subsection (A) sets forth the default rules for the sharing of distributions among members before dissolution of the limited liability company and the commencement of the winding up of the company's business and affairs. It provides that any such "interim" distributions be made to the members (or their respective transferees) in equal shares. In contrast, § 29-703(B) of the Prior Act required that interim distributions be made first to return the members' capital contributions in proportion to the value of their respective contributions, and thereafter in equal shares.

In many (perhaps most) cases, the members will desire to share interim distributions in proportions that are not equal. The operating agreement in those cases must specify the sharing proportions and priorities in order to override the default rules and thereby accomplish the members' objectives. If the operating agreement fails to do that, a history of multiple unequal distributions, without objection by any member, should serve as evidence of the members' oral agreement regarding how interim distributions are to be shared.

Subsection (B) states that interim distributions (i.e., distributions before the company's dissolution) will be made only "if the company decides to make an interim distribution." This rather vague statement is clarified by A.R.S. § 29-3407 of the Act, which provides (as a default rule) that interim distributions are decided by a majority of the managers in a manager-managed company or by a majority in interest of the members in a member-managed company. Subsection (B) also provides (as a default rule) that no member is entitled to a distribution upon his or her dissociation as a member, regardless of the cause of dissociation.

Subsection (C) is substantially the same as A.R.S. § 29-704 of the Prior Act.

Subsection (D) is substantially the same as A.R.S. §§ 29-705 and 29-734 of the Prior Act.

Modified RULLCA Comment
(Rev. 2/23/2024)

Past uniform unincorporated entity acts and many current LLC acts provide default rules for allocation of profits, and UPA (1997) even provided a default structure for maintaining capital accounts. For the following reasons, this act, incorporating changes made by the Harmonization Project, provides a default rule only for rights to share in distributions:

- Capital accounts are maintained for one purpose, to determine how distributions will be made to members. The rules for maintenance of capital accounts can be very complex. Generally, however, profits increase capital account balances (and increase the amounts that will be distributed to the members) and losses reduce capital account balances (and reduce the amounts that will be distributed to the members). If the statute has a simple default rule for how distributions are to be made to the members, providing an additional set of default profit and loss allocation provisions and capital account rules will be, at best, duplicative and, at worse, inconsistent with the distribution rules.
- Some argue that capital account rules and profit and loss allocation provisions are necessary to comply with tax requirements. Tax income or loss is allocated to "partners" (including members of an LLC taxed as a partnership) according to the partners' economic interests in the LLC, and these interests are based on distributions that would be made to partners on liquidation of the LLC. By including default distribution provisions, the act includes the information necessary to make these tax determinations. To the extent the tax law allows partners to make further tax elections or satisfy alternative safe harbors, the partners may look to the tax law for guidance and include necessary provisions in their agreements.

Subsection (~~a~~A) – The rule stated applies to redemptions as well as operating distributions but is a default rule in both contexts. *See* the comment to ~~Section 102(4)(A~~A.R.S. § 29-3102(6)(a)**.**

Subsection (~~b~~B) – The second sentence of this subsection accords with ~~Section 603(a~~A.R.S. § 29-3603(A)(3) – upon dissociation a person is treated as a mere transferee of its own transferable interest. Like most *inter se* rules in this act, this one is subject change by the operating agreement. *See* the comment to ~~Section 603(a~~A.R.S. § 29-3603(A)(3).

Subsection (~~d~~D) – *See also* ~~Section 405(d~~A.R.S. § 29-3405(D) (pertaining to the rights of members and transferees that receive a distribution in the form of indebtedness) and ~~405(e~~A.R.S. § 29-3405(E) (pertaining to solvency testing for payments on indebtedness issued to redeem an interest).

A.R.S. § 29-3405. LIMITATIONS ON DISTRIBUTIONS.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as section 405 of RULLCA, with one exception. Both A.R.S. § 29-3405(A)(2) and RULLCA § 405(a)(2) prohibit distributions that result in the limited liability company's assets being less than its liabilities. RULLCA, however, treats preferential distribution rights as a liability of the company if a distribution is to be made to a member having inferior distribution rights. This treatment of preferential rights was rejected to make the Act conform to the Prior Act.

Subsection (A) also proscribes a distribution if, after the distribution, the limited liability company would not be able to pay its debts as they become due in the ordinary course. The Prior Act contained no similar restriction.

Subsection (B) is the same as A.R.S. § 29-706(B) of the Prior Act.

Subsection (C) is substantively the same as RULLCA § 405(c), but it adds an explicit clarification that a redemption of a member's transferable (i.e., economic) interest includes the limited liability company's purchase of all or part of a member's transferable interest (even though the purchase is not called a "redemption") and any transfer of money or other property by the company in exchange for the relinquishment of a member's management or information rights. This clarification is not a substantive departure from RULLCA, which contains the same provisions in its definition of the term "distribution" in § 102(4) of RULLCA.

The restrictions on distributions under A.R.S. § 29-3405 cannot be reduced or eliminated by the terms of an operating agreement pursuant to A.R.S. § 29-3105(C)(13).

Modified RULLCA Comment
(Rev. 2/23/2024)

Both this section and ~~Section 406~~A.R.S. § 29-3406 were derived essentially from the Model Business Corporation. Act section 6.40. Both sections are necessary and appropriate because a limited liability company provides its members and managers a corporate-like liability shield. ~~With the exception noted in the comment to Subsection (a)(2), the~~The provisions of this section are non-waivable. ~~Section 105(c)(15~~A.R.S. § 29-3105(C)(12) and (C)(13).

"Distribution" does not include "amounts constituting reasonable compensation for present or past service or payments made in the ordinary course of business under a bona fide retirement plan or other bona fide benefits program." ~~Section 102(4)(B~~A.R.S. § 29-3102(6)(c).

Subsection (~~a~~A) – Insolvency is a fundamental issue under this section, and this subsection provides two tests of insolvency. The tests are disjunctive; a distribution violates this section if after the distribution the LLC fails either of the tests. The subsection applies both to interim and liquidating distributions.

Solvency is also a fundamental issue under bankruptcy and fraudulent transfer law, which provide their own respective definitions of the concept.

~~**Subsection (a)(2)** – The reference to "preferential rights upon dissolution and winding up" is a default rule, because removing this protection for preferred members or transferees is an *inter se* matter. *See* Section 105(d)(1)(B). The rest of the section is not subject to change in the operating agreement. Section 105(c)(15).~~

Subsection (~~b~~B) – This subsection states a standard of ordinary care, in contrast with the generally-applicable standard stated in ~~Section 409(c)~~A.R.S. § 29-3409(C) (gross negligence).

Subsection (~~b~~B)(2) – This alternative valuation provision is likely to be both useful and fair when the limited liability company has appreciated assets but for accounting purposes these assets are valued at book value less depreciation.

Subsection (~~c~~C) – This subsection provides three alternative rules for determining the point(s) in

time of as which to apply the Subsection (~~a~~A) solvency tests. The timing depends on which of three categories encompasses a distribution: (i) a distribution in the nature of a redemption (regardless of whether the distribution includes a distribution of indebtedness); (ii) any distribution of indebtedness other than a distribution in the nature of a redemption; and (iii) any distribution that involves neither a redemption nor a distribution of indebtedness. A requirement for additional solvency testing pertaining to distributions of indebtedness appears in Subsection (~~e~~E).

Subsection (~~c~~C)(1) – ~~Section 102(4)(A)~~A.R.S. § 29-3102(6)(B) encompasses distributions in the nature of a redemption.

Subsection (~~c~~C)(1)(~~A~~a) and (~~B~~b) – Under Subparagraph (~~A~~a), any beginning of payment activity triggers the rule and sets the date as of when to apply the solvency tests. Under Subparagraph (~~B~~b), the LLC's complete acquisition of the rights is necessary to trigger the rule.

Subsection (~~c~~C)(2) – This provision states the general rule for distributions in the form of debt which ~~arenot~~are not connected with a redemption.

Subsection (~~c~~C)(3) – This provision states alternative rules for all distributions of money or property (*i.e.*, not debt). The measuring date depends on the length of time between the authorization and payment of the distribution.

Subsection (~~d~~D) – *Compare* Subsection (~~d~~D), *with* ~~Section 404(d)~~A.R.S. § 29-3404(D) (characterizing as a creditor a person who has become entitled to receive a distribution).

Subsection (~~e~~E) – This subsection contains two rules pertaining to indebtedness issued as part of a distribution and the solvency tests of Subsection (~~a~~A). The first sentence states the sensible rule that indebtedness that is essentially subordinated to the solvency requirement – *i.e.*, not payable if making payment would transgress that requirement – is not counted in determining liabilities for purposes of the solvency tests. The second sentence applies the solvency tests to each payment of principal and interest on any indebtedness issued as a distribution, in addition to any previous testing required by Subsection (~~c~~C)(1)(~~A~~a) or (~~c~~C)(2).

> EXAMPLE: An LLC and one of its members agree that the LLC will buy out the member's entire ownership interest in the LLC in return for a promissory note from the LLC, payable in installments. Under the redemption agreement, the member surrenders all its interests and rights on January 15 and the LLC signs and delivers the note to the person dissociated as a member on February 15. Under the note, payment of interest is due monthly beginning March 15, with a balloon payment of the principal due December 30.

Under Subsection (~~c~~C)(1)(~~B~~b), the solvency tests are applied as of January 15. Under Subsection (~~e~~E), the solvency tests are again applied on the March 15, April 15, etc., and again on December 30.

Subsection (~~f~~F) – The cited sections provide methods for extinguishing or limiting the debts of an LLC that is winding up its affairs and activities and thus any debt affected by any of the cited sections is irrelevant for purposes of solvency testing.

A.R.S. § 29-3406. LIABILITY FOR IMPROPER DISTRIBUTIONS.

Arizona Comment
(Rev. 2/23/2024)

This section differs markedly from section 406 of RULLCA, which imposes personal liability on the part of managers and members who consent to a distribution that violates section 405. In contrast, A.R.S. § 29-3406(A), in keeping with the Prior Act, imposes personal liability only upon the recipient of a prohibited distribution. The RULLCA provisions imposing liability on managers and members who consented to the distribution, as well as the right of contribution among those consenting persons, were not incorporated into the Act.

In another departure from RULLCA, subsection (A) imposes liability upon a recipient of a wrongful distribution whether or not the recipient knew the distribution violated A.R.S. § 29-3405. This strict liability conforms to the treatment of recipients under the Prior Act, as well as the provisions of Arizona's Fraudulent Transfer Act.

A.R.S. § 29-706(D) of the Prior Act established a six-year statute of limitations on the recovery of wrongful distributions, whereas RULLCA prescribes a two-year statute of limitations. A.R.S. § 29-3406(B) strikes a middle ground with a three-year period to bar actions for recovery of wrongful distributions, which is the same limitations period applicable to distributions made by a Delaware limited liability company under 6 DE Code § 18-607 (2015).

As of the date of this comment, legal authorities are divided regarding whether company creditors have the right to enforce the liability of distribution recipients under this section. The resolution of this issue depends upon one's interpretation of the phrase in subsection (A) stating that the recipient of a distribution in violation of this section "is personally liable to the limited liability company …." As noted in the Modified RULLCA Comment to this section, at least two appellate courts have ruled that company creditors lack the right to compel the company to enforce its right to require the return of a wrongful distribution. On the other hand, the third sentence of the Modified RULLCA Comment states that the provisions of this section are non-waivable, citing the provisions of RULLCA § 105(c) which prohibit an operating agreement from restricting the rights of third parties (i.e., company creditors). The plain implication of this comment is that company creditors are intended beneficiaries of A.R.S. § 29-3406 and should have standing to enforce its provisions. *See also CB Richard Ellis, Inc. v. Terra Nostra Consultants,* 230 Cal. App. 4th 405 (2014) where the court upheld the creditor's enforcement rights on the theory that the distributions in question constituted a "*de facto* dissolution" of the company.

Given the issues surrounding creditors' enforcement rights under the Act, a creditor of an insolvent company should also pursue its remedies under the Arizona Fraudulent Transfer Act or other equitable principles. In addition, a creditor could seek the appointment of a receiver of the company to enforce the company's rights against a distribution recipient, and a trustee in bankruptcy (or a lender acting under a broad power of attorney) would likely have the authority to enforce the company's rights under this section.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section and ~~Section 405~~A.R.S. § 29-3405 were derived essentially from Model Business Corporation Act section 6.40. As with ~~Section 405~~A.R.S. § 29-3405, this section is appropriate and necessary due to the liability shield of a limited liability company. The provisions of this section are non-waivable. ~~Section 105(c)(15~~A.R.S. § 29-3105(C)(12) and (C)(13).

~~This section contemplates two categories of liability: liability of those who have authorized improper distributions, Subsection (a), and the liability of those who have received improper distributions, Subsection (c).~~Liability that has accrued under this section is not affected by a person subsequently ceasing to be a member, manager or transferee.

The liability is to the LLC, not to the creditors of an insolvent LLC. *Weinstein v. Colborne Foodbotics, LLC*, 302 P.3d 263, 268 (2013); *Rev O, Inc. v. Woo*, 725 S.E.2d 45, 52 (N.C. Ct. App. 2012).

This section does not preclude or interfere with claims for fraudulent transfer. *See* the comment to Subsection (~~e~~B).

Subsection (~~a~~A) ~~– The liability is not strict liability but rather attaches only to the extent a decision maker has failed to comply with the duties stated in Section 409~~. ~~To the extent those duties have been permissibly revised by the operating agreement, the revised standards apply to this subsection~~. ~~*See also* Section 405(b)(1) (permitting reasonable reliance on specified financial information).~~

~~**Subsection (b)** – *Compare* Subsection (b), *with* Section 105(d)(2) (generally permitting provisions of this type).~~

~~**Subsection (c)**~~ – Actual knowledge is not necessary to impose liability. ~~Reason to know does not suffice~~. ~~*Compare* Subsection (c), *with* Section 103(a)-(b).~~

~~**Subsections (c) and (d)(2)** –~~ Liability could apply to a person who receives a distribution under a charging order~~, but only if the person meets the knowledge requirement~~. ~~That situation is very unlikely unless the person with the charging order is also a member or manager~~.

~~**Subsection (e)** –~~When the distribution is in the form of indebtedness, the distribution may occur on several different dates. *See* the comment to ~~Section 405(e~~A.R.S. § 29-3405(E).

Subsection (B) – This statute of limitations applies only to actions "under this section" and does not affect claims under other applicable law, which most often is fraudulent transfer law. For a different approach, *see* DEL. CODE ANN. tit. 6, § 17-607(c) (West 2013) (applying a 3-year statute of limitations to claims "under this chapter or other applicable law"); NY LTD. LIAB. CO. § 508(c) (McKinney 2013) (same). *But see, e.g., In re The Heritage Org., LLC*, 413 BR 438, 461 (Bankr. ND Tex. 2009) (invoking the Texas Uninform Fraudulent Act [TUFTA] to recover distributions made by a Delaware LLC headquartered in Texas; rejecting DEL. CODE ANN. tit. 6, § 18-607(c) on choice of law grounds; stating that "the Delaware legislature cannot limit the reach of TUFTA").

A.R.S. § 29-3407. MANAGEMENT OF LIMITED LIABILITY COMPANY.

Arizona Comment
(Rev. 2/23/2024)

This section differs from RULLCA section 407 in multiple respects to preserve the management rules under the Prior Act. A.R.S. § 29-3407 consists entirely of default rules that may be modified or eliminated by the operating agreement without limitation, except that, under A.R.S. § 29-3107(D)(2), third parties (i.e., persons other than members and managers) have the right to reasonably rely on the company's status as member- or manager-managed specified in its filed articles of organization, regardless of any contrary term in its operating agreement. In addition, a provision in an operating agreement may be unenforceable if it violates the contractual obligation of good faith and fair dealing

(A.R.S. § 29-3105(C)(5)) or is contrary to principles of equity and contract law applicable to the enforcement of contracts generally (A.R.S. § 29-3111).

Classification as Member-Managed or Manager-Managed

Subsection (A) provides that each limited liability company will be classified as member-managed unless its articles of organization (as amended) filed with the commission indicate that it is manager-managed. This rule preserves prior law under A.R.S. § 29-681(A). By contrast, section 407 of RULLCA makes the operating agreement control this determination, which leads to two problematic consequences. First, third parties will be unaware of whether a company is member- or manager-managed unless they have access to and review the operating agreement. Second, even with access to the operating agreement, it may not be clear whether the company is member- or manager-managed, especially in the case of an oral operating agreement. Section 407 of RULLCA prescribes three different specific phrases that will make the company manager-managed if those specific words "or words of similar import" appear in the operating agreement. The Act avoids potential interpretational issues by making the classification a matter of checking the filed articles of organization.

See A.R.S. § 29-3107(D) and related comments regarding the situation where a company's filed articles of organization conflict with its operating agreement with respect to its management structure.

Default Rules for Managing a Member-Managed Company

Subsection (B) sets forth the default rules for management of member-managed companies that are significantly different and more detailed than those provided by RULLCA. Section 407(b) of RULLCA simply provides that (i) management is vested in the members who have equal rights; (ii) a majority of the members is needed to resolve any disagreement among the members regarding a matter that is within the ordinary course of the company's activities; and (iii) the unanimous approval of the members is necessary to amend the operating agreement or to undertake any act that is outside the ordinary course of the company's activities. While it may sometimes be difficult to distinguish between transactions that are within or outside the ordinary course, there can be no doubt that the latter category includes many transactions that are critical to the success of an enterprise. For example, the following transactions under most circumstances will be determined to be outside the ordinary course: obtaining or refinancing a loan; the purchase, sale or lease of real property; the hiring or firing of upper management personnel or the company's outside accounting or law firm; the making of a relatively large capital expenditure; and the settlement of an important lawsuit. By making these critical decisions subject to unanimous member approval, RULLCA risks management paralysis whenever a single member withholds his or her consent to any matter deemed outside the ordinary course of the company's activities.

A second problem that arises under RULLCA is its failure to authorize each member (in a member-managed company) and each manager (in a manager-managed company) to act for the company in the ordinary course of the company's activities. Instead, RULLCA provides that such authority exists only if set forth in the operating agreement of if it can be established applying the common law of agency to the facts and circumstances of a particular situation. For the reasons explained in the Arizona Comment to A.R.S. §29-3301, the Act preserves the rules under the Prior Act regarding a member's authority (in a member-managed company) and a manager's authority (in a manager-managed company) to act for the company in the ordinary course. The RULLCA Comment to § 407 contains a lengthy discussion of how the law of agency applies to members and managers and it demonstrates how complicated and uncertain reliance on actual or apparent authority can be in the absence of default rules that address the subject of management authority.

To avoid these problems, subsection (B) divides all management decisions into three categories of

transactions, similar to the Prior Act. Matters falling within the first category are within the authority of each individual member in a member-managed company. The second category consists of matters that are subject to the approval of a majority in interest of the members in a member-managed company. The third category is comprised of matters that are subject to unanimous approval of the members (in both manager-managed and member-managed companies.)

The first category consists simply of transactions that are within the ordinary course of the company's activities and affairs, except where a known difference exists among the members. *See* A.R.S. § 29-3103 for guidance on whether a person "knows" a fact.

The second category covers the following matters:

(i) matters that are within the ordinary course but with respect to which the members are known to differ;

(ii) matters that are outside the ordinary course but within the company's purpose;

(iii) whether to make distributions before the company's dissolution and commencement of winding up; and

(iv) whether to make advances for indemnification of a manager or member before adjudication of his or her right to indemnification.

The third category covers the following matters:

(i) matters that are outside the company's purpose as stated in the operating agreement or that otherwise violate operating agreement;

(ii) amendment to the company's articles of organization to change its management structure from member-managed to manager-managed, or vice versa;

(iii) amendments to the operating agreement;

(iv) issuance of an additional transferable interest (as defined by A.R.S. § 29-3102(29)) by the company; and

(v) any other action that is subject to unanimous member approval under the Act (e.g., a plan of merger or other restructure, and the admission or expulsion of a member).

These default management rules are the same as under the Prior Act, except that, in a member-managed company, the decisions of the members with respect to matters in the second category are now made according to a "majority in interest" rather than a majority of the members voting per capita.

Majority in Interest

The concept of a majority in interest of the members is not found in either the Prior Act or in RULLCA, both of which call for per capita voting by members. Per capita voting (*i.e.,* giving a member holding a 5% transferable interest and a member holding a 95% transferable interest equal management rights) is probably contrary to the expectations of most business people, who generally expect that the owners' voting rights should be weighted according to their relative economic interests. These default voting rules will be applied only where the members have not agreed (orally or in writing) upon their

relative voting rights. In many poorly documented cases, the services contributed by one or more members ("sweat equity") are likely to be of significant value in relation to any cash or property contributed by another member. Accordingly, voting rights are not based upon capital contributions because that default rule would serve as a very unfair method for apportioning the members' voting rights in many cases. Instead, A.R.S. § 29-3102(12) defines "majority in interest" to mean one or more members who own a majority of the interests in the company's profits, and the members' interests in "profits" is determined according to their relative rights to receive distributions, other than distributions that constitute a return of contributions.

> EXAMPLE 1: A and B form a member-managed LLC to purchase a run-down commercial property, renovate it, lease the vacant space, and then sell the leased-up property. A contributes $1 million and B, who is a licensed contractor, contributes development and supervision services without compensation. A and B have never reached agreement regarding the division of sale proceeds or other profits. Upon sale of the property in connection with winding up the company, the default rules under A.R.S. §§ 29-3404(A) and 29-3707(B) provide that the sale proceeds will be applied first to the repayment of the company's debts, second to the return of A's cash contribution, and third to the members in equal shares. Accordingly, each member holds a 50% interest in profits and neither member alone holds a majority in interest.

> EXAMPLE 2: Same as Example 1, except that A and B agreed that sale proceeds would be distributed 60% to A and 40% to B following the return of A's contributions. A's interest in profits is 60% and A alone holds a majority in interest.

Default Rules for Managing a Manager-Managed Company

Subsection (C) sets forth default rules for management of manager-managed companies that are more detailed than those provided under RULLCA § 407(c). Similar to the default rules for management of member-managed companies, subsection (C) divides all management decisions into three categories:

(i) Transactions within the ordinary course of the company's activities and affairs are within the authority of each individual manager, unless and until the manager knows of another manager's disagreement.

(ii) The approval of a majority of the managers (voting per capita) is necessary to authorize any transactions within the ordinary course with respect to which the managers disagree; any transaction that is outside the ordinary course of the company's activities but within the company's purpose stated in the operating agreement (if any); the amount and time of any interim distribution to the members; and whether to advance defense costs to a manager or member under A.R.S §29-3408(C).

(iii) The approval of all of the members is necessary to authorize the same acts or transactions that are subject to unanimous member approval in the case of a member-managed company under subsection (B)(4), listed above.

Designation and Removal of Managers

Subsection (C)(5) provides (as a default rule) that a majority in interest of the members may choose, remove, add or replace a manager at any time. This is an important departure from RULLCA §407(c)(5), which prescribes per capita voting by members to designate or remove managers. As a result of substituting majority in interest voting for per capita voting to change a manager, a majority in interest of the members can assert effective control of those decisions in the second category that are determined

by per capita voting of the managers. For example, a majority in interest of the members that is unhappy with a manager's decision can immediately replace the manager. A.R.S. § 29-681(B) of the Prior Act was unclear regarding whether a manager may be added or removed by the members after the company's formation.

Meetings and Proxies

Subsection (D) expressly allows both members and managers to take any action under the Act without a meeting, so long as the action is approved by the minimum number of members or managers required under the Act. RULLCA § 407(d) limits this default rule to actions by members. Subsection (D) also provides that a member may appoint a proxy to vote or give consent on behalf of the member, but the appointment must be evidenced by a record signed by the member. A manager does not have the right to act through a proxy under the statutory default rules, but the operating agreement may give the manager this right. The Prior Act did not address the subject of proxies.

Management Rights after Dissolution of the Company

Subsection (E), like RULLCA § 407(e), provides that the default management rules remain in effect after the dissolution of the company, with one explicit exception: a person that wrongfully causes the dissolution of the company loses all management participation rights as a member and a manager. The Act adds to this exception that the person must be excluded in the determination of a majority in interest of the members and a majority of the managers.

Neither RULLCA nor the Act describes how a member or manager can wrongfully cause the dissolution of a limited liability company under A.R.S. § 29-3701. The concept of "wrongful dissolution" of the company is a vestige of early partnership law, where the withdrawal of any partner at any time automatically triggered dissolution of the partnership, and withdrawal of a partner in violation of the partnership agreement was treated as a wrongful dissolution of the partnership. However, under the default rules of both the Act and RULLCA, the withdrawal or other dissociation of a member does not cause dissolution of a limited liability company, so a wrongful dissolution of the company is not possible under the Act's default rules. (In contrast, both RULLCA and the Act define the concept of a member's wrongful *dissociation* in A.R.S. § 29-3601(B).) RULLCA's comment to § 407(e) suggests that a wrongful dissolution of the company might occur only if the operating agreement so provides. Given the uncertainties in the application of subsection (E), the better practice is to avoid using the term "wrongful dissolution" of a limited liability company in its operating agreement unless the term is explicitly defined, and the consequences of a wrongful dissolution are clearly spelled out, in the operating agreement.

Subsection (E) states that the default management rules under this section remain in effect after the company's dissolution. *See* the Arizona Comment to A.R.S. § 29-3702(B) regarding the effect of the company's dissolution on the managers' and members' management rights and authority.

Interest on Reimbursement Obligations

RULLCA subsection 407(g) requires a limited liability company to pay interest on advances made by a member to the company and on amounts the company owes to a member for expense reimbursements. Because the Prior Act did not require interest payments under these circumstances, RULLCA's default rule on interest was deleted from the Act to preserve existing law. The Act's silence on the subject of interest on member advances and reimbursements should not be interpreted to say that no interest is owed by the company on these obligations. Rather, the accrual of interest should be determined according to other law, *e.g.,* A.R.S. § 44-1201(A). To avoid any uncertainty under other law, the better practice is to address the subject of interest on these obligations in the operating agreement.

Relevance of Actual Authority

A member's or manager's authority under subsection (B) or (C) will in many cases be supplemented by his or her actual authority to act for the company under the terms of the operating agreement. Accordingly, the common law of agency continues to be relevant to determine whether a member or manager has acted within or beyond his or her authority to bind the company. The Modified RULLCA Comment to § 407 contains an explanation of how agency law may apply under various circumstances.

Authority Contrasted with Duty

The management rights under A.R.S. § 29-3407 describe the authority of the members and managers to bind the limited liability company (subject to the terms of the operating agreement) but they do not affect the substance of the members' and managers' duties to the company. In other words, a member or manager who acts within his or her authority may nevertheless be held accountable if the action violates a duty to the company under A.R.S. § 29-3409 or the operating agreement.

> EXAMPLE 3: A, B, and C are the members of a member-managed limited liability company, each holding a one-third interest in the company's profits. A and B, who together hold a majority in interest, cause the company to purchase commercial real property without first obtaining an environmental assessment. The property turns out to be worthless because of heavy environmental contamination. Even though A and B clearly had the authority to purchase the property on behalf of the company under A.R.S. § 29-3407(B)(3)(a), their authority does not insulate them from liability for violating their duty of care under A.R.S. § 29-3408(C).

> EXAMPLE 4: Under the facts of Example 3, C brings a derivative action in the name of the company against A and B for violating their duty of care in connection with the purchase of the contaminated property. A and B, who together hold a majority in interest, authorize the company to advance all of their legal fees incurred in the defense of the derivative action. Even though A and B clearly have the authority to cause the company to advance their legal fees under A.R.S. § 29-3407(B)(3)(d), their authority does not insulate them from liability for a possible violation of their duty of loyalty under A.R.S. § 29-409(B)(2) (relating to conflicts of interest). Whether the advance of their defense expenses is a violation of the duty of loyalty will depend upon other relevant circumstances, such as whether the advance is allowed under the terms of the operating agreement or is fair under A.R.S § 29-3409(G).

Modified RULLCA Comment
(Rev. 2/23/2024)

~~**Subsection (a)** – This subsection follows implicitly from the definitions of "manager-managed" and "member-managed" limited liability companies, Section 102(10) and (12), but is included here for the sake of clarity~~. ~~Although this act has eliminated the link between management structure and statutory apparent authority, the act retains the manager-managed and member-managed constructs as options for members to use to structure their *inter se* relationship~~. ~~*See also* the comments to Sections 301 (No Agency Power of Member as Member), and 409 (Standards of Conduct).~~

~~**Subsection (b)** – The subsection follows essentially the long-standing default paradigm for management rights of general partners. *See* UPA (1914) § 18; UPA (1997) (Last Amended 2013) § 401.~~ The stated rules under A.R.S. § 29-3407 are subject to change by the operating agreement. ~~Section 105~~A.R.S. § 29-3105.

In general, a member's actual authority to act for an LLC will depend fundamentally on the operating agreement.

EXAMPLE: Rachael and Sam, who have known each other for years, decide to go into business arranging musical tours. They fill out and electronically sign ~~a one page~~the form of articles of organization available on the website of the ~~filing office~~Arizona Corporation Commission and become the organizers of MMT, LLC. ~~They are the only members of~~The filed articles indicate that the ~~LLC,~~company is member-managed, naming Sam and ~~their~~Rachel as the initial members. Their understanding of who will do what in managing the enterprise is based on several lengthy, late-night conversations that preceded the LLC's formation. Sam is to "get the acts," and Rachael is to manage the tour logistics. There is no written operating agreement.

In the terminology of this act, MMT, LLC is member-managed, ~~Section 407(a~~A.R.S. § 29-3407(A), and the understanding reached in the late night conversations has become part of the LLC's operating agreement, ~~Section 102(13).~~A.R.S. § 29-3102(17). In the terminology of agency law, the operating agreement constitutes a manifestation by the LLC to Rachael and Sam concerning the scope of their respective authority to act on behalf of the LLC. RESTATEMENT (THIRD) OF AGENCY § 2.01, cmt. c (2006) (explaining that a person's actual authority depends first on some manifestation attributable to the principal and stating: "[a]ctual authority is a consequence of a principal's expressive conduct toward an agent, through which the principal manifests assent to be affected by the agent's action, and the agent's reasonable understanding of the principal's manifestation").

Circumstances outside the operating agreement can also be relevant to determining the scope of a member's actual authority.

EXAMPLE: Homeworks, LLC is a manager-managed LLC with three members. The LLC's written operating agreement:

- specifies in considerable detail the management responsibilities of Margaret, the LLC's manager-member, and also states that Margaret is responsible for "the day-to-day operations" of the company;
- puts Garrett, a non-manager member, in charge of the LLC's transportation department; and
- specifies no management role for Brooksley, the third member.

When the LLC's chief financial officer quits suddenly, Margaret asks Brooksley, a CPA, to "step in until we can hire a replacement."

Under the operating agreement, Margaret's request to Brooksley is within Margaret's actual authority and is a manifestation attributable to the LLC. If Brooksley manifests assent to Margaret's request, Brooksley will have the actual authority to act as the LLC's chief financial officer.

In the unlikely event that two or more people form a member-managed LLC without any understanding of how to allocate management responsibility, ~~agency law, operating in the context the act's "gap fillers" on management responsibility,~~A.R.S § 29-3407(B) will produce the following result:

A single member of a multi-member, member-managed LLC:

- has no actual authority to bind the LLC to any matter "outside the ordinary course of the activities of the company," ~~Section 407(b~~A.R.S. § 29-3407(B)(3)(a); and
- has the actual authority to bind the LLC to any matter ~~"~~in the management and conduct of the company's ~~[~~ordinary course of~~]~~ activities and affairs," ~~Section 407(b~~A.R.S. § 29-3407(B)(2), unless the member has reason to know that other members might disagree or the member has some other reason to know that consultation with fellow members is appropriate~~.~~..

~~For an explanation of this result, see Section 407(c), comment, which provides a detailed analysis in the context of a multi-manager LLC whose operating agreement is silent on the analogous question.~~

~~For a discussion of the apparent authority of a member to bind an LLC, see Section 301(b), comment.~~

Subsection (~~b~~B)(4) – This list is not exhaustive~~.~~, as subsection (B)(4)(e) makes clear. Other approval rights appear in the context of the provisions to which the rights apply. *E.g.*, ~~Section 401(c~~A.R.S. § 29-3401(C)(3) (providing that "[a]fter formation of a limited liability company, a person becomes a member … with the affirmative vote or consent of all the members"); ~~Section 703(b~~A.R.S. § 29-3703(B)(1) (requiring "the affirmative vote or consent of each member" to rescind dissolution~~); Sections 1023, 1033, 1043, 1053 (same with regard to Article 10 transactions~~).

Subsection (~~c~~C) – Like Subsection (~~b~~B), this subsection states default rules that, under ~~Section 105~~A.R.S. § 29-3105, are subject to the operating agreement. For example, a limited liability company's ~~operating agreement~~articles of organization might state "This company is manager-managed," ~~Sections 102(10~~A.R.S. § 29-3102(14) and ~~407(a~~A.R.S. § 29-3407(A), while the operating agreement provides~~providing~~ that managers must submit specified ordinary matters for review by the members.

The actual authority of an LLC's manager or managers is a question ~~of~~ to be determined under this Subsection (C) and agency law, and depends fundamentally on this Subsection (C), the contents of the operating agreement, and any separate management contract between the LLC and its manager or managers. These agreements are the primary source of the manifestations of the LLC (as principal) from which a manager (as agent) will form the reasonable beliefs that delimit the scope of the manager's actual authority. RESTATEMENT (THIRD) OF AGENCY § 3.01 (2006). *See also* RESTATEMENT (SECOND) OF AGENCY §§ 15, 26 (1958).

Other information may be relevant as well, such as the course of dealing within the LLC, unless the operating agreement effectively precludes consideration of that information. *See* the comment to ~~Section 105(a)(4~~A.R.S. § 29-3105(A)(1)(d) (stating that the operating agreement governs "the means and conditions for amending the operating agreement").

If the operating agreement and a management contract conflict, the reasonable manager will know that the operating agreement controls the extent of the manager's rightful authority to act for the LLC– despite any contract claims the manager might have. *See* the comment to ~~Section 105(a)(2~~A.R.S. § 29-3105(A)(1)(b) (stating that the operating agreement governs "the rights and duties under this [act] of a person in the capacity of manager"). *See also* RESTATEMENT (THIRD) OF AGENCY § 8.13, cmt. b (2006) and RESTATEMENT (SECOND) OF AGENCY § 432, cmt. b (1958) (stating that, when a principal's instructions to an agent contravene a contract between the principal and agent, the agent may have a breach of contract claim but has no right to act contrary to the principal's instructions).

If: (i) an LLC's operating agreement merely states that the LLC is manager-managed and does not further specify the managerial responsibilities; and (ii) the LLC has only one manager, the actual authority analysis is simple. In that situation, this subsection~~:~~ (C):

- serves as "gap filler" to the operating agreement; and thereby
- constitutes the LLC's manifestation to the manager as to the scope of the manager's authority; and thereby
- delimits the manager's actual authority, subject to whatever subsequent manifestations the LLC may make to the manager (*e.g.,* by a vote of the members, or an amendment of the operating agreement).

If the operating agreement states only that the LLC is manager-managed and the LLC has more than one manager, the question of actual authority has an additional aspect. It is necessary to determine what actual authority any one manager has to act alone.

~~Paragraphs (c)(1)-(3),~~ A.R.S. § 29-3407(C)(1) through (4) combine to provide the answer. A single manager of a multi-manager LLC:

- has no actual authority to commit the LLC to any matter encompassed in ~~Paragraph (c~~Subsection (C)(3) and (4) or for which this act elsewhere requires unanimity;
- has the actual authority to commit the LLC to usual and customary matters, unless the manager has reason to know that: (i) other managers might disagree; or (ii) for some other reason consultation with fellow managers is appropriate; and
- has no actual authority to take unusual or non-customary actions that ~~will have a substantial effect on the LLC~~are outside the ordinary course of the company's activities and affairs.

The first point follows self-evidently from the language of ~~Paragraph (c~~Subsection (C)(3) and (4), and from other provisions of the Act requiring the affirmative vote or consent of the members, which reserves specified matters to the members. Given that language, no manager could reasonably believe to the contrary (unless the operating agreement provided otherwise).

The second point follows because:

Subsection (~~c~~C)(2) serves as the gap-filler manifestation from the LLC to its managers with respect to matters within the ordinary course of the company's activities and affairs, and does *not* require managers of a multi-manager LLC to act *only* in concert or after consultation. ~~To the contrary, subject to the operating agreement Subsection (c)(2) expressly provides that "each manager has equal rights in the management and conduct of the company's activities and affairs."~~

- It would be impractical to require collective action on even the smallest of decisions.
- However, to the extent a manager has reason to know of a possible difference of opinion among the managers, ~~Paragraph (c)(1~~Subsection (C)(3)(b) requires decision by "a majority of the managers."

The third point is governed by Subsection (C)(3)(a~~ matter of common sense.~~). The more serious the matter, the less likely it is that a manager has actual authority to act unilaterally. *Cf.* RESTATEMENT (THIRD) OF AGENCY § 3.03, cmt. c (2006) (noting the unreasonableness of believing, without more facts, that an individual has "an unusual degree of unilateral authority over a matter fraught with enduring consequences for the institution" and stating that "[t]he gravity of the matter from the standpoint of the organization is relevant to whether a third party could reasonably believe that the manager has authority to proceed unilaterally").

The common law of agency will also be relevant to determine the apparent authority of an LLC's manager or managers, and in that analysis what the particular third party knows or has reason to know

about the management structure and business practices of the particular LLC will always be relevant. RESTATEMENT (THIRD) OF AGENCY § 3.03, cmt. d (2006) ("The nature of an organization's business or activity is relevant to whether a third party could reasonably believe that a [manager] is authorized to commit the organization to a particular transaction.").

As a general matter, absent countervailing facts, courts may see the position of manager as clothing its occupants with the apparent authority to take actions that reasonably appear within the ordinary course of the company's business. The actual authority analysis stated above supports that proposition; absent a reason to believe to the contrary, a third party could reasonably believe that a manager possesses the authority contemplated by the gap-fillers of this ~~act.~~Subsection (C). *But see* the comment to ~~Section 102(9~~A.R.S. § 29-3102(13) (stating that "confusion around the term 'manager' is common to almost all LLC statutes").

Subsection (~~c)(1~~C)(3) – For limited liability companies that have more than one manager, this act provides that ~~in most circumstances a "matter relating to the activities and affairs of the company is~~the matters specified in Subsection (C)(3) will be decided ~~…~~ by a "majority of the managers." However, unlike corporate statutes, this ~~act~~Act does not provide a rule for the quantum of participation necessary to constitute "a majority." *Cf., e.g.,* MINN. STAT. § 302A.237 (2014) (providing rules for determining the votes need to constitute "an act of the board"). If a manager-managed LLC has more than one manager, the operating agreement should consider what "a majority" means in the event a manager position is vacant.

Subsection (~~c)(3~~C)(4) – This list is not exhaustive~~.~~, as subsection (C)(4)(e) makes clear. *See* the comment to Subsection (~~b~~B)(4).

Subsection (~~c)(4~~C)(6) – Under the default rule stated in this paragraph, dissolution of an entity that is a manager of an LLC does not end the entity's status as manager. Likewise, dissolution of an entity that is a member does not cause the entity to dissociate. *See* ~~Section~~ A.R.S. § 29-3602(10)~~602(11)~~ (providing that termination of such an entity causes dissociation).

An LLC does not cease to be "manager-managed" simply because no managers are in place. In that situation, absent additional facts, the LLC is manager-managed and the manager position is vacant. Non-manager members who exercise managerial functions during the vacancy (or at any other time) will have duties as determined by other law, most particularly the law of agency.

Subsection (~~c)(6~~C)(7) – For example, the obligation to safeguard trade secrets and other confidential or propriety information learned when the person is a manager remains in force after the person ceases to be a manager.

Subsection (~~d~~D) – In this context, the doctrine of *noscitur a sociis* limits the authorized extent of a proxy holder or other agent. (The doctrine of *noscitur a sociis* holds "that the meaning of an unclear word or phrase should be determined by the words immediately surrounding it." BLACK'S LAW DICTIONARY (9th ed. 2009).

In particular, unless the operating agreement so provides, neither a proxy nor other agent may be used to circumvent the transfer restrictions that are fundamental to the law of limited liability companies. *See* Article 5 and RESTATEMENT (SECOND) OF CONTRACTS § 318(2) (1981) (stating that "a promise requires performance by a particular person … to the extent that the obligee has a substantial interest in having that person perform or control the acts promised").

Subsection (~~e~~E), second sentence – The default rules of this act do not contemplate a person

wrongfully causing dissolution, as distinguished from wrongfully dissociating. *Compare* ~~Section 701~~A.R.S. § 29-3701, *with* ~~Section 601~~A.R.S. § 29-3601(b). However, the operating agreement might contemplate wrongful dissolution, and then the second sentence of this subsection would apply unless the operating agreement provided otherwise.

Subsection (~~h~~G) – This provision traces back to the UPA (1914) § 18(f) and is included to avoid its absence being misinterpreted as implying a contrary rule.

This ~~act~~Act does not provide for remuneration to a manager of a manager-managed LLC. That issue is for the operating agreement, or a separate agreement between the LLC and the manager. A manager may also have a common law right to compensation. RESTATEMENT (THIRD) AGENCY § 8.13, cmt. d (2006) ("Unless an agreement between a principal and an agent indicates otherwise, a principal has a duty to pay compensation to an agent for services that the agent provides.").

A.R.S. § 29-3408. REIMBURSEMENT; INDEMNIFICATION; ADVANCEMENT; INSURANCE.

Arizona Comment

(Rev. 2/23/2024)

The Prior Act did not address a member's or manager's right to reimbursement or indemnification from a limited liability company. The section provides default rules governing both mandatory and permissive reimbursements and indemnities, as well as a permissive default rule allowing the company to advance costs of defense incurred by a member or manager under certain circumstances. These rules are not intended to displace other law, such as the law of agency, with respect to reimbursement and indemnity rights of a member or manager when acting as an agent of the company. For an example of the law of agency applied to the duties of managers and members of a limited liability company, *see In re Sky Harbor Hotel Properties, LLC v. Patel Properties, LLC*, 443 P.3d 21 (Ariz., June 25, 2019) (decided prior to the effective date of the Act).

Reimbursement

Subsection (A) requires a company to reimburse a present or former member of a member-managed company or manager of a manager-managed company for any payment previously made by the member or manager if the payment satisfied all of the following:

(1) the payment was made in the course of the member's or manager's activities on behalf of the company;

(2) the payment did not violate the distribution rules under A.R.S. § 29-3405 (as modified by the operating agreement);

(3) the payment not violate the management authority rules under A.R.S. § 29-3407 (as modified by the operating agreement); and

(4) the payment not violate the member's or the manager's duties under A.R.S. § 29-3409 (as modified by the operating agreement).

The Drafting Subcommittee decided to include language making clear that the standards that must be met under A.R.S. § 29-3405, 3407, and 3409 are such standards as modified by the operating agreement. This was a departure from RULLCA, which imposed the burden on the drafter of the operating agreement to align the standards for indemnification or reimbursement with any modification of

the member's or manager's statutory duties set forth the operating agreement. If the drafter does not do so, the standards for indemnification or reimbursement would be as set forth in the statute without modification.

The third limitation above might preclude reimbursement of a payment that was made outside the ordinary course of the company's business or where the members or managers disagreed whether the payment should be made.

> EXAMPLE 1: A payment was made by one of the managers of a manager-managed limited liability company to replace a piece of major equipment. The paying manager did not obtain the consent of a majority of all of the managers prior to making the purchase and is now seeking reimbursement by the company. This action was outside the ordinary course of the company's activities and affairs, and thus the company is not required to reimburse the paying manager for this expenditure because A.R.S. § 29-3407(C)(3)(a) requires such actions to be approved by a majority of the managers.

> EXAMPLE 2: A payment was made by the same manager, but this time the payment was for a routine purchase of office supplies. Again, the paying manager did not obtain the consent of a majority of all of the managers prior to making the purchase and is now seeking reimbursement by the company. Although this purchase was within the ordinary course of the company's activities and affairs, the manager was aware of a disagreement among the managers with respect to this particular purchase. Here, too, the company is not required to reimburse the paying manager for this expenditure because A.R.S. § 29-3407(C)(3)(b) requires the approval of a majority of the managers where there is a known disagreement among the managers with respect to an action.

The fourth limitation above might preclude reimbursement of a payment that involved a conflict of interest on the part of the paying member or manager.

> EXAMPLE 3: A payment to replace a piece of major equipment was made by the same manager. Knowing that this action was outside the ordinary course of the company's activities and affairs, the paying manager first obtained approval by a majority of all of the managers prior to making the purchase. The paying manager is now seeking reimbursement by the company. Prior to reimbursement, the other managers become aware that the paying manager purchased the piece of equipment from another company owned by the paying manager, a fact that was not disclosed prior to the purchase and constitutes a material conflict of interest. Although this time the requirements of A.R.S. § 29-3407 were satisfied, the company is again not required to reimburse the paying manager because A.R.S. § 29-3409(J)(4) required that the paying manager first disclose the material conflict of interest and all material facts relating to the decision that were within the paying manager's knowledge and not known or reasonably available to the other managers.

> Subsection (A) does not entitle a member to reimbursement by a manager-managed company.

Indemnification

Subsection (B) addresses indemnification which, unlike reimbursement, does not require a prior payment on the part of a member or manager and typically involves a third-party claim or demand against a person or a loss or liability incurred by a person. The company is required to indemnify a present or former member or manager if the claim or liability:

(1) exists by reason of the person's present or former capacity as a member or manager; and

(2) did not arise out of the person's breach of the operating agreement or of A.R.S. § 29-3405 (distribution rules), A.R.S. § 29-3407 (management rules), or A.R.S. § 29-3409 (fiduciary duties), in each case as modified by the operating agreement.

Again, the standards that must be met under A.R.S. § 29-3405, 3407, and 3409 are as modified by the operating agreement.

Advances

Subsection (C) permits, but does not require, the company to advance reasonable defense costs incurred by a person relating to a claim made against the person by reason of the person's present or former capacity as a member or manager. Subsection (c) of RULLCA specifically characterized the decision to advance expenses as a matter "in the ordinary course" of the company's activities and affairs. The Drafting Subcommittee deleted this phrase because it decided that the decision to advance expenses should be treated as outside the ordinary course of business and therefore subject to majority in interest vote of the members under A.R.S. § 29-3407(B)(3) or majority vote of the managers under A.R.S. § 29-3407(C)(3).

Advancement of defense costs becomes a very sensitive issue in the context of intra-company disputes involving mismanagement claims or other wrongful conduct claims asserted by minority members against one or more controlling managers or members. Those in control will commonly cause the company to advance their legal fees and other defense costs, even where the claim is that of mismanagement. To help address this situation, RULLCA states that a person receiving advances must promise to repay the company if it is ultimately determined that the requirements for indemnification were not satisfied. The Drafting Subcommittee deleted the reference to a promise so that the repayment obligation exists whether or not a promise is made. Also, in situations where the person receiving advances is ultimately determined not to be entitled to indemnification, the minority member claimants may assert a claim or breach of the duty of loyalty under A.R.S. § 29-3409 because the decision to advance expenses involved a conflict of interest and did not satisfy the unanimity requirement set forth in A.R.S. § 29-3408(D), discussed below.

Permissive Indemnification and Wrongful Acts

Subsection (D) was added by the Drafting Subcommittee to clarify that, if approved by all of the members (even in a manager-managed company) after disclosure of all material facts, a company may voluntarily reimburse or indemnify a manager or member with respect to a claim or liability even if reimbursement or indemnification is not required under A.R.S. § 29-3408(A) or (B). Note that transferees of an interest in the company have no veto right in this situation.

The Drafting Subcommittee was concerned about the possibility of a manager of a manager-managed company or a member of a member-managed company who, being accused of wrongdoing, causes the company to indemnify himself or an affiliate against the claim of wrongdoing where the other members do not agree that the requirements for reimbursement or indemnification have been satisfied. Ultimately, the Drafting Subcommittee decided that this issue did not require specific statutory safeguards in A.R.S. § 29-3408 because the duty of loyalty to avoid conflicts of interest under A.R.S. § 29-3409, as discussed in Example 3 above, would be breached if the member or manager caused the company to indemnify the person against his or her own wrongdoing. If the members disagree about whether the requirements for reimbursement or indemnification have been satisfied, and if the manager or members in control of the company proceed to make the reimbursement or indemnification for their or their affiliates'

personal benefit, the action would constitute a breach of the duty of loyalty, as well as a violation of the unanimity requirement set forth in A.R.S. § 29-3408(D), if it is ultimately determined that the requirements for reimbursement or indemnification were not satisfied.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsections (~~a~~A) and (~~b~~B) – A limited liability company's obligation, if any, to reimburse or indemnify others (*e.g.*, employees, independent contractors, other agents) is a question for other law, including the law of agency, contract and restitution. The fact a person has dissociated as a member or ceased to be a manager does not affect any obligations incurred by the limited liability company under these subsections for conduct occurring before the dissociation or cessation.

Subsection (~~a~~A) – The reimbursement obligation stated here is a default rule and roughly parallels a rule of agency law. RESTATEMENT (THIRD) OF AGENCY § 8.14(2)(a) (2006) (stating that "[a] principal has a duty to indemnify an agent … when the agent makes a payment (i) within the scope of the agent's actual authority, or (ii) that is beneficial to the principal, unless the agent acts officiously in making the payment").

This subsection applies only to managers of manager-managed limited liability companies and members of member-managed companies. The definite article in the phrase "the member or manager~~""~~" and "the member's" refers back to the original phrase: "A limited liability company shall reimburse a member of a member-managed company or the manager of a manager-managed company ...."

A limited liability company's obligation, if any, to reimburse others (including LLC employees and non-managing members of a manager-managed LLC) is a question for other law, including the law of agency and restitution. The fact a person has ceased to be a member of a member-managed LLC or a manager of a manager-managed LLC does not affect any obligations incurred by the LLC under this subsection for payments made before the cessation.

~~To the extent an operating agreement modifies or displaces the default rules stated in Sections 407 and 409, the agreement should also address this section~~. ~~For example, if the operating agreement establishes a duty of ordinary care (modifying Section 409(c)), the agreement should specify which level of care is necessary to satisfy this subsection~~. ~~It is not necessary that the levels of care be the same, only that the operating agreement make the situation clear and thereby avoid difficult issues of interpretation.~~

Subsection (~~b~~B) – This subsection provides for indemnification but only as a default rule. Subject only to ~~Section 105(c)(7~~A.R.S. § 29-3105(C)(6), the operating agreement can relax these preconditions substantially. The agreement can also impose stricter preconditions.

The rule's eligibility requirements correspond to the default rules on management duties, which is appropriate because otherwise the statutory default rule on indemnification could undercut or even vitiate the statutory default rules on duty. ~~To the extent an operating agreement modifies or displaces the default rules stated in Sections 405, 407, or 409, the agreement should also address this section~~. ~~See the comment to Subsection (a).~~

Although referring broadly to any "person," this subsection is actually limited to present and former members or managers. The indemnification obligation applies only to a "debt, obligation, or other liability incurred by the person by reason of the person's former or present capacity as a member or manager." Thus, by its terms this subsection does not apply to a person in the capacity of an "officer," unless being an officer constitutes being a manager. ~~For a discussion of the vagaries of the term~~

~~"manager," *see* Section 102(9), comment.~~

Of course, the operating agreement may mandate indemnification to officers, employees, and other persons providing services to or acting for the limited liability company. Within the limitations stated in ~~Section 105(c~~A.R.S. § 29-3105(C)(~~7~~6), the operating agreement may obligate an LLC to indemnify a person even when the person has breached a managerial duty or the operating agreement itself.

Subsection (~~c~~C) – This subsection authorizes but does not require a limited liability company to provide advances to cover expenses. *Cf. Majkowski v. American Imaging Mgmt. Servs., LLC*, 913 A.2d 572, 589 (Del. Ch. 2006) ("Because rights to indemnification and advancement differ in important ways, our courts have refused to recognize claims for advancement not granted in specific language clearly suggesting such rights."). The phrase "hold harmless" likewise does not encompass advances. *Id* The authorization applies only to those persons eligible for indemnification under Subsection (b), but the operating agreement certainly can authorize a broader scope and also make advances obligatory.

~~The reference to "ordinary course" pertains to Section 407(b)(3) (stating that any "difference arising among members [in a member-managed LLC] as to a matter in the ordinary course of the activities of the company may be decided by a majority of the members").~~ ~~As for a manager-managed LLC, *see* Section 407(c)(1) ("Except as expressly provided in this [act], any matter relating to the activities and affairs of the [manager-managed] company is decided exclusively by the manager, or, if there is more than one manager, by a majority of the managers.") (emphasis added).~~

Subsection (~~d~~E) – This subsection's language is very broad and authorizes an LLC to purchase insurance to cover, *e.g.,* a manager's intentional misconduct. It is unlikely that such insurance would be available. In contrast to Subsection (a), this subsection encompasses all members, not just members in a member-managed LLC. This authorization comes from the act, not the operating agreement, and therefore is not subject to ~~Section 105(c)(7~~A.R.S. § 29-3105(C)(6).

A.R.S. § 29-3409. STANDARDS OF CONDUCT FOR MEMBERS AND MANAGERS.

Arizona Comment
(Rev. 2/23/2024)

This section is intended to resolve uncertainty under prior law regarding the extent to which managers and members owe fiduciary and other duties to the limited liability company and each other. The consensus of the Drafting Subcommittee was that common law would impose those duties on managers in a manager-managed company and on members in a member-managed company, but that the failure of the Prior Act to address this subject created uncertainty. A.R.S. § 29-3409 follows the general organization and incorporates most of the duties set forth in RULLCA § 409, but it modifies some of the duties in significant ways.

Subsections (A) through (H) address the duties of each member in a member-managed company. Subsections (I) through (P) address the duties of each manager in a manager-managed company. Subsection (Q) addresses the duties of a member in a manager-managed company, and subsection (R) provides guidance on whether a conflict of interest is "material."

Most of the provisions of A.R.S. § 29-3409 are default rules, subject to modification or elimination by agreement. However, A.R.S. § 29-3105(C)(5) prohibits the elimination of the contractual obligation of good faith and fair dealing, and the lessening of the duty to refrain from willful or intentional misconduct. The Act allows the members substantially greater freedom than RULLCA to

modify both statutory and common law duties, as explained more fully in the Arizona Comment to § 29-3105.

This section does not set forth all of the duties of a member or manager, and other duties may arise under common law. For example, when a member or manager acts as an agent of the company, the common law of agency imposes the duty to act only within the scope of the member's or manager's authority. *See* Restatement (Third) of Agency (2006) § 8.09 and related comments. The common law of agency supplements the Act regarding the rights, duties and obligations of a member or manager when acting as an agent of the company. *See* A.R.S. § 29-3111 and related comments.

Member Duties in Member-Managed Company

Subsection (A) states that a member of a member-managed company owes to the company and the other members two duties: the duty of loyalty described in subsection (B) and the duty of care described in subsection (C). Note that this subsection does not displace the common law of fiduciary duties. Under the common law, a member may owe duties other than the duty of loyalty and the duty of care. Note also that the duties are owed to each other member as well as to the company, but not to transferees. The Drafting Subcommittee deleted RULLCA's cross-reference to § 801 because, as discussed in the Arizona Comment to A.R.S. § 29-3801, the Act does not prohibit a direct action where the damages result from an injury to the company.

Subsection (B) provides that the fiduciary duty of loyalty includes four components. The use of the word "includes" is intended to signify that the following four components are not exhaustive:

(1) to account for (and hold as trustee) any benefit derived by the member to which it is not entitled. The Drafting Subcommittee added the phrase "to which the member is not entitled" to clarify that a member may receive payments or other benefits contemplated by the operating agreement, approved by the other members, or pursuant to principles of agency and other laws, and those payments or benefits are permissible and thus outside the scope of this restriction.

(2) to refrain from dealing with the company "as or on behalf of a person having an interest adverse to the company." As explained in the Modified RULLCA Comment, this duty is interpreted broadly to encompass conflicts of interest generally.

(3) to refrain from competing with the company before the company's dissolution. Note that this duty ends at dissolution and does not prevent a member's competition while the company's affairs are being wound up.

(4) to disclose to the other members any material conflict of interest with respect to any decision under consideration by the members, or any transaction regarding the company or another member's interest in the company. In these conflict of interest situations, a member is required to disclose all material facts relating to the decision or transaction under consideration, other than facts already known or reasonably available to the other members. Note that this duty extends to situations where a member offers to purchase the interest of another member.

The Drafting Subcommittee added the duty of disclosure in subsection (B)(4) to RULLCA § 409(b) to address the situation where a member actively involved in management utilizes superior knowledge regarding the company's affairs to the disadvantage of the other members. This duty of disclosure should be understood in the context of the Drafting Subcommittee's decision to delete from

RULLCA § 410 the affirmative duty of the company and each of its members to provide information without demand. These changes to RULLCA were made for two primary reasons. First, as discussed in the Arizona Comment to A.R.S. § 29-3410, the Drafting Subcommittee believed that the disclosure duties under RULLCA § 410(a) were too broad and burdensome for most small, informally managed companies. Instead, the affirmative disclosure duty in subsection (B)(4) is limited to only those times when a specific decision or transaction involving a conflict of interest is being voted upon or approved. Second, to the extent that a member has an affirmative duty to disclose information, the duty should be a component of the fiduciary duty of loyalty.

Subsection (C) provides that the duty of care consists of the requirement to refrain from reckless or grossly negligent conduct and from willful or intentional misconduct. The Drafting Subcommittee deleted the "knowing violation of law" standard contained in RULLCA § 409(c) because the standard did not distinguish between trivial and serious violations of law and because of inconsistencies among federal and state laws regarding cannabis and other subjects.

Subsection (D) is substantially the same as RULLCA § 409(d). It establishes that each member must perform his or her duties, and exercise his or her rights, under the Act (as well as the operating agreement) consistently with the contractual obligation of good faith and fair dealing. This obligation may not be eliminated by the operating agreement pursuant to A.R.S. § 29-3105(C)(5). Significantly, the Act follows RULLCA's characterization of this obligation as contractual in nature, even as it applies to the performance of a member's statutory duties under the Act. The RULLCA comment for subsection (D) explains the reasons for applying contractual standards to the performance of statutory duties.

Subsection (E), which is identical to RULLCA § 409(e), provides that a member's conduct in furtherance of his or her own interests is not a per se violation of the member's duties under the Act. A member's pursuit of self-interest, however, may be relevant in determining whether the member has violated the duty of loyalty in connection with a conflict of interest transaction.

Subsection (F) states that all members must join in any authorization (before the fact) or ratification (after the fact) of any act or omission by a member that would otherwise violate the duty of loyalty, and only after the member has disclosed all material facts. This unanimity rule is a default rule, and is substantially the same as RULLCA § 409(f) with two exceptions. First, the ratification or authorization may cover not only a specific act or transaction, but also a specific omission as well as a specified category of acts, transactions, and omissions. For example, the other members by unanimous vote may authorize a member to enter into one or more leases of space within a company-owned building to the member's affiliates, as a category of transactions, and need not authorize each individual lease. Second, the reference to the statutory duty of loyalty includes any modification of that duty set forth in the operating agreement.

Note that the default rule requiring all members to ratify or authorize a conflict of interest transaction is very different from the analogous rule under the Arizona Business Corporation Act, where conflict of interest transactions may be approved by majority vote of the disinterested directors or shareholders. In a limited liability company with numerous members, the approval of every member may be extremely difficult or impossible to obtain. Because of these difficulties, lawyers may wish to consult with clients about including a provision in the operating agreement that allows a majority of the disinterested managers, or a majority in interest of the disinterested members, to authorize or ratify a conflict of interest transaction.

Subsection (G), like RULLCA § 409(g), establishes a "no harm no foul" rule as a defense to a member who has violated the conflict of interest duty or has failed to disclose a conflict of interest prior to a member vote. So long as the decision or transaction is fair to the company, the member will not have

violated his duty to avoid or to disclose a conflict of interest, or any similar duty arising in equity or under the common law. The purpose of this subsection is to prevent harmless violations from being used as a sword against a member. Of course, the burden of proving fairness of the transaction is on the offending member.

Subsection (H) is substantially the same as RULLCA § 409(h). It states that a member has the same enforcement rights against the limited liability company as a third party with respect to a transaction or contract that either (i) involves a conflict of interest so long as the operating agreement or the other members authorized or ratified the transaction or contract or (ii) is being enforced by a member in a manager-managed company who, under subsection (Q), does not owe fiduciary duties to the company. If, for example, a member makes a secured loan to the company that was authorized by the operating agreement or by the other members, the member has the right to enforce his or her remedies against the collateral without having to seek another member authorization. This subsection is similar to A.R.S. § 29-608 of the Prior Act.

Manager Duties in a Manager-Managed Company

The Drafting Subcommittee decided to depart from RULLCA's approach in describing the duties of managers. RULLCA § 409(i) simply states six rules for applying a member's duties in a member-managed company to a manager's duties in a manager-managed company. The Drafting Subcommittee concluded that these six rules contained some ambiguities and so, for the sake of clarity, decided to describe each of a manager's duties in subsections (J) through (P) corresponding to a member's duties under subsections (B) through (H).

For the most part, the provisions governing a manager's duties are adapted from those governing a member's duties in a member-managed company by simply substituting the word "manager" for "member" as appropriate. However, the following clarifications and substantive departures from RULLCA are significant:

(1) A manager's duty to refrain from competition ends at the company's dissolution, and does not continue during the company's winding up.

(2) The required disclosures in connection with a conflict of interest transaction must be made to other managers or members (or both) depending upon whose approval is sought for the decision or transaction at issue.

(3) A manager must perform his or her duties under the Act and the operating agreement in conformity with the contractual obligation of good faith and fair dealing, even though he or she may not have signed the operating agreement.

(4) The authorization or ratification of a specific act, transaction, or omission or category of acts, transactions, or omissions that would otherwise violate the duty of loyalty must come from the members, not the other managers.

(5) The *per se* rule under subsection (E), which provides that a member's pursuit of self interest does not of itself establish a violation of the member's duties, applies equally to a manager under subsection (M). RULLCA would have limited the benefit of that rule to members.

The RULLCA comment to subsection (E) asserts, without any apparent basis in the statutory text, that a member enjoys the benefit of the "no violation" *per se* rule only

> when the member acts as a party to the operating agreement, and not when the member acts as a manager or co-manager. The Drafting Subcommittee rejected this view because management rights are inherently intertwined with other rights under an operating agreement and the Drafting Subcommittee could not discern any policy reason to justify the distinction made by the RULLCA comment. Accordingly, the portion of the RULLCA comment relating to subsection (E) was deleted from the Modified RULLCA Comment below.

Member Duties in a Manager-Managed Company

RULLCA § 409(i)(6) simply states that in a manager-managed company, a member has no duty to the company or the other members solely by reason of being a member, except for the obligation of good faith and fair dealing. The Drafting Subcommittee believed that this statement, standing alone, might be misinterpreted to raise a presumption that the member has no duty of loyalty or duty of care. Accordingly, A.R.S. § 29-3409(Q) adds a sentence clarifying that a member in a manager-managed company may have fiduciary duties depending upon the extent to which the member controls or participates in the management of the company, to be determined under law other than the Act. For instance, under A.R.S. § 407(C)(5) certain decisions require the unanimous approval of the members, even in a manager-managed company. It is also common for an operating agreement to enumerate certain major decisions that require member approval in manager-managed companies. In those situations, the members making the decisions may have fiduciary duties.

> EXAMPLE 1: Under the terms of the operating agreement, a corporate member holding a 51% transferable interest in a manager-managed limited liability company has the right to designate and replace the sole manager in its discretion from time to time. The member designates one of its executive officers as manager and, as a practical matter, directs the management of the company's business. The corporate member should be subject to the duty of loyalty and the duty of care.

> EXAMPLE 2: An individual member in the same company holds a 10% transferable interest but under the terms of the operating agreement has no right (and in fact does not) participate in management decisions. This member should owe only the contractual obligation of good faith and fair dealing.

Continuing Relevance of Common Law of Fiduciary Duties

Although A.R.S. § 29-3409 is intended to codify the major components of the common law of fiduciary duties, this section does not purport to exhaustively cover all elements of those duties under Arizona case law. Moreover, at least three other situations may call for the application of the common law of fiduciary duties:

(1) The duties of a member in a manager-managed company should be based upon the application of the common law of fiduciary duties to the specific facts of each case.

(2) The duties set forth in A.R.S. § 29-3409 are owed expressly to the limited liability company and its members. Accordingly, a transferee of an interest who is damaged by manager or member conduct in violation of the statutory duty of loyalty or statutory duty of care must seek recovery based upon the common law of fiduciary duties.

(3) For a limited liability company formed under the Prior Act, claims of wrongdoing on the part of its members or managers will be litigated under common law if the claims arise out of acts or omissions occurring before September 1, 2020.

Whether fiduciary or other common law duties exist in these three situations will depend upon the specific facts and circumstances of each case, and the common law can be expected to evolve as future judicial opinions are published. The court decisions referenced in the remaining portions of this comment comprise some, but not all, of the existing relevant Arizona case law. Lawyers should be alert to other relevant case law as well as future judicial opinions that are published after the last revision date of this comment.

In a case decided under the Prior Act, the Arizona Supreme Court applied the common law of agency to hold that members and managers who serve as agents of a limited liability company owe fiduciary duties to the company. *In re Sky Harbor Hotel Properties, LLC v. Patel Properties, LLC*, 443 P.3d 21 (Ariz., June 25, 2019). In so holding, the Court rejected contrary dicta from its opinion the preceding year in *Butler Law Firm, PLC v. Higgins*, 243 Ariz 456 (2018).

Members and managers often interact with the limited liability company and its members in ways other than as agent, and *Sky Harbor* does not address these situations. For example, members or managers may make management decisions and set policies for the company similar to directors of a corporation. In addition, members may engage with each other in the purchase and sale of their respective interests. None of these actions involve agency on behalf of the company, but the common law of fiduciary duties may apply based upon the nature of the parties' relationship and the specific circumstances of each case. Management control is an important factor, but not the only factor, in many of the relevant court decisions. For example, Arizona courts have previously analyzed the applicability of fiduciary duties in connection with the following kinds of relationships:

(1) Despite the absence of any statutory basis in the corporate code, Arizona courts have held that majority shareholders in an Arizona corporation owe fiduciary duties to minority shareholders. *See, e.g.*, Garrett v. Reid-Cashion Land & Cattle Company, 34 Ariz 245 (1928); Mims v. Valley National Bank, 14 Ariz App 190 (1971). Those fiduciary duties arose out of the majority shareholder's power over the corporation, presumably as a matter of common law. Quoting favorably from a Kansas court decision, the Arizona Supreme Court endorsed the following principle in Roche v. Golden State Lands, Inc. 107 Ariz 335 (1971):

> Fiduciary relationships recognized and enforced in equity do not depend upon nomenclature; nor are they necessarily the product of any particular legal relationship … but they necessarily spring from an attitude of trust and confidence and are based upon some form of agreement, either expressed or implied, from which it can be said that the minds have met in a manner to create mutual obligations.

(2) An accounting firm that prepared financial statements for a corporation did not owe fiduciary duties to the purchaser of the corporation, even though the purchaser relied upon the statements. The purchaser failed to present evidence to show a confidential relationship involving "great intimacy, disclosure of secrets, or intrusting of power." Standard Chartered PLC v. Price Waterhouse, 190 Ariz 6 (1996).

(3) A bank did not owe a fiduciary duty to its customer because evidence failed to show that the bank was the customer's financial advisor or that the customer relied upon the bank's financial advice. McCalister v. Citibank (Arizona), 171 Ariz 207 (Ariz App 1992). Compare Stewart v. Phoenix Nat. Bank, 49 Ariz 34 (1937) for opposite result under different facts.

(4) Based upon common law cited from Corpus Juris Secundum, partners owe each other fiduciary duties. DeSantis v. Dixon, 72 Ariz 345 (1951). *See also* Jerman v. O'Leary, 145 Ariz 397 (1985).

(5) No fiduciary or confidential relationship was found between independent contractors in the absence of any evidence showing great intimacy, disclosure of secrets, entrusting of power, or superiority of position. Rhoads v. Harvey Publications, Inc., 145 Ariz 142 (1984).

Modified RULLCA Comment

(Rev. 2/23/2024)

This section states some of the core aspects of the fiduciary duty of loyalty, provides a duty of care, and incorporates the contractual obligation of good faith and fair dealing. ~~The section follows the structure of many LLC acts, first stating the duties of members in a member-managed limited liability company and then using that statement and a "switching" mechanism, Subsection (i), to allocate duties in a manager-managed company~~. The duties stated in this section are subject to the operating agreement, but ~~Section 105(c~~A.R.S. § 29-3105(C) and (~~d~~D) contain important limitations on the power of the operating agreement to affect fiduciary and other duties and the obligation of good faith and fair dealing.

For the effect of dissociation on a person's duties under this section, *see* ~~Section 603(a~~A.R.S. § 29-3603(A)(2).

Subsection (~~a~~A) – This subsection recognizes two core managerial duties but, unlike some earlier uniform acts, does not purport to state all managerial duties. Indeed, many cases characterize a manager's duty to disclose as a fiduciary duty. *E.g., Salm v. Feldstein*, 20 A.D.3d 469, 470, 799 N.Y.S.2d 104, 105 (N.Y. App. Div. 2005*)* (stating that, "[a]s the managing member of the [limited liability] company and as a co-member with the plaintiff, the defendant owed the plaintiff a fiduciary duty to make full disclosure of all material facts"); *Metro Commc'n Corp. BVI v. Advanced Mobilecomm Technologies Inc.*, 854 A.2d 121, 156 n. 78 (Del. Ch. 2004) (referring to "certain standards governing the disclosure-related duties of the fiduciaries of Delaware business entities;" noting that "[t]hese standards have been mostly articulated in the corporate context but the corporate standards often serve as the default rule in the alternative entity context"). A.R.S. § 29-3409(B)(4) and (J)(4) add the duty of disclosure as a component of the duty of loyalty of members in a member-managed company and of managers in a manager-managed company.

Subsection (~~b~~B) – This subsection states ~~three~~four core aspects of the fiduciary duty of loyalty of a member in a member-managed company: (i) not "usurping" company opportunities or otherwise wrongly benefiting from the company's operations or property; (ii) avoiding conflict of interests in dealing with the company (whether directly or on behalf of another); ~~and~~ (iii) refraining from competing with the company, and (iv) disclosing all facts relating to a material conflict of interest present in any contract or transaction then under consideration by the members. Essentially the same duties exist in agency law and under the law of all types of business organizations.

The subsection applies beginning with "the conduct of the company's activities and affairs," which by definition cannot exist before the company exists; thus the stated duties do not apply to pre-formation activities. In some circumstances, comparable duties might arise from other law, particular the law of agency. *See, e.g.,* ~~Section 401(a~~A.R.S. § 29-3401(A) and (~~b~~B) (stating that the organizer acts "on behalf of others").

The stated duties of loyalty comprise a default rule. ~~Under Section 105(d)(3)(A): "If not~~

~~manifestly unreasonable, the operating agreement may … alter or eliminate the aspects of the duty of loyalty stated in Section 409(b).”~~

Subsection (~~b~~B)(1) – The phrase “hold as trustee” dates back to UPA (1914) § 21 and reflects the availability of disgorgement remedies, such as a constructive trust. In contrast to an actual trustee, a person subject to this duty does not: (i) face the special obstacles to consent characteristic of trust law; or (ii) enjoy protection for decisions taken in reliance on the governing instrument and other sources of information. *Cf.* UNIFORM STATUTORY TRUST ENTITY ACT (2009) (Last Amended 2013) § 506 (“A trustee [of a statutory trust]… is not liable to the trust or to a beneficial owner for breach of any duty, *including a fiduciary duty*, to the extent the breach results from reasonable reliance on: (i) a term of the governing instrument; (ii) a record of the statutory trust; or (iii) an opinion, report, or statement of another person that the person to which the opinion, report, or statement is made or delivered reasonably believes is within the other person’s professional or expert competence and is made or delivered to the trustee … .”) (emphasis added). A limited liability company’s operating agreement should be treated as a member’s governing instrument for purposes of applying these principles of trust law.

Subsection (~~b~~B)(1)(~~A~~a) – This provision is consistent with a basic principle of agency law – namely, that an agent may not benefit at all from the performance of the agency unless the principal consents. RESTATEMENT (THIRD) OF AGENCY § 8.06, cmt. c (2006). Typically, however, the operating agreement will legitimize particular benefits – *e.g.*, a management fee paid to a managing member in addition to that member’s share of distributions. Also, an agreed allocation of distributions takes those benefits outside the reach of this provision.

Subsection (~~b~~B)(1)(~~B~~b) – For the expansive meaning of “property,” *see* ~~Section 102(17~~A.R.S. § 29-3102(21). The term includes confidential information.

Subsection (~~b~~B)(1)(~~C~~c) – This act does not specify what constitutes “a company opportunity,” but ample case law exists. *See, e.g.*, *Ebenezer United Methodist Church v. Riverwalk Development Phase, II, LLC,* 45 A.3d 883, 887 (Md. App. 2012) (discussing the “interest or reasonable expectancy test”); *In re McCook Metals, L.L.C.*, 319 B.R. 570, 596 (Bkrtcy. N.D.Ill. 2005) (discussing the “line of business test”).

This duty continues through winding up, although in that context the scope of company opportunities inevitably narrows.

In most, if not all, situations, usurping a company opportunity also breaches the duty not to compete, ~~Paragraph~~Subsection (~~b~~B)(3), but not *vice versa*.

Subsection (~~b~~B)(2) – In this context, the phrase “adverse interest” is a term of art, meaning “to be on the other side of the table” in some dealing with the limited liability company. Absent informed consent by the LLC, this duty is breached by the mere existence of the conflict of interest; the LLC need not prove that the outcome of the dealing was adverse to the LLC. *But see* Subsection (~~g~~G) (permitting the defense of fairness). This duty continues through winding up.

Subsection (~~b~~B)(3) – Although competition is often thought of in terms of potential customers, this duty applies equally to competition for resources, including employees. ~~The duty not to compete continues longer in a manager-managed LLC. *See* Subsection (i)(2).~~

Subsection (~~c~~C) – ULLCA (2006) §409(c) stated a different rule: “Subject to the business judgment rule, the duty of care of a member of a member-managed limited liability company in the conduct and winding up of the company’s activities is to act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes

to be in the best interests of the company." As part of the Harmonization Project, the ULLCA duty of care was conformed to the duty of care stated in ULPA (2001) and UPA (1997).

Neither this act nor the two harmonized partnership acts refer to the duty of care as a fiduciary duty, because: (i) the duty of care applies in many non-fiduciary situations; and (ii) breach of the duty of care is remediable only in damages while breach of a fiduciary duty gives rise also to equitable remedies, including disgorgement, constructive trust, and rescission. *See* ULPA (2001) (Last Amended 2013) § 409(c) and UPA (1997) (Last Amended 2013) § 409(c).

The change in label is consistent with the RESTATEMENT (THIRD) OF AGENCY § 8.02 (2006), which refers to the agent's "fiduciary duty to act loyally, but eschews the word "fiduciary" when stating the agent's duties of "care, competence, and diligence." *Id.* § 8.08. However, the change in label is merely semantics; no change in the law is intended.

The operating agreement can raise the standard of care, or subject to ~~Sections 105(c~~A.R.S. § 29-3105(C)(~~7~~5) and (~~d)(3)(~~C)(6), lower it. A person's practical exposure for breaching the duty of care involves not only the standard of care but also any operating agreement provision that, subject to A.R.S. § 29-3105(C)(5) and (C)(6): (i) exonerates the person from liability for breach of the duty of care, ~~Section 105(c)(7~~A.R.S. § 29-3105(D)(2); or (ii) entitles the person to indemnification despite such breach, ~~Section 408(b), comment~~A.R.S. § 29-3105(D)(4).

Subsection (~~d) – This subsection refers~~**D) and (I)** – These subsections refer to the "*contractual* obligation of good faith and fair dealing" (emphasis added) and thereby invokes the implied obligation that exists in every contract. *See* RESTATEMENT (SECOND) CONTRACTS § 205 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."). The adjective ("contractual") should help avoid decisions like *Phelps v. Frampton*, 2007 MT 263, 339 Mont. 330, 342-43, 170 P.3d 474, 483 (2007) (holding that Montana's version of UPA (1997) creates a statutory obligation of good faith and fair dealing separate from the implied contractual covenant).

At first glance, it may seem strange to apply a contractual obligation to statutory duties and rights – *i.e.*, duties and rights "under this [act]." However, for the most part those duties and rights apply to relationships *inter se* the members and the LLC and function only to the extent not displaced by the operating agreement. These statutory default rules are intended in essence to function like a contract; applying the contractual notion of good faith and fair dealing therefore makes sense.

The contractual obligation of "good faith" has nothing to do with the corporate concept of good faith that for years bedeviled courts and attorneys trying to understand: (i) Delaware's famous corporate law exoneration provision; and (ii) that provision's exception "for acts or omissions not in good faith." DEL. CODE ANN. tit. 8, § 102(b)(7) (2012). In that context, good faith is an aspect of the duty of loyalty. *See Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369-70 (Del. 2006).

Likewise, the contractual obligation of good faith and fair dealing has nothing to do with the "utmost good faith" sometimes used to describe the fiduciary duties that owners of closely held businesses owe each other. *See, e.g., Meinhard v. Salmon*, 249 N.Y. 458, 477, 164 N.E. 545, 551 (1928) ("[W]here parties engage in a joint enterprise each owes to the other the duty of the utmost good faith in all that relates to their common venture. Within its scope they stand in a fiduciary relationship."); *Donahue v. Rodd Electrotype Co. of New England, Inc.,* 367 Mass. 578, 593, 328 N.E.2d 505, 515 (1975) ("[S]tockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise1 that partners owe to one another. In our previous decisions, we have defined the standard of duty owed by partners to one another as the utmost good faith and loyalty.") (footnotes omitted) (citations omitted) (internal quotations omitted).

To the contrary, the contractual obligation of good faith and fair dealing is not a fiduciary duty, does not command altruism or self-abnegation, and does not prevent a member from acting in the member's own self-interest:

> "Fair dealing" is not akin to the fair process component of entire fairness, *i.e.,* whether the fiduciary acted fairly when engaging in the challenged transaction as measured by duties of loyalty and care … . It is rather a commitment to deal "fairly" in the sense of consistently with the terms of the parties' agreement and its purpose. Likewise "good faith" does not envision loyalty to the contractual counterparty, but rather faithfulness to the scope, purpose, and terms of the parties' contract. Both necessarily turn on the contract itself and what the parties would have agreed upon had the issue arisen when they were bargaining originally.

Gerber v. Enter. Products Holdings, LLC, 67 A.3d 400, 418-19 (Del. 2013) (quoting *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d 434, 440–42 (Del. Ch. 2012), *aff'd in part, rev'd in part on other grounds*, 68 A.3d 665 (Del. 2013)) (footnotes omitted) (citations omitted) (internal quotations omitted without ellipsis by *Gerber*). *See also* Subsection (e).

Courts should not use the contractual obligation to change *ex post facto* the parties' or this act's allocation of risk and power. To the contrary, the obligation should be used only to protect agreed-upon arrangements from conduct that is manifestly beyond what a reasonable person could have contemplated when the arrangements were made.

The operating agreement or this act may grant discretion to a member or manager, and the contractual obligation of good faith and fair dealing is especially salient when discretion is at issue. However, a member or manager may properly exercise discretion even though another member suffers as a consequence. Conduct does not violate the obligation of good faith and fair dealing merely because that conduct substantially prejudices a party. Indeed, parties allocate risk precisely because prejudice may occur.

The exercise of discretion constitutes a breach of the obligation of good faith and fair dealing only when the party claiming breach shows that the conduct has no honestly-held purpose that legitimately comports with the parties' agreed-upon arrangements:

> An implied covenant claim ... looks to the past. It is not a free-floating duty unattached to the underlying legal documents. It does not ask what duty the law should impose on the parties given their relationship at the time of the wrong, but *rather what the parties would have agreed to themselves had they considered the issue in their original bargaining positions at the time of contracting*.

Gerber v. Enter. Prods. Holdings, LLC, 67 A.3d 400, 418 (Del. 2013) (quoting *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d 434, 440–42 (Del. Ch. 2012), *aff'd in part, rev'd in part on other grounds*, 68 A.3d 665 (Del. 2013)) (emphasis added) (footnotes omitted) (citations omitted) (internal quotations omitted without ellipsis by *Gerber*).

In sum, the purpose of the contractual obligation of good faith and fair dealing is to protect the arrangement the members have chosen for themselves, not to restructure that arrangement under the guise of safeguarding it.

As to ~~the power of the operating agreement to affect~~whether the contractual obligation of good faith and fair dealing~~, *see* Section 105(c)(6) (prohibiting elimination but allowing the agreement to~~

~~"prescribe standards, if not manifestly unreasonable, by which the performance of the obligation is to be measured"). For examples, *see* Section 105(c)(6), comment. As to whether the obligation stated in this subsection~~ applies to transferees, *see* ~~Section 107(b), comment~~A.R.S. § 29-3107(B) and related comments.

~~Subsection (e) – A member in a member-managed LLC has at least two different roles: (i) as a party to the operating agreement, with rights and obligations under that agreement; and (ii) as manager or co-manager of the enterprise. This provision pertains to the first role. A member's exercise of rights under the operating agreement is subject to the obligation of good faith and fair dealing, Subsection (d), but a person does not breach that contractual obligation "solely because the [person's exercise of rights] furthers the [person's] own interest." In contrast, this provision is ineffective with regard to a member's duties as manager or co-manager. For example, a member's liability under Section 409(b)(3) (prohibiting competition) is not "solely because the member's conduct furthers the member's own interest." Rather, the liability results from the breach of a specific obligation – i.e., the codified aspect of the duty of loyalty that prohibits competition.~~

~~With regard to a manager-managed LLC: (i) the same analysis applies to a member that is a manager; and (ii) with regard to a non-managing member the analysis as to contractual rights applies and the analysis as to managerial duties is inapposite.~~

~~Subsection (f~~**Subsection (F)** – Here and elsewhere in this act, information "is material if there is a substantial likelihood that a reasonable [decision maker] would consider it important in deciding how to vote" or take other action under this act or the operating agreements. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132 (1976).

The operating agreement can provide additional or different methods of authorization or ratification, subject to the strictures of ~~Section 105(c~~A.R.S. § 29-3105(C)(5), (~~d)(1), and (d)(3)(A)(B~~C)(6) and (D)(3).

Subsection (~~g~~G) – This subsection codifies judge-made law applicable to all business entities. *See, e.g., Gottsacker v. Monnier*, 281 Wis. 2d 361, 379, 697 N.W.2d 436, 444 (Wisc. 2005) (referring to "a willful failure to deal fairly with the LLC or its other members"); *Lonergan v. EPE Holdings, LLC*, 5 A.3d 1008, 1019 (Del. Ch. 2010) (discussing "entire fairness" in the context of a limited partnership"); *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994) (discussing "entire fairness" in the context of a corporation's merger with an affiliate); *Lonergan v. EPE Holdings, LLC*, 5 A.3d 1008, 1019 (Del. Ch. 2010) (discussing "entire fairness" in the context of a limited partnership").

Subsection (~~h~~H) – This subsection is the modern, reformulated version of a language that sought to overturn the now-defunct notion that debts to owners were categorically inferior to debts to non-owner creditors. *See, e.g.*, ULPA (2001) § 112 ("A partner may lend money to and transact other business with the limited partnership and has the same rights and obligations with respect to the loan or other transaction as a person that is not a partner."). The reformulation makes clear that this provision has nothing to do with the fiduciary duty pertaining to conflict of interests. *See BT-I v. Equitable Life Assurance Soc'y of the United States*, 75 Cal. App. 4th 1406, 1415, 89 Cal. Rptr. 2d 811 (1999) (examining the prior formulation, explaining its history and stating "[w]e cannot discern anything in the purpose of [the prior formulation] that suggests an intent to affect a general partner's fiduciary duty to limited partners").

This subsection states a default rule. The operating agreement may provide that debt to a member (or members generally) is subordinate to other limited liability company obligations. The agreement that creates the debt may do likewise.

Subsection (~~i) – This is the "switching" mechanism, referred to in the introduction to this comment~~. ~~The list does not include Subsection (h).~~

~~Subsection (i)(1) – This provision switches most managerial duties to the managers and away from members~~. ~~Of course, if a member is a manager, the duties apply to the member-manager in the person's capacity of manager.~~

~~Subsection (i)(2) – On the assumption that the members of a manager-managed LLC are dependent on the manager, this paragraph extends the duty not to compete longer than in a member-managed LLC.~~

~~Subsection (i)(3~~**Q)** – The contractual obligation of good faith and fair dealing applies to members regardless of whether they are managers; non-managing members have rights and perhaps duties under the operating agreement and under this act. As to non-member managers, the operating agreement (and the corresponding obligation of good faith and fair dealing) are relevant regardless of whether the manager is party to the agreement. *See* ~~Section 105(a~~A.R.S. § 29- 3105(A)(2) (stating that the operating agreement "governs … the rights and duties under this [act] of a person in the capacity of manager"). Also, non-member managers will have rights and obligations under this act, which per Subsection (~~d~~I) are also subject to the obligation of good faith and fair dealing.

~~Subsection (i)(4) – As explained in the comment to Subsection (e), that provision does not apply to the managerial function.~~

~~Subsection (i)(5) – The power to ratify belongs to the entity's owners; thus Subsection (f) does not switch from members to managers.~~

~~Subsection (i)(6) –~~ This ~~paragraph~~subsection merely negates a claim of fiduciary duty that is exclusively status-based and does not immunize misconduct.

> EXAMPLE: Although a limited liability company is manager-managed, one member who is not a manager owns a controlling interest and effectively, albeit indirectly, controls the company's activities. A member owning a minority interest brings an action for dissolution under ~~Section 701(a)(4)(C)(ii) (oppression~~A.R.S. § 29-3701(A)(4)(d)(i) (illegal or fraudulent acts by "the managers or those members in control of the company"). This paragraph does not prevent the court from construing the claim as alleging a breach of fiduciary duty by the controlling member.

A.R.S. § 29-3410. RECORDS TO BE KEPT, RIGHTS TO INFORMATION AND RECORDS OF MEMBER, MANAGER AND PERSON DISSOCIATED AS MEMBER.

Arizona Comment
(Rev. 2/23/2024)

Subsection (A) generally follows A.R.S. § 29-607 of the Prior Act by requiring a limited liability company to keep a specified list of information, including names and addresses of members and managers, articles of organization and operating agreements (and amendments thereto), written promises by members to make capital contributions, tax returns, and financial statements, but without specifying the location at which they are to be kept. This subsection does not require a particular format in which the information must be kept (e.g., physical copies, electronic copies, or the "cloud"). There is no similar requirement in RULLCA. A member does not have an absolute right to access these records, but must make a demand that satisfies the same three requirements (explained below) applicable to

demands for any other company records.

The Act rejects the requirements in subsection (a)(2) of RULLCA, which imposes an affirmative (and continuous) obligation on a member-managed limited liability company to furnish to each member, without demand, information concerning the company's affairs, financial condition and other circumstances that the company knows is material to the member's rights and duties under the operating agreement. Subsection (a)(3) of RULLCA imposes that same affirmative obligation on each member to provide information to the company without demand, to the extent the member is in possession of the relevant information. Subsection (b) of RULLCA imposes similar rights and obligations on the managers of a manager-managed company. In lieu of these requirements, the Act obligates the company to provide access to records only after a demand is made that satisfies certain requirements. Specifically, A.R.S. § 29-3410(B) grants to each member and manager the right to inspect and copy, after making a written demand, the records required to be maintained by a limited liability company pursuant to subsection (A), and other company records as is "just and reasonable", if the following three requirements are satisfied:

(i) The records must be sought for a purpose that is reasonably related to the rights and duties of the requesting member or manager under the Act or the operating agreement;
(ii) The demand for inspection and copying records must itself be communicated in a record that describes with reasonable particularity the records being sought and the purpose for seeking the records; and
(iii) The records sought must be directly connected to the asserted purpose.

With respect to the first requirement, the Act departs from RULLCA and the Prior Act by narrowing the permitted purpose for the demanded records. The Act requires that the purpose be reasonably related to the requesting member's or manager's rights and duties, instead of RULLCA's broader standard of "reasonably related to the member's interest as a member."

EXAMPLE 1: A member demands access to all records of the company's distributions during the preceding two years, as well as the company's income tax returns for that period, for the stated purpose of determining whether the member received the proper amount of distributions. These records are reasonably related to the member's distribution rights and the company must provide access to these records.

EXAMPLE 2: A member demands access to the same records as in Example 1, but the stated purpose is to enable the member to value his or her interest in connection with a personal loan to be secured by the member's interest. The company may reject the demand because its purpose is not reasonably related to the member's rights and duties as a member.

The Act also substitutes the obligation to make records available wherever the obligation to "provide information" appears in subsections (b) and (c) of RULLCA. The purpose of that change is to remove any implication that the limited liability company must create information or analyses that are not in its existing records.

EXAMPLE 3: A member demands access to financial statements of the limited liability company that are prepared in accordance with generally accepted accounting principles. The company may reject that demand if its existing financial statements are not prepared in that manner.

Subsection (D) creates a duty for the limited liability company to provide to its members and managers, without demand, information that is pertinent to any matter being voted on or consented to

by members or managers. This duty differs from RULLCA in that it does not require the company to provide information that the company reasonably believes that the manager or member already knows or that is already in the manager's or member's possession. Note that individual members or managers may also have a fiduciary duty to make disclosures, in addition to those required under A.R.S. § 29-3410, in connection with decisions or transactions in which they have a material conflict of interest. *See* A.R.S. § 29-3409 (B)(4) and (J)(4).

The obligation to maintain and provide information under A.R.S. § 29-3410 is imposed primarily on the limited liability company. The member(s) or manager(s) that control the limited liability company would determine how the company performs its obligations and the limitations the company may impose on access to or use of company information. However, Subsection (E) imposes on members and managers an obligation to make records available to the limited liability company as necessary for the company to satisfy its obligations under A.R.S. § 29-3410. This obligation on the part of members and managers is significantly different from RULLCA because it does not arise until the company receives a demand for inspection. By contrast, section 410(a)(3) of RULLCA requires each member in a member-managed company (and RULLCA section 401(b)(1) requires each manager in a manager-managed company) to provide, on a continuous basis without demand, any information in his or her possession that is material to the proper exercise of each other member's rights and duties under the operating agreement or the Act.

Subsection (L), which is neither in the Prior Act nor in RULLCA, permits a court to award reasonable attorneys' fees and costs in connection with disputes regarding members' and managers' rights to obtain information or on restrictions imposed by the company on access to or use of the information. The purpose of this addition is to disincentivise frivolous demands for records as well as wrongful refusals to make records available.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section is derived from the Uniform Limited Partnership Act (2001) §§ 304 (rights to information of limited partners and former limited partners) and 407 (rights to information of general partners and former general partners). The rules stated here are what might be termed "quasi-default rules" – subject to some change by the operating agreement. *See* ~~Section~~ A.R.S. § 29-3105(~~c~~C)(7~~8~~) (prohibiting unreasonable restrictions on the information rights stated in this section).

Although the rights and duties stated in this section are extensive, they are not necessarily all-inclusive. This ~~a~~Act's statement of fiduciary duties is not exhaustive, *see* the comment to ~~Section~~ A.R.S. § 29-3409(a), and some cases characterize owners' information rights as reflecting a fiduciary duty of those with management power. *E.g., Bakerman v. Sidney Frank Importing Co., Inc.*, No. Civ.A. 1844–N, 2006 WL 3927242 at *14 (Del. Ch. Oct. 16, 2006) (holding that an LLC manager owed "certain duties to members of the LLC" and stating that "[w]hen fiduciaries communicate with their beneficiaries in the context of asking the beneficiary to make a discretionary decision—such as whether to consent to a sale of substantially all the assets of an LLC—the fiduciary has a duty to disclose all material facts bearing on the decision at issue") (citing *Loudon v. Archer–Daniels–Midland Co.*, 700 A.2d 135, 137 (Del.1997)). Also, the rights stated in this section are in addition to whatever discovery rights a party has in a civil suit.

~~**Subsection (a)** – Paragraph 1 states the rule pertaining to information memorialized in "any record maintained by the company." Paragraph 2 applies to information not in such a record. Appropriately, Paragraph (2) sets a more demanding standard for those seeking such information.~~

~~**Subsection (a)(2) and (3)** – In appropriate circumstances, violation of either or both of these~~

~~provisions might cause a court to enjoin or even rescind action taken by the LLC, especially when the violation has interfered with an approval or veto mechanism involving member consent. *E.g.*, *Blue Chip Emerald LLC v. Allied Partners Inc.*, 299 A.D.2d 278, 279-80 (N.Y. App. Div. 2002) (invoking partnership law precedent as reflecting a duty of full disclosure and holding that "[a]bsent such full disclosure, the transaction is voidable").~~

~~**Subsection (a)(2)** – This paragraph imposes a duty on the limited liability company, not the members who manage the LLC. However, a member could be liable in damages if the member were to: (i) breach a duty under Section 409 or the operating agreement; and (ii) in doing so cause or suffer the LLC to breach the duty stated in this paragraph.~~

~~**Subsection (a)(2)(A)** – For the meaning of "material" as applied to information, *see* Section 409(f), comment.~~

~~**Subsection (a)(3)** – This paragraph imposes a duty directly on each member. Therefore, a member's violation of this paragraph is actionable in damages without need to show a violation of a duty stated in Section 409.~~

~~**Subsection (b)(1)** – This is a switching provision. The comments to Paragraph (a)(2) and (3) apply here by analogy.~~

Subsection (B~~b~~)~~(2)~~ ~~– This paragraph refers to "information" rather than "records maintained by the company" so in some circumstances the company might have an obligation to memorialize information. *Compare* Subsection (b)(2), *with* Subsection (a). Such circumstances will likely be rare or at least unusual.~~ This section generally concerns providing existing information, not creating it. In any event, a member or manager does not trigger the company's obligation under this paragraph merely by satisfying Subparagraphs (B~~A~~)(1) through (B)(3~~C~~). The member or manager must also satisfy the "just and reasonable" requirement.

Subsection (D~~b)(4~~) – For the meaning of "material" as applied to information, *see* A.R.S. § ~~Section~~ 29-3409(F~~f~~), comment.

Subsection (F~~e~~) – When a member dies, ~~Section~~ A.R.S. § 29-3504 provides information rights to the legal representative of the deceased member.

Subsection (~~e~~F)(1) – A person dissociated as a member has information rights in that capacity only as to the period during which the person was a member. To the extent that further information is accessible under ~~Section~~ A.R.S. § 29-3504(2) (providing access to the legal representative of a deceased member ~~partner~~), that access is limited both in purpose ("for purposes of settling the estate") and in scope ("the rights the deceased ~~partner~~ member had under ~~Section~~ section 29-3410").

Subsection (I~~f~~) – Some old cases involved conflicts over whether a shareholder could exercise inspection rights through another person. *White v. Coeur D'Alene Big Creek Mining Co.*, 55 P.2d 720, 723 (Idaho 1936) (stating that "[t]he refusal to permit respondent [shareholder] to appoint his own attorney or agent to make the examination [of the corporation's books] was in effect a denial of his right" of inspection); *State v. Monida & Yellowstone Stage Co.*, 124 N.W. 971, 972 (Minn. 1910) (upholding a trial court's mandamus order, "which shall provide that [the shareholder complainant], or such attorney or agent as he may select, … shall be allowed to inspect the books, records, and papers of the defendant [corporation]"). In light of that history, for the avoidance of doubt, this subsection expressly authorizes taking action through an agent. No negative inference should be drawn about using agents to take other action under this ~~a~~Act.

Subsection (Kh) – This provision provides fallback protection for gaps in the operating agreement. For example, those managing an LLC may protect trade secrets from disclosure and may prohibit various misuses of confidential information even if the operating agreement omits to do so.

The reference to "ordinary course" pertains to Section 407(b)(3) (stating that any "difference arising among members [in a member-managed LLC] as to a matter in the ordinary course of the activities of the company may be decided by a majority of the members"). As for a manager-managed LLC, *see* Section 407(c)(1) ("Except as expressly provided in this [act], *any* matter relating to the activities and affairs of the [manager-managed] company is decided exclusively by the manager, or, if there is more than one manager, by a majority of the managers.") (emphasis added). This approach is necessary, lest a requesting member (or manager-member) have the power to block imposition of a reasonable restriction or condition needed to prevent the requestor from abusing the LLC.

The burden of persuasion under this subsection contrasts with the burden of persuasion under Section A.R.S. § 29-3105(c)(8) (prohibiting unreasonable limitations on the information rights provided by this section). Under that subsection, as a matter of ordinary procedural law the burden is on the person making the claim.

ARTICLE 5
TRANSFERABLE INTERESTS AND RIGHTS OF TRANSFEREES AND CREDITORS

A.R.S. § 29-3501. NATURE OF TRANSFERABLE INTEREST

Arizona Comment
(Rev. 2/23/2024)

The Act did not make any changes to Section 501 of RULLCA. However, the Modified RULLCA Comment to Section 501 must be read in light of A.R.S. § 29-3407, which provides that certain management decisions (those decisions identified in A.R.S. § 29-3407(B)(3) or A.R.S. § 29-3407(C)(5)) are to be made by a "majority in interest" based on profit interests of the members (as defined in A.R.S. § 29-3102(12)) rather than per capita (that is, one vote per member regardless of percentage interest), as in RULLCA and the Prior Act. Therefore, under the default rule of the Act, an increase in the transferable interest of a member will result in a concomitant increase in certain governance rights. *See* the Arizona comment to A.R.S. § 29-3502(A)(3)(a) for further discussion of this concept.

Modified RULLCA Comment
(Rev. 2/23/2024)

For the definition of transferable interest, *see* ~~Section 102(24)~~A.R.S. § 29-3102(29). Absent a contrary provision in the operating agreement or the consent of the members, a "transferable interest" is the only interest in an LLC which can be transferred to a person who is not already a member. *See* ~~Section 502~~A.R.S. § 29-3502. ~~As to whether a member may transfer governance rights to a fellow member, the question is moot absent a provision in the operating agreement changing the default rule, *see* Section 407(b)(2) (allocating governance rights *per capita*). In the default mode, a member's transfer of governance rights to another member: (i) does not increase the transferee's governance rights; (ii) eliminates the transferor's governance rights; and (iii) thereby changes that denominator but not the numerator in calculating governance rights.~~

> ~~EXAMPLE: LCN Company, LLC is a member-managed limited liability company with three members, Laura, Charles, and Nora. The operating agreement does not displace this act's default rule on the allocation of governance rights among members. Thus, each member has 1/3 of those rights~~. ~~Laura transfers her entire ownership interest to Charles. The transfer does not increase Charles's governance rights but does eliminate Laura's~~. ~~After the transfer, Laura has no governance rights (regardless of whether Charles and Nora agree to expel Laura under Section 602(5)(B)). As a result, Charles and Nora each have 1/2 of the governance rights.~~

Whether a transferable interest pledged as security is governed by Article 8 or 9 of the Uniform Commercial Code depends on the rules stated in those articles.

A.R.S. § 29-3502. TRANSFER OF TRANSFERABLE INTEREST

Arizona Comment
(Rev. 2/23/2024)

Subsection (A) – The Act modifies this provision of RULLCA by (i) removing a reference to Section 503(f) of RULLCA to reflect the Act's elimination of foreclosure of a charging order as a remedy for a member's judgement creditors, consistent with the Prior Act, and (ii) granting limited information

rights to transferees under A.R.S. § 29-3410(B) for the purpose of enforcing the transferee's right to receive distributions.

Subsection (A)(3)(a) – This subsection is identical to RULLCA. However, it is important to note that the extent to which a transferring member continues to have governance rights under the Act depends first on which of the three categories of approval applies for a particular action under A.R.S. § 29-3407. In addition, the transferring member's continuing voting rights will depend on factors such as whether the transferring member retains any transferable interest, whether the transferor withdraws or is expelled as a member, whether the transferee is already a member or is admitted as a member, and whether the action being undertaken is subject to the approval of a "majority in interest" rather than a per capita majority of the members. Under subsection (A)(3)(a), a transferee of a transferable interest who is not already a member, and is not admitted as a member in connection with the transfer, does not receive any governance rights in connection with the transferable interest. However, a transferee of a transferable interest who is admitted as a member will acquire voting power and a transferee who already is a member will see his voting power increase for those decisions that are made by a "majority in interest" of the members under A.R.S. § 29-3407(B)(3) or (C)(5) because the proportionate amount of his profit interest has increased.

A transferor who is a member and who continues to be a member following the transfer retains the rights of a member other than with respect to the transferred interest and retains all the duties and obligations of a member. *See* A.R.S. § 29-3502(G). Note that under A.R.S. § 29-3602(A)(17), a member who transfers the entirety of his or her transferable interest is automatically dissociated as a member if either (a) at the effective time of the transfer, at least one transferee is a member or becomes a member, or (b) at any time after the effective time of the transfer, at least one transferee becomes a member and the transferring member has not otherwise acquired a transferable interest. This default event of dissociation is not in RULLCA but was added to the Act in order to preserve consistency with the Prior Act and helps avoid situations where a member no longer has any economic rights yet retains the management rights of a member. Once dissociated, the transferor no longer has any management rights.

Thus, in a member-managed company, under the default rules of A.R.S. § 29-3407(B), if a member transfers the entirety of his transferable interest and the transferee is not already a member and is not admitted as a member, then the transferor retains voting rights with respect to certain decisions but not others. Specifically, and subject to the terms of the operating agreement:

(i) the transferring member retains the right to manage and conduct the company's activities and affairs in the ordinary course pursuant to A.R.S. § 29-3407(B)(2),

(ii) the transferring member no longer has any voting rights under A.R.S. § 29-3407(B)(3) (four categories of actions that require a "majority in interest" of the members) because, while he remains a member, he no longer has any interest in the LLC's profits as required under A.R.S. § 29-3102(12), and

(iii) the transferring member retains voting rights for decisions that require the consent of all of the members under A.R.S. § 29-3407(B)(4).

In a manager-managed company, under the default rules of A.R.S. § 29-3407(C), if a member transfers the entirety of his transferable interest and the transferee is not already a member and is not admitted as a member, then the transferor again retains voting rights with respect to certain decisions but not others, although the scope of those decisions is more limited given that the company is managed by managers and members have only limited management rights. Specifically, and subject to the terms of the operating agreement:

(i) the transferring member retains voting rights for decisions that require the consent of all of the members under A.R.S. § 29-3407(C)(4), and

(ii) the transferring member no longer has any voting rights under A.R.S. § 29-3407(C)(5) (appointing or removing a manager, which requires a "majority in interest" of the members) because, although he remains a member, he no longer has any interest in the LLC's profits as required under A.R.S. § 29-3102(12).

If a member transfers all of his transferable interest to a non-member transferee (and thus is not automatically dissociated under A.R.S. § 29-3602(A)(17)), and the other members want to avoid a situation where the transferring member has no economic interest in the company yet continues to have certain management rights, the other members could either admit the transferee as a member (thus automatically dissociating the transferor under A.R.S. § 29-3602(A)(17)) or expel the transferring member as permitted by A.R.S. § 29-3602(4)(b). If the transferring member is not expelled and the transferee is not admitted as a member, then the voting rights under A.R.S. § 29-3407(B)(3) or (C)(5) that were associated with the transferable interest that was transferred effectively disappear and the proportionate voting power of the remaining members increases. Note that the same result occurs if the transferring member transfers all of his interest to the company itself in a redemption. Since the company itself is not a member, then the automatic dissociation under A.R.S. § 29-3602(A)(17) does not occur. If the intent is that the member whose interest is being redeemed will no longer be a member following the redemption, then the practitioner should address the status of the transferring member in the redemption documentation by either affirmatively having the transferor withdraw as a member or be expelled by the other members.

If a member transfers less than all of his transferable interest to a non-member transferee (and thus A.R.S. § 29-3602(A)(17) does not apply), and the other members want to avoid a situation where the transferee has an economic interest in the company but no management rights, the other members could admit the transferee as a member. This would not dissociate the transferor – both the transferor and transferee would be members each holding a transferable interest.

EXAMPLE 1: ABC Company, LLC is a member-managed limited liability company with three members - Alex, Beth, and Chuck - who each own 33.33% of the company's transferable interests. The operating agreement does not displace the Act's default rules on transfers, management rights, and dissociation of members. Alex then transfers his entire transferable interest to Chuck. As a result of the transfer, Alex is automatically dissociated as a member (because Chuck is a member at the effective time of the transfer) and Chuck's voting power for decisions that require a "majority in interest" of the members increases from 33.33% to 66.66% (and as a result, his vote alone is sufficient to approve such decisions). Alex no longer has any management rights as a result of being dissociated.

EXAMPLE 2: Same situation as Example 1, but this time Alex transfers his entire transferable interest to a third party, Denise, who is not admitted as a member. Following the transfer, Alex no longer has any voting power for decisions that require a "majority in interest" of the members because he no longer has any interest in the company's profits. However, Denise, because she is not a member, does not obtain any voting power associated with that 33.33% transferable interest. Instead, the voting power associated with Alex's 33.33% transferred interest effectively disappears and Beth's and Chuck's voting power for "majority in interest" decisions increase to 50% each. However, Alex, who remains a member, may continue to take actions on behalf of the company in the ordinary course of the company's activities and affairs and retains a vote in decisions that require the consent of all of the members.

EXAMPLE 3: Same situation as Example 2, but now Denise is admitted as a member at the effective time of the transfer. As a result, Alex is automatically dissociated as a member and loses all of his management rights. Beth, Chuck, and Denise, who each own 33.33% of the company's transferable interests, now each have 33.33% voting power for decisions that require a "majority in interest" of the members and may each take actions on behalf of the company in the ordinary course of the company's activities and affairs and each have a vote in decisions that require the consent of all of the members.

EXAMPLE 4: Same situation as Example 2. Because she is not admitted as a member, Denise has no management or voting rights and Alex, who remains a member, may continue to take actions on behalf of the company in the ordinary course of the company's activities and affairs and retains a vote in decisions that require the consent of all of the members. (However, the voting power associated with his 33.33% transferred interest for "majority in interest" decisions effectively disappeared and Beth's and Chuck's voting power for "majority in interest" decisions increased to 50% each). Beth and Chuck don't want a situation where Alex has no economic interest in the company yet continues to have certain management rights. Therefore, Beth and Chuck expel Alex as a member. Beth and Chuck now hold all management and voting rights.

Subsection (B) – The Act adds a provision to this subsection, not found in RULLCA, granting to transferees (and dissociated members) the right to obtain information described in A.R.S. § 29-3410(B) that is reasonably related to the transferee's right to receive distributions. For the reasons discussed in the Modified RULLCA Comment to Section 502, transferees (and dissociated members) have very limited rights under the Act's default rules. In addition to the loss of management participation rights under subsection (A) of this section, transferees under the Act's default rules have no rights:

- to assert claims for breach of the duty of loyalty or the duty of care on the part of a member or manager pursuant to A.R.S. § 29-3409(A);
- of approval with respect to authorization or ratification of a member's or manager's breach of the duty of loyalty under subsections (F) and (N) of A.R.S. § 29-3409;
- to apply for judicial expulsion of a member for wrongful conduct under A.R.S. § 29-3602(A)(5);
- to apply for judicial dissolution of the limited liability company for any of the reasons described in A.R.S. § 29-3701(A)(4), including wrongful conduct on the part of the managers or members in control of the company;
- of approval with respect to a plan for restructuring the limited liability company under A.R.S. § 29-4004;
- of approval with respect to a rescission of dissolution of the limited liability company under A.R.S. § 29-3703(B)(1);
- to maintain a derivative action to enforce a right of the limited liability company under A.R.S. § 29-3802;
- of approval with respect to amendments to the operating agreement except to the limited extent provided under A.R.S. § 29-3107(B);
- of approval with respect to the admission of a new member under A.R.S. § 29-3401(C)(3) or the removal or appointment of a manager under A.R.S. § 29-3407(C)(5);
- of approval with respect to an amendment to the articles of organization that changes the company's management structure from member-managed to manager-managed (or vice versa) under subsections (B)(4)(c) and (C)(4)(c) of A.R.S. § 29-3407; or
- of approval with respect to the company's issuance of additional interests in the company under subsections (B)(4)(d) and (C)(4)(d) of A.R.S. § 29-3407.

The foregoing list is not exhaustive. In light of these limitations of rights, subsection (B) of this section expands RULLCA’s scope of a transferee’s information rights to include information reasonably related to his or her rights to receive distributions. For example, if a transferee believes he or she is not being paid the amount of distributions to which he or she is entitled, this provision would allow the transferee to obtain information to the extent reasonably appropriate to investigate the matter.

Subsection (D) – The Act clarifies that a certificate of a transferable interest may not be issued in bearer form. Among other reasons, this prohibition is important to enable the members to identify the owners of all transferable interests and to determine a majority in interest of the members for purposes of voting on certain management decisions.

Subsection (F) – This subsection deviates from RULLCA by providing that a transfer in violation of a restriction on transfer is ineffective not only if the prospective transferee had knowledge or notice of the restriction at the time of the transfer, as in RULLCA, but also if the restriction is set forth in a written operating agreement. Thus, is it incumbent upon the prospective transferee of a transferable interest to inquire about and review the company’s operating agreement prior to acquiring a transferable interest to ensure that the transfer is permissible under the operating agreement and to obtain appropriate representations and warranties from the transferor.

Subsection (G) – This subsection establishes the general rule that a member who transfers a transferable interest (even 100% of his or her transferable interest) retains his or her status as a member, with all its attendant voting and management rights, unless he or she is expelled as a member or is otherwise dissociated. Although the subsection only specifically cross references expulsion under A.R.S. § 29-3602(4)(b), a member may of course be dissociated under any of the provisions of A.R.S. § 29-3602, including by express withdrawal under A.R.S. § 29-3602(1), by a provision of the operating agreement under A.R.S. § 29-3602(2), or by automatic dissociation pursuant to A.R.S. § 29-3602(A)(17) discussed above.

Subsection (H) – This subsection deviates from RULLCA by providing that, in connection with a transfer to a person who becomes a member, the transferee is liable for the transferor's obligations to make capital contributions or to return any improper distributions previously paid to the transferor not only if the transferee had knowledge of the obligations when the transferee became a member, as in RULLCA, but also if the obligations are set forth in a written operating agreement. Thus, again, it is incumbent upon the transferee of a transferable interest to inquire about and review the company’s operating agreement prior to acquiring a transferable interest to confirm whether any such obligations exist and to obtain appropriate representations and warranties from the transferor.

Modified RULLCA Comment

(Rev. 2/23/2024)

One of the most fundamental characteristics of LLC law is its fidelity to the “pick your partner” principle. *See, e.g., Bynum v. Frisby*, 73 Nev. 145, 149-50, 311 P.2d 972, 975 (1957) (stating that (i) “the assignment of a partnership interest from one partner to a stranger does not bring that stranger into fiduciary relationship with the remaining partners” and (ii) absent consent by the remaining partners “[t]he stranger remains a stranger” with no rights to management or even information).

This section is the core of the Aact’s provisions reflecting and protecting that principle. A member’s rights in a limited liability company are bifurcated into economic rights (the transferable interest) and governance rights (including management rights, consent rights, rights to information, rights to seek judicial intervention). Unless the operating agreement otherwise provides, a member acting

without the consent of all other members lacks both the power and the right to: (i) bestow membership on a non-member, ~~Section 401(d)~~A.R.S. § 29-3401(C); or (ii) transfer to a non-member anything other than some or all of the member's transferable interest, ~~Section~~ A.R.S. § 29-3502(A~~a~~)(3). The rights of a mere transferee are quite limited – *i.e.*, to receive distributions and information reasonably related to the right to receive distributions, ~~Section~~ A.R.S. § 29-3502(B~~b~~), and, if the LLC dissolves and winds up, to receive specified information pertaining to the LLC from the date of dissolution. ~~Section~~ A.R.S. § 29-3502(C~~c~~).

This section applies regardless of whether the transferor is a member, a transferee of a member, a transferee of a transferee, etc. *See* ~~Section~~ A.R.S. § 29-3102(29~~4~~) (defining "transferable interest" in terms of a right "initially owned by a person in the person's capacity as a member" regardless of "whether or not the person remains a member or continues to own any part of the right").

~~This section does not directly consider whether a member may transfer governance rights to another member without obtaining consent from all the other members. As noted above, Section 501, cmt., the question is moot under this act's default rule for allocating governance rights.~~

~~However, the question can be pivotal when the operating agreement displaces the default rule on governance rights but does not determine whether transfer restrictions (whether contractual, statutory, or both) apply to transfers of governance rights from one member to another. Case law is scant but suggests that this act does not protect members from control shifts that result from transfers among members (as distinguished from transfers to non-members who seek thereby to become members). *Blythe v. Bell*, No. 11 CVS 933. 2012 WL 7807800, at ¶ 6 (N.C. Dist. Dec. 10, 2012) (holding in a case of "first impression in North Carolina" that "in the absence of articles of incorporation or an operating agreement to the contrary . . . the assignment of control (*i.e.*, governance) interests between members is effective without unanimous member consent;" *Achaian, Inc. v. Leemon Family L.L.C.*, 25 A.3d 800, 810 (Del. Ch. 2011) (Strine, Ch.) (holding that the terms of the LLC agreement did not preclude one member of a three-member LLC from transferring the member's entire interest (including governance rights) to a second member without first having the consent of the third member; stating that the third member's "argument relies on a very thinly sliced version of [the "pick-your-partner principle, the strained version being] . . . that once one chooses his initial co-members, one continues to hold a veto over how much additional voting power they may acquire;" explaining that "[t]he problem for [the third member] is that nothing in the LLC Agreement supports [that member's] reading of it that would require an already admitted Member, like [the acquirer – *i.e.*, the second member], to be become once, twice (or even three times) a Member each and every time that Member acquires an additional block of Interests").~~

Other law may affect the applicability of this section. *See* 11 U.S.C. § 541(c)(1) (providing that, initially at least, all property of a debtor becomes part of the bankruptcy estate regardless of restrictions on transfer); UCC §§ 9-406, 9-408 (overriding specified restrictions on assignment in specified circumstances, regardless of whether state law or a contract imposes the restrictions).

In any event, this section does not apply to the transfer of ownership interests in a member that is an entity.

> EXAMPLE: ABC, LLC has three members: Ralph (an individual), Alice, Inc. ("Alice"), and Norton, LLC ("Norton"). Section 502 applies to any attempt by Ralph, Alice, or Norton to transfer their respective membership interest in ABC. Section 502 is inapplicable, however, to a change in control of Alice or Norton or even a complete change in their respective membership.

Subsection (~~a~~A)—The definition of "transfer," ~~Section~~ A.R.S. § 29-3102(28~~3~~), and this subsection's reference to "in whole or in part" combine to mean that this section encompasses not only unconditional, permanent, and complete transfers but also temporary, contingent, and partial ones. Thus,

for example, a charging order under Section 503 effects a transfer of part of the judgment debtor's transferable interest, as does the pledge of a transferable interest as collateral for a loan and the gift of a life-interest in a member's rights to distribution.

Subsection (~~a~~A)(2)—The phrase "by itself" contemplates ~~Section~~ A.R.S. § 29-3602(4~~5~~)(B), which creates a risk of dissociation via expulsion when a member transfers all of the member's transferable interest.

Subsection (~~a~~A)(3)—Mere transferees have no right to participate in management or otherwise intrude as the members carry on the affairs of the limited liability company and their activities as members.

Because ~~Section~~ A.R.S. § 29-3102(28~~2~~)(~~G~~g) defines "transfer" to include "a transfer by operation of law," this section affects the power of other law to effect transfers of a member's ownership interest. For example, a divorce court lacks the power to award a member's spouse anything beyond the member's transferable interest. Nor does the member have the power to enter into a property settlement purporting to effect any greater transfer.

For the divorce court, the best solution is to value the member's complete ownership interest (*i.e.*, the transferable interest as enhanced by the management and information rights and the standing to sue) and: (i) if possible, award the member's spouse marital property of equal value; or (ii) if not possible, award the member's spouse a money judgment and a charging order to enforce the judgment.

Granting the non-member any part of member's transferable interest is almost always imprudent; marital discord will almost inevitably carry over into the business relationship. Granting the member's ex-spouse the entire transferable interest is rarely a viable alternative. If the member is an active participant in the limited liability company, the approach is impossible. The member's transferable interest will typically constitute much or all of the member's remuneration for the partner's activity. Even if the member is essentially passive, granting the transferable interest to the ex-spouse puts him or her at great risk as a "bare naked assignee." *See* the comment to ~~Section~~ A.R.S. § 29-3107(~~b~~B).

When a member dies, subject to the operating agreement other law may effect a transfer of the member's transferable interest to the member's estate or personal representative. However, for the reasons just stated, other law lacks the power to transfer anything more than a transferable interest. (~~Section~~ A.R.S. § 29-3~~(~~504~~)~~ does provide extra information rights for the purposes of settling the estate of the deceased member.)

Subsection (A~~a~~)(3)(~~B~~b)—*See* ~~Section~~ A.R.S. § 29-3410(J~~g~~) (providing that subject to A.R.S. §§ 29-3502 and 3504, ~~that section's~~ information rights do not apply to transferees).

Subsection (B~~b~~)—Amounts due under this subsection are of course subject to offset for any amount owed to the limited liability company by the member or person dissociated as a member on whose account the distribution is made. ~~Section~~ A.R.S. § 29-3404(D~~d~~). As to whether an LLC may properly offset for claims against a transferor that was never a member is matter for other law, specifically the law of contracts dealing with assignments.

Subsection (~~c~~C)—This very limited grant of information rights encompasses only transactions occurring at or after the date of the LLC's dissolution. The transferee has only the right to information as to the allocation of net assets among the LLC's creditors, members, and transferees—and only from the date of dissolution.

This subsection does not prevent a transferee from contracting with a member-transferor to require the member-transferor to disclose further information to the transferee. Whether such an agreement would breach the operating agreement, the implied contractual obligation of good faith and fair dealing, ~~Section~~ A.R.S. § 29-3409(D~~d~~), or a fiduciary duty depends on the circumstances.

If a dissolved LLC rescinds its dissolution, ~~Section~~ A.R.S. § 29-3703, this subsection no longer applies.

Subsection (D~~d~~)—The use of certificates can raise issues relating to Articles 8 and 9 of the Uniform Commercial Code.

Subsection (F~~f~~)—This provision originated as UPA (1997) § 503(e), was then consistent with U.C.C section 9-318(3), and is now consistent with U.C.C section 9-406(a) (stating that "an account debtor . . . may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee").

The term "notice" includes "reason to know," ~~Section~~ A.R.S. § 29-3103(B~~b~~)(1), and ordinarily a potential transferee has reason to inquire about transfer restrictions that might be contained in the operating agreement.

Subsection (~~g~~G)—Under this subsection, a member remains a member (with all attendant rights and obligations) even after permanently transferring the entirety of the transferable interest. Although this subsection only specifically references~~, unless: (i) the other members opt for~~ expulsion under ~~Section~~ A.R.S. § 29-3602(4~~5~~)(b~~B~~)~~; or (ii) as otherwise provided in the operating agreement~~ as an exception to the general rule, dissociation may occur under any of the provisions of A.R.S. § 29-3602.

A.R.S. § 29-3503. CHARGING ORDER

Arizona Comment
(Rev. 2/23/2024)

This section deviates from RULLCA in order to preserve Arizona law and policy under the Prior Act. A charging order remains the exclusive remedy by which a judgment creditor of a member may enforce a judgment against the member's interest in a limited liability company. To preserve prior Arizona law, subsections (b), (c) and (f) of RULLCA have been deleted in their entirety and the remaining subsections have been renumbered.

Subsection (b) of RULLCA was deleted because it included an open-ended authorization for a court to impose "orders necessary to give effect to the charging order" and thereby would enable a court to interfere in the management of a limited liability company. Subsection (c) of RULLCA was deleted because it would have expressly authorized a court to order the sale of the debtor member's interest to satisfy the judgment, a remedy that was not available under the Prior Act. Subsection (f) of RULLCA prescribed rules regarding the foreclosure of a sole member's interest and was deleted because the foreclosure remedy was eliminated.

Many members of the Drafting Subcommittee were concerned that the exclusivity of the charging order remedy under the Prior Act effectively allowed debtors to put their assets out of the reach of judgment creditors and thereby frustrate the collection of legitimate judgments. A judgment debtor who owns shares of an Arizona corporation enjoys no such protection against the forced sale of her shares, and it is difficult to articulate a principled reason to prohibit foreclosure of an interest in a limited liability

company. At one point during the drafting project, a majority of the Drafting Subcommittee approved and circulated a proposed draft that would have permitted foreclosure of a judgment debtor's interest if the judgment creditor could prove that the company was formed or operated with the actual intent to hinder, delay, or defraud the judgment creditor. This tentative draft met vigorous opposition from the estate planning bar, and especially from asset protection lawyers, who explained that the exclusivity of the charging order remedy had been a part of the Prior Act for more than twenty years and had been relied upon by thousands of Arizona residents in deciding to form their limited liability companies in Arizona rather than in another "asset protection" friendly state. Because of this reliance factor, the Drafting Subcommittee decided to keep the charging order as the exclusive remedy available under the Act.

Several estate planning lawyers also urged the Drafting Subcommittee to add statutory language that would enhance the ability of a judgment debtor member to defeat collection of the judgment. Specifically, a request was made to state expressly that foreclosure would not be available in the case of a single member company and that the court's equitable powers would not allow interference in the management of the company, e.g., by ordering distributions to the debtor member. Although the Drafting Subcommittee clarified RULLCA's definition of "limited liability company" in A.R.S. § 29-3201 to expressly acknowledge the existence of single member companies, the Drafting Subcommittee declined to make any other changes to RULLCA that would enhance the asset protection provisions of prior Arizona law. As a matter of public policy, the Act should not be construed to affect the applicability of Arizona's fraudulent transfer law or to diminish the court's equitable power to prevent fraud or other injustice (including the application of a "reverse piercing" principle in appropriate circumstances to hold the company liable for the debts of a member.)

Subsection (a) of RULLCA was modified to change references to a "lien" to a "charging order" in order to avoid any inference that a charging order may be foreclosed.

Modified RULLCA Comment

(Rev. 2/23/2024)

The charging order concept dates back to the English Partnership Act of 1890 and in the United States has been a fundamental part of law of unincorporated business organizations since 1914. *See* UPA (1914) § 28. As much a remedy limitation as a remedy, the charging order is the sole method by which a person acting as judgment creditor of a member or transferee can extract value from the member's or transferee's ownership interest in a limited liability company. ~~*See*~~(*But see* the final two paragraphs of this comment ~~to Subsection (h).~~below relating to consensual security interests under the Uniform Commercial Code and to "reverse pierce" principles and fraudulent transfer law.)

Under this section, the judgment creditor of a member or transferee is entitled to a charging order against the relevant transferable interest. While in effect, that order entitles the judgment creditor to whatever distributions would otherwise be due to the member or transferee whose interest is subject to the order. However, the judgment creditor has no say in the timing or amount of those distributions. The charging order does not entitle the judgment creditor to accelerate any distributions or to otherwise interfere with the management and activities of the limited liability company.

By its terms, this section does not apply to foreign limited liability companies. *See* ~~Section 102(8~~ARS § 29-3102(11) (defining "[l]imited liability company" to mean "an entity *formed under this [act] or which becomes subject to this [act]*") (emphasis added); *see also Fannie Mae v. Heather Apartments Ltd. P'ship*, A13-0562, 2013 WL 6223564, at *6 (Minn. Ct. App. Dec. 2, 2013) (considering the remedies available to a judgment creditor with respect to the judgment debtor's interest in a Cook Islands LLC; rejecting the debtor's argument that the creditor's "only remedy is to obtain a charging

order under" [the Minnesota LLC statute]; explaining that "this argument fails because that statute only applies to Minnesota limited liability companies" which that statute "defines . . . as 'a limited liability company, other than a foreign limited liability company, *organized or governed by this chapter*'") (emphasis added) (statutory citations omitted).

The operating agreement has no power to alter the provisions of this section to the prejudice of third parties. ~~Section 105(c)(15).~~ A.R.S. § 29-3105(C)12.

Subsection (~~a~~A) – The phrase "judgment debtor" encompasses both members and transferees. The ~~lien~~charging order pertains only to a distribution, which excludes "amounts constituting reasonable compensation for present or past service or payments made in the ordinary course of business under a bona fide retirement plan or other bona fide benefits program." ~~Section 102(4)(B~~ARS § 29-3102(6)(c). A judgment creditor that wishes to levy on such amounts should use the appropriate creditor's remedy, such as garnishment (which may be subject to exemptions or exclusions not relevant to a charging order). *Cf. PB Real Estate, Inc. v. Dem II Props.*, 719 A.2d 73, 76 (Conn. 1998) (rejecting the contention of an LLC's two members that "payments of $28,000 to each of them" should be treated "as expenses for wages" rather than as distributions).

Whether an application for a charging order must be served on the limited liability company, the judgment debtor, or both is a matter for other law, principally the law of remedies and civil procedure. The order itself must be served on the limited liability company. Whether the order must also be served on the judgment debtor is a matter for other law.

If a distribution consists of rights to acquire interests in a limited liability company, the charging order applies only to those rights within the definition of transferable interest. *See* ~~Section 102~~ARS § 29-3102(24) (defining transferable interest).

~~Subsection (b) – Paragraph (2) refers to "other orders" rather than "additional orders." Therefore, given appropriate circumstances, a court may invoke Paragraph (1), Paragraph (2), or both.~~

Subsection (~~b)(1) – The receiver contemplated here is emphatically not a receiver for the limited liability company, but rather a receiver for the distributions subject to the charging order. The principal advantage provided by this paragraph is an expanded right to information. However, that right goes no further than "the extent necessary to effectuate the collections of distributions pursuant to a charging order." For a correctly narrow reading of this provision, *see* Wells Fargo Bank, Nat. Ass'n v. Continuous Control Solutions, Inc., No. 11-1285, 2012 WL 3195759 (Iowa Ct. App. Aug. 8, 2012).~~**B)** – This provision allows the judgment debtor to end the charging order without need for a hearing.

~~Subsection (b)(2) – This paragraph must be understood in the context of: (i) the very limited nature of the charging order; and (ii) the importance of preventing overreaching on behalf of a person that is not a judgment creditor of the LLC, has no claim on the LLC's assets, and has no right to interfere in the activities, affairs, and management of the LLC. In particular, the court's power to make "all other orders" is limited to "orders necessary to give effect to the charging order."~~

> ~~EXAMPLE: A judgment creditor with a charging order believes that the limited liability company should invest less of its surplus in operations, leaving more funds for distributions. The creditor moves the court for an order directing the limited liability company to restrict re-investment. Subsection (b)(2) does not authorize the court to grant the motion.~~

> ~~EXAMPLE: A judgment creditor with a judgment for $10,000 against a member obtains a~~

~~charging order against the member's transferable interest. Having been properly served with the order, the limited liability company nonetheless fails to comply and makes a $3000 distribution to the member. The court has the power to order the limited liability company to pay $3000 to the judgment creditor to "give effect to the charging order."~~

~~Under Subsection (b)(2), the court has the power to decide whether a particular payment is a distribution, because that decision determines whether the payment is part of a transferable interest subject to a charging order.~~

~~EXAMPLE: Member A of ABC, LLC has for some years received distributions form the LLC. However, when a judgment creditor of Member A obtains a charging order against Member A's transferable interest, the LLC ceases to make distributions to Member A and instead provides a salary to Member A equivalent to former distributions. A court might deem this salary a disguised distribution. (In any event, however, the salary will be subject to garnishment.)~~

~~This act has no specific rules for determining the fate or effect of a charging order when the limited liability company undergoes a merger, conversion, interest exchange, or domestication under [Article] 10. In the proper circumstances, such an organic change might trigger an order under Subsection (b)(2).~~

~~Subsection (c) – The phrase "that distributions under the charging order will not pay the judgment debt within a reasonable period of time" comes from case law. *See*, e.g., Stewart v. Lanier Park Med. Office Bldg., Ltd., 578 S.E.2d 572, 574 (Ga. Ct. App. 2003) ("Judicial sale may be appropriate where . . . it is apparent that distributions under the charging order will not pay the judgment debt within a reasonable amount of time."); Nigri v. Lotz, 453 S.E.2d 780, 783 (Ga. Ct. App. 1995).). A purchaser at a foreclosure sale obtains only the very limited rights of a transferee under Section 502 and is in some ways more vulnerable and less powerful than the holder of a charging order. After foreclosure and sale, Subsection (b) no longer applies. More generally, the court is no longer involved in the matter~~. ~~For the vulnerability of a transferee, *see* Section 107(b), comment.~~

~~Subsection (d) – This provision allows the judgment debtor to end the charging order without need for a hearing.~~

Subsection (~~e~~C) – Traditionally, charging order provisions referred to the possibility of "redeeming" an interest subject to a charging order. That usage was confusing, leaving several important questions unanswered. This act substitutes a far simpler approach, contemplating the limited liability company~~partnership~~ or its members buying the underlying judgment and thereby dispensing with any interference the judgment creditor might seek to inflict on the limited liability company~~partnership~~.

In many circumstances, buying the judgment is superior to the mechanism provided by this subsection, because: (i) this subsection requires full satisfaction of the underlying judgment; and (ii) the LLC or the other members might be able to buy the judgment for less than face value. On the other hand, this subsection operates without need for the judgment creditor's consent, so it remains a valuable protection in the event a judgment creditor seeks to do mischief to the LLC.

Whether ~~a member-managed~~an LLC's decision to invoke this subsection is "ordinary course" or "outside the ordinary course~~," Section 407(b)(3) and (4)(A),~~" for purposes of A.R.S. § 29-3407(B)(2) and (B)(3)(a) (in the case of a member-managed company) (or A.R.S. § 29-3407(C)(2) and (C)(3)(a) in the case of a manager-managed company) depends on the circumstances. However, the involvement of this subsection does not by itself make the decision "outside the ordinary course." ~~For a manager-managed LLC, the distinction is irrelevant. Section 407(c)(1).~~

~~Subsection (f) – The charging order remedy – and, more particularly, the exclusiveness of the remedy – protect the "pick your partner" principle. That principle is inapposite when a limited liability company has only one member. The exclusivity of the charging order remedy was never intended to protect a judgment debtor, but rather only to protect the interests of the judgment debtor's co-owners.~~

~~Put another way, the charging order remedy was never intended as an "asset protection" device for judgment debtors. *See* Olmstead v. F.T.C., 44 So. 3d 76, 83 (Fla. 2010) (recognizing "the full scope of a judgment creditor's rights with respect to a judgment debtor's freely alienable membership interest in a single-member LLC"); In re Albright, 291 B.R. 538, 540 (Bankr. D. Colo. 2003) (holding that, "[b]ecause there are no other members in the LLC, . . . the Debtor's bankruptcy filing effectively assigned her entire membership interest in the LLC to the bankruptcy estate, and the Trustee obtained all her rights, including the right to control the management of the LLC"). Accordingly, when a charging order against an LLC's sole member is foreclosed, the member's entire ownership interest is sold and the buyer replaces the judgment debtor as the LLC's sole member.~~

~~This subsection was added during the Harmonization Project but not for the purposes of harmonization. The subsection addresses an issue that does not exist with partnerships; neither a general nor a limited partnership can continue perpetually in existence with only one partner. *See* ULPA (2001) (Last Amended 2013) § 801(a)(5) (stating that dissolution is caused upon "the passage of 90 consecutive days during which the partnership has only one partner"); UPA (1997) (Last Amended 2013) § 801(6) (stating that dissolution is caused upon "the passage of 90 consecutive days during which the partnership does not have at least two partners").~~

Subsection (~~g~~D) – This subsection preserves otherwise applicable exemptions but does not create any. *In re Foos*, 405 B.R. 604, 609 (Bankr. N.D. Ohio 2009) (interpreting the comparable provision in UPA (1997) and stating, "it is clear that [the provision] does not create an exemption").

Subsection (~~h~~E) – This subsection does not override Uniform Commercial Code, Article 9, which may provide different remedies for a secured creditor acting in that capacity. A secured creditor with a judgment might decide to proceed under Article 9 alone, under this section alone, or under both Article 9 and this section. In the last-mentioned circumstance, the constraints of this section would apply to the charging order but not to the Article 9 remedies.

This subsection is not intended to prevent a court from effecting a "reverse pierce" where appropriate. In a reverse pierce, the court conflates the entity and its owner to hold the entity liable for a debt of the owner. *Litchfield Asset Mgmt. Corp. v. Howell*, 799 A.2d 298, 312 (Conn. App. Ct. 2002) (approving a reverse pierce where a judgment debtor had established a limited liability company in a patent attempt to frustrate the judgment creditor), *overruled on other grounds by*, *Robinson v. Coughlin*, 830 A.2d 1114 (Conn. 2003). Likewise, this subsection does not supplant fraudulent transfer law.

A.R.S. § 29-3504. POWER OF LEGAL REPRESENTATIVE OF DECEASED MEMBER

Arizona Comment
(Rev. 2/23/2024)

This section is substantially the same as RULLCA Section 504. Subsection (2) gives the legal representative all the information rights of a deceased member provided that the information requested is for purposes of settling a deceased member's estate. However, the Act does not address which information is related to this purpose. That issue will be informed by law outside the Act, such as probate law and judicial decisions.

A.R.S. § 29-3504(1) specifically provides that the legal representative of a deceased member has the information rights of a transferee under A.R.S. § 29-3502(C). The scope of information rights this subsection grants is relatively limited however, as it applies only to information related to the company's transactions following dissolution.

However, other sections of the Act may provide additional rights. A.R.S. § 29-3602(A)(6) provides that an individual is dissociated as a member if he or she dies, and A.R.S. § 29-3603(A)(3) provides that any transferable interest owned by a person in the capacity of a member before dissociation is owned by the person as a transferee after dissociation. Because A.R.S. § 3502(B) provides information rights to transferees reasonably related to distributions, those information rights will likely also extend to the personal representative of a deceased member.

Modified RULLCA Comment
(Rev. 2/23/2024)

The estate and those claiming through the estate are transferees, and as such they have very limited rights to information. This section provides temporary, additional information rights to the legal representative of the estate. ~~Sections~~ A.R.S. § 29-3410 and 29-502(C~~c~~) pertain only to information rights.

ARTICLE 6
DISSOCIATION

A.R.S. § 29-3601. POWER TO DISSOCIATE AS MEMBER; WRONGFUL DISSOCIATION.

Arizona Comment
(Rev. 2/23/2024)

"Dissociation" of a member refers to a person or entity losing its status as a member (and thereby losing its management participation rights and most information rights). The Prior Act did not use the term "dissociation" but did define "events of withdrawal" in former A.R.S. §§ 29- 733 to 744. A.R.S. § 29-3601 and -3602, define various events that result in loss of member status and, when a transfer of an interest in the limited liability company is involved, describe whether the transferor remains a member. Certain rights, duties, and liabilities (and liability "shields") are specified for former members and transferees. Pursuant to A.R.S. § 29-3105, all portions of all three sections of Article 6 are default rules. *See* Modified RULLCA Comment to A.R.S. § 29-3105, but *see also* Modified RULLCA Comments to A.R.S. § 29-3601(A) and 29-3602.

Subsection (A) establishes the power of any member to withdraw at any time.

Subsection (B) lists the events in which a person's dissociation as a member is wrongful. This list differs from RULLCA by omitting two events. Unlike RULLCA, a withdrawal by the "express will" of a person is not wrongful under the Act unless it violates an express provision of the operating agreement, because the Drafting Committee decided a member who desires to dissociate, and thereby terminate any ongoing fiduciary duties associated with member status, should have that right absent an express prohibition in the operating agreement. Likewise, the "willful" dissolution or termination of an entity (a person that is not an individual, estate, or trust other than a business trust) is not wrongful under the Act if it does not violate an express provision of the operating agreement (even if the entity is expelled because of its dissolution). The Act preserves the provision of the Prior Act that expressly allows the Company to offset the damages arising from a member's wrongful dissociation against any amount otherwise distributable to the member, a provision that is absent in RULLCA.

The damages recoverable by the company or the other members for wrongful dissociation under subsection (C) are different from, and in addition to, the damages arising from a member's breach of the operating agreement or its duties under A.R.S. § 29-3409. In the case of a breach of the operating agreement or those duties, the common law of contracts or torts will determine the measure of damages proximately caused by the breach. The breaching member's liability for those damages is unaffected by whether or not the breach results in the member's wrongful dissociation. If, however, the member's dissociation is wrongful under subsection (B), additional damages may be recoverable to compensate for harm caused by the member's dissociation. For example, if the dissociation triggers a loan default by the company because its covenants under the loan agreement include a requirement to obtain the lender's approval of any change in the company's members, the costs incurred in negotiating a waiver of the default or refinancing the loan may be recovered from the dissociated member if the dissociation was wrongful under subsection (B). In drafting an operating agreement, careful consideration should be given to whether some or all of the members should commit to remain as members, as well as the duration of their commitment, because a dissociation in violation of that commitment will be wrongful under subsection (B) and implicate additional damages under subsection (C).

The phrase "completion of winding up," which is used in A.R.S. § 29-3601(B)(2) (and also in A.R.S. § 29-3602(16)) means the completion of disposition of assets pursuant to A.R.S. § 29-3707.

Pursuant to A.R.S. § 29-3105, all portions of A.R.S. § 29-3601 are default rules and can therefore be overridden by an operating agreement.

Modified RULLCA Comment
(Rev. 2/23/2024)

This article deals with the dissociation of a person as a member. Article 7 deals with the dissolution of a limited liability company.

Subsection (aA)—The operating agreement can vary this provision, even to the extent of negating a member's power to dissociate. Doing so, however, is fundamentally at odds with the concept of a limited liability company as a creature of contract. *See* theModified RULLCA comment to Section 105A.R.S. § 29-3105 (Role and Inevitability of Operating Agreement). Only in exceptional circumstances does a party to a contract lack the power to breach, and courts will not enjoin a person to remain in an ongoing contractual relationship that involves trust and confidence. E. ALLAN FARNSWORTH, CONTRACTS § 12.7, at 781 (3d ed. 1999) ("A court will not grant specific performance of a contract to provide a service that is personal in nature. This refusal . . . is based [in part] of the undesirability of compelling the continuance of personal relations after disputes have arisen and confidence and loyalty have been shaken and the undesirability, in some instances, of imposing what might seem like involuntary servitude.") (footnote omitted). Moreover, eliminating or even substantially restricting a member's power to dissociate may have dreadful practical consequences.

Subsection (bB)—This subsection lists exhaustively ("only if") the dissociations that are "wrongful," but the list is a default rule. The operating agreement can expand the list; *e.g.*, by making wrongful a dissociation that breaches the implied contractual covenant of good faith and fair dealing. In theory, the operating agreement can provide for liquidated damages (subject to the requirements of contract law) and, in theory, can also contract or even eliminate the list of wrongful dissociations.

Subsection (bB)(1)—The reference to "an express provision of the operating agreement" means that a person's dissociation as a member in breach of the obligation of good faith and fair dealing is not wrongful dissociation for the purposes of this section. The breach might be actionable on other grounds.

Subsection (bB)(2)(Cb)—This subsection refers to Section 602(8),A.R.S § 29-3602(7), which involves *inter alia* dissociation on account of bankruptcy, which in turn is subject to bankruptcy law. *See, e.g.,* 11 U.S.C.A. § 365(e) (invalidating "ipso facto" clauses, subject to some exceptions).

Subsection (cC)—A person who prematurely dissociates as a member in violation of an express provision of the operating agreement risks liability for any resulting damages. For example, the limited liability company might incur substantial expenses in replacing the member's expertise, reputation, or creditworthiness.

In effect, this subsection equates wrongful dissociation with breach of contract. Accordingly, courts should look to contract law to determine what consequential damages are recoverable. *See Hadley v. Baxendale*, 9 Exch. 341 (1854); RESTATEMENT (SECOND) OF CONTRACTS § 351 (1981); *see also Williams v. Hildebrand*, 247 S.W.2d 356, 358 (Ark. 1952) (interpreting UPA (1914) § 38(2)(a)(II), pertaining to wrongful dissolution, and stating that "the measure of damages, when the partnership was to have continued for a fixed term, is the profits that the injured partner would have received").

A.R.S. § 29-3602. EVENTS CAUSING DISSOCIATION.

Arizona Comment
(Rev. 2/23/2024)

This section lists all events that result in dissociation. A particular set of facts may fit more than one of the listed events. Some events apply to any "person," some only to individuals, some only to persons who are "not an individual," some only to entities, some only to "unincorporated entities," some only to "testamentary or intervivos trusts" or the trustee of such a trust, and some only to "estates" or the personal representative of an estate.

Certain terms used in A.R.S. § 29-3602 are not defined: The term "unincorporated entity" includes a limited liability company, limited partnership, limited liability partnership, limited liability limited partnership, and general partnership. "Withdraw" means a voluntary dissociation. "Completion of winding up" means the completion of disposition of assets pursuant to A.R.S. § 29-3707.

Unlike RULLCA Section 602(3), the Act does not provide that a person is dissociated upon a transfer of its entire interest in a foreclosure sale of the interest, because A.R.S. § 29-3503 does not authorize foreclosure; that provision was intended to continue the law and policy of the Prior Act with respect to charging orders being the sole remedy with respect to the limited liability company interest of a member who is a judgment debtor.

The Act differs from RULLCA in these additional ways:

- In Subsection (4)(b)(ii), there is an exception to the usual default rule that a person is dissociated if it is expelled as a member by the consent of the other members because it has transferred of all of its transferable interest; the exception is in the case of a charging order on the interest. Under RULLCA this exception requires a charging order "which has not been foreclosed"; under the Act, no foreclosure of the charging order is authorized, so the exception does not reference a requirement that the charging order has not been foreclosed.

- Subsections (6)(b) and (7) provide that a member is dissociated if a guardian or general conservator is appointed or the member becomes a debtor in bankruptcy, signs an assignment for the benefit of creditors, or seeks a trustee, regardless of whether the limited liability company is member-managed or manager-managed. In contrast, under RULLCA, in these cases such a member is dissociated only if the limited liability company is member-managed.

- Subsection (6)(d) provides that an individual is dissociated if a court enters an adjudication that the individual is incompetent to manage his or her person or estate. RULLCA does not contain this event of dissociation.

- Subsection (10) states that a member that is an entity is dissociated when its existence terminates. The determination of the time when the existence of an entity terminates for purposes of subsection (10) is governed by the statute governing the type of entity, and the time of the entity member's termination is to be distinguished from the time of its dissolution. For example, in the case of a member that is an Arizona limited liability company that dissolves, although the Act does not explicitly state when termination occurs, the company should not be considered "terminated" until it has completed

winding up (by applying and distributing known assets pursuant to A.R.S. § 29-3707) and has filed articles of termination, whether dissolution was voluntary or by administrative dissolution. A.R.S. § 29-2702(I), providing for the continuation of a limited liability company's existence after filing articles of termination for the limited purposes of suits and other appropriate actions, should not be interpreted to prevent termination for purposes of subsection (10). In the case of administrative dissolution, the expiration of the time for reinstatement without winding up should not cause termination for purposes of subsection (10). Likewise, if the member is an Arizona corporation, for purposes of subsection (10), its existence should terminate after the completion of winding up.

Note that each subsection of A.R.S. § 29-3602 is an independent cause for dissociation of a member, and more than one subsection may apply to any given fact pattern. For example, after a member that is a limited liability company has dissolved, subsection (4)(d) allows all the members to expel the dissolved member even though the member has not completed winding up its affairs.

- Subsection (15), which is not contained in RULLCA, provides that, pursuant to a division under Article 10, a person is dissociated if the person ceases to be a member or the company is not the surviving entity in the division.

- Subsection (17), which differs from RULLCA, provides that a member that transfers its entire transferable interest (defined in A.R.S. § 29-3102(29)) will automatically dissociate upon the admission of the transferee, or immediately upon the transfer if at least one transferee is already a member or immediately becomes a member. The loss of member status is effective without any expulsion vote by the other members and without any voluntary withdrawal by the transferring member. In contrast, under RULLCA, the transferring member would retain its member status (and all of its management, voting, and information rights) until it voluntarily withdraws or is expelled by the other members, notwithstanding the admission of the transferee as a member with respect to the transferred interest. Subsection (17) retains default rules under the Prior LLC Act, which the Drafting Committee believed comport with commercial expectations. Note that if the transferring member transfers all of his transferable interest to a non-member (which includes a transfer to the company itself in a redemption), the transferor will retain his status as a member unless he affirmatively withdraws or is expelled by the other members, or at least one transferee becomes a member.

  EXAMPLE: A, B, and C are members of a limited liability company with equal contributions, profit interests, and distribution rights. A transfers all his rights to receive distributions to D, and B and C consent to D's admission as a member. The transfer documents do not contain A's voluntary withdrawal as a member, and B and C do not vote to expel A. Members B, C, and D subsequently agree to admit E as an additional member in exchange for additional needed capital, an act that requires consent of all members. The consent of A to the admission of E is not needed because, under subsection (17), A was dissociated as a member on D's admission as a member, without the need for any expulsion vote or voluntary withdrawal.

Pursuant to A.R.S. § 29-3105, all portions of A.R.S. § 29-3602, including subsection (17), are default rules that can be overridden by an operating agreement.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section mostly states default rules, which the operating agreement may vary. However, it would make no sense to vary some of the rules – *e.g.,* to provide that the death of a member who is an individual does not cause the individual's dissociation as a member, Paragraph (~~7~~6)(A), or that an entity remains a member even *after* the existence of the person has terminated. Paragraph (~~11).~~10).

Paragraph (1)—Operating agreements often require notice of dissociation to be in writing and to specify the effective date of the dissociation.

~~**Paragraph (3)**—The cited section pertains to a charging order against the transferable interest of the sole member of a limited liability company.~~

Paragraph (~~4~~3)—Many operating agreements provide for "no cause" expulsion, and courts considering such provisions will likely look to cases addressing the issue in the context of partnerships. In that context, courts have taken somewhat different approaches. *Compare Gelder Med. Grp. V. Webber*, 363 N.E.2d 573, 576 (N.Y. 1977), *with Winston & Strawn v. Nosal*, 664 N.E.2d 239, 245 (Ill. App. Ct. 1996). *See also* the Modified RULLCA comment to ~~Section~~ A.R.S. § 29-409(~~d~~D) (stating and explaining the implied contractual covenant of good faith and fair dealing).

Paragraph (~~5)(B~~4)(b)—This paragraph permits expulsion when a member no longer has any "skin in the game~~." Under this paragraph (unless the operating agreement provides otherwise), a member's transferee can protect itself from the vulnerability of "bare naked assignee" status, Section 107(b), cmt., by obligating the member/transferor to retain a one-percent interest and exercise the member's governance rights (including the~~" (i.e., any distribution right~~ to bring a derivative suit) to protect the transferee's interests.~~, even if nominal).

Paragraph (~~6~~5)—The reference to "a direct action under Section 801(b)" reflects the "separate entity" nature of a limited liability company. ~~Section 801(b) limits a member's standing to bring a direct action to circumstances in which the member can "plead and prove an actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company."~~ For example, a member might invoke Paragraph (~~6)(B~~5)(b) if another member's breach of the operating agreement harmed the first member directly~~. If~~ or indirectly. Even if a member has suffered only indirect harm, the Paragraph (~~6)(B~~5)(b) claim ~~belongs to~~may be pursued by the LLC ~~and not the member. If the LLC fails to bring suit, the member may assert the claim~~or the member directly or derivatively. *See* ~~Sections 802–06.~~A.R.S. §§ 29-3802 to -3806.

Although the operating agreement can revise or eliminate the possibility of judicial expulsion, doing so requires careful planning. *Cf. Huatuco v. Satellite Healthcare*, CV 8465-VCG, 2013 WL 6460898, at *1, n.2 (Del. Ch. Dec. 9, 2013) (stating that "the right to judicial dissolution is a default right which the parties may eschew by contract" while reserving the question of "[w]hether the parties may, by contract, divest this Court of its authority to order a dissolution in all circumstances, even where it appears manifest that equity so requires—leaving, for instance, irreconcilable members locked away together forever like some alternative entity version of Sartre's Huis Clos").

For examples of conduct warranting an expulsion order, *see All Saints Univ. of Med. Aruba v. Chilana*, A-2628-09T1, 2012 WL 6652510 (N.J. Super. Ct. App. Div. Dec. 24, 2012) (discussing a pattern of conduct); *Sherwood Park Bus. Ctr., L.L.C. v. Taggart*, 323 P.3d 551, 561 (Or. Ct. App. 2014) (upholding expulsion of a member who "had stolen a large amount of money from [the limited liability company], had intentionally failed to provide financial information, and had made himself unavailable to

carry on the business"); *CCD, L.C. v. Millsap,* 116 P.3d 366, 373 (Utah 2005) (holding that a member's "misappropriat[ion of] trust account funds totaling at least $11,540.06 for his personal use" warranted expulsion, where the member's "misconduct continued the pattern of behavior that [had previously] resulted in losses to the company of $625,000[, where the new misconduct] . . . took place after [the member's] prior wrongdoing had been discovered and after [the limited liability company] had assented to permit [the member] to atone for his misdeeds by fulfilling the terms of the amended operating agreement").

For an analysis that helps distinguish Paragraph (~~6)(C~~5)(c) from Paragraphs (~~6)(A~~5)(a) and (~~B~~b), *see All Saints Univ. of Med. Aruba v. Chilana*, A-2628-09T1, 2012 WL 6652510, at *15 (N.J. Super. Ct. App. Div. Dec. 24, 2012) (interpreting predecessor law and noting that the "not reasonably practicable standard" does not require a showing of wrongful conduct). *Cf. Dunnagan v. Watson*, 204 S.W.3d 30, 40 (Tex. Ct. App. 2006) (same issue in the context of dissolution). Where grounds exist for both dissociation and dissolution, a court has the discretion to choose between the alternatives. *Robertson v. Jacobs Cattle Co.*, 830 N.W.2d 191, 201–02 (Neb. 2013) (discussing analogous provisions of UPA (1997)). "[T]here is no textual basis for imposing a higher burden of proof for dissociation than dissolution." *Brennan v. Brennan Assocs.*, 977 A.2d 107, 121 (Conn. 2009) (general partnership).

Paragraph (~~6~~5)(c~~C~~) This provision has an analog among the causes for dissolution. *See* ~~Section~~ A.R.S. § 29-3701(a)(4)(B).

~~**Paragraph (7)(B)**—This provision does not apply to a manager-managed limited liability company because, given the limited rights of non-manager members, the stated occurrences do not necessarily justify dissociation. For a parallel provision approach under the uniform limited partnership act, *see* ULPA §§ 601(b)(6) (2001) (Last Amended 2013) (limited partner), 603(6)(B) and (C) (general partner). As for the effect of the stated occurrences on a person's role as a manager, *see* Section 407(c)(4) (permitting the removal of a manager "at any time by the affirmative vote or consent of a majority of the members without notice or cause").~~

Paragraph (~~8(A~~7)(a)—This provision is subject to bankruptcy law. *See, e.g.,* 11 U.S.C.A. § 365(e) (invalidating "ipso facto" clauses, subject to some exceptions).

Paragraphs (~~9~~8) and (~~10~~9)—A change in trustee or personal ~~representation~~representative does not cause dissociation.

Paragraph (~~11~~10)—This provision is the entity analog to Paragraph (~~7)(A~~6)(a) (death of an individual). Although in theory the operating agreement could change this rule, doing so would be nonsensical. *See* the Modified RULLCA comment to ~~Section~~A.R.S. §29-3703(~~a~~A) (noting that a terminated limited liability company cannot rescind its dissolution because "a 'dead' entity lacks both the capacity and power to bring itself back from the dead").

Paragraph (~~12)(A~~11)(a)—If a limited liability company disappears as part of a merger, no person can continue as a member of the company. When the merger takes effect, the members of the disappearing company are perforce dissociated. Depending on the plan of merger, those persons may become members of a surviving limited liability company. In those circumstances, the merger will have dissociated them from one LLC and admitted them into membership in the surviving LLC. *See* A.R.S. § ~~Sections~~ ~~401(c~~29-3401(C)(2~~), 1026(c)(10~~) and 29-2206(A)(8).

Paragraph (~~12)(B~~11)(b)—It is possible for a plan of merger to "shuffle the equity" of the surviving entity, even to the extent of "taking out" some or all of the owners of the surviving entity. A reverse triangular merger involving a limited liability company as the surviving entity would dissociate all

the members of the LLC.

Paragraph (~~14~~13)—By definition, a limited liability company that converts ceases to be a limited liability company. *See* ~~Section 1046~~the Arizona Entity Restructuring Act, Title 29, Chapter 6 (A.R.S. § 29-2101 *et seq.*). Thus, when the plan of conversion takes effect, all the members of the converted entity are dissociated from that entity. In many cases, those persons will all be owners of the converted entity. In some cases, the conversion will "shuffle the equity" and "take out" some of the members of the converting LLC.

Paragraph (~~15~~14)—Domestication does not by itself dissociate a member, because the domesticated entity remains both a limited liability company and "the same entity without interruption as the domesticating ~~company~~entity." ~~Section 1056~~A.R.S. § 29-2506(A~~a~~)(1)(b~~B~~). However, an "equity shuffle" could dissociate a member.

A.R.S. § 29-3603. EFFECT OF DISSOCIATION.

Arizona Comment
(Rev. 2/23/2024)

A.R.S. § 29-3603 is substantially the same as RULLCA Section 603 and sets forth default rules regarding the consequences of dissociation. It has no counterpart in the Prior Act.

Note that, in the case of death of an individual, A.R.S. § 29-3504 provides that the deceased member's legal representative may exercise the rights of a transferee provided in A.R.S. § 29-3502(C) and, for the purposes of settling the estate, the rights the deceased member had under A.R.S. § 29-3410 from the date of dissolution.

Under A.R.S. § 29-3105, all portions of A.R.S. § 29-3603 are default rules that can be overridden by an operating agreement.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (~~a~~A)—This provision makes no reference to power-to-bind matters~~, because~~. For manager-managed LLCs, the ~~act~~Act provides that a member *qua* member has no power to bind the LLC~~.~~ ~~Section 301~~ solely by reason of being a member except to the extent that authority has been delegated to the member by the manager, members, or operating agreement. *See* A.R.S. § 29-3301.

Subsection (~~a~~A)(2)—This provision establishes a dividing line, separating out "matters arising and events occurring after the person's dissociation." If the limited liability company has continuing projects with clients, ongoing relationships with clients, or both, the dividing line requires special attention with regard to non-competition and ~~partnership~~ company opportunities duties. *See* ~~Section 409~~A.R.S. § 29-3409(B~~b~~)(1), (3).

Disputes involving law firms have generated much of the relevant case law. *See, e.g.*, *Jewel v. Boxer*, 156 Cal. App. 3d 171, 175 (Cal. Ct. App. 1984); *Meehan v. Shaughnessy*, 535 N.E.2d 1255, 1257 (Mass. 1989). To a large extent, a well-drawn operating agreement can delineate the parties' respective rights and responsibilities and thereby avoid problems. However, if the company becomes insolvent, the bankruptcy court may well scrutinize the members' *inter se* arrangements. *See Geron v. Robinson & Cole L.L.P.*, 476 B.R. 732, 743 (S.D.N.Y. 2012) (considering whether a law firm had "fraudulently transferred . . . assets when its partners adopted the Jewel Waiver [releasing rights recognized by *Jewel v. Boxer*] on

the eve of dissolution without consideration").

This provision applies regardless of whether the limited liability company is member-managed or manager-managed. However, in the latter case, the pre-dissociation duties will be much narrower, because in a manager-managed LLC a member *qua* member has no management duties~~. Section 409(i)(1).~~ except to the extent the member controls or participates in the management or affairs of the company. A.R.S. § 29-3409(Q). But each member remains subject to the obligation of good faith and fair dealing. ~~Section~~A.R.S. § 3409(D~~i~~)~~(3~~).

This provision does not determine the effect of a person's dissociation as a member on the person's future obligations or rights under the operating agreement. Some contractual obligations typically extend beyond dissociation – *e.g.*, non-competition provisions, buyout arrangements. To the extent provisions of the operating agreement continue to apply, the common law obligation of good faith continues to apply as well. *See* the RULLCA comment to ~~Section~~A.R.S. § 409(d) (explaining that the subsection "invokes the implied obligation that exists in every contract" as a matter of common law).

Subsection (~~a~~A)(3)—This paragraph accords with ~~Section 404(b~~A.R.S. § 29-3404(B)—dissociation does not result in a distribution. In general, when a person dissociates as a member, the person's rights as a member disappear and the person's status degrades to that of a mere transferee—even when the dissociation takes the form of expulsion. *All Saints Univ. of Med. Aruba v. Chilana*, A-2628-09T1, 2012 WL 6652510, at *12 (N.J. Super. Ct. App. Div. Dec. 24, 2012).

Like most *inter se* rules in this act, this one is subject to the operating agreement. For example, the operating agreement has the power to provide for the buyout of a person's transferable interest in connection with the person's dissociation.

~~Section 504~~A.R.S. § 29-3504 provides additional information rights to the deceased member's legal representatives for the purposes of settling the estate or in the context of the company's dissolution and winding up, when an individual's death has caused dissociation. Article 10 covers organic transactions such as mergers and conversions.

Subsection (~~b~~B)—In a member-managed limited liability company, a member's obligation to safeguard trade secrets and other confidential or proprietary information is incurred when the member learns or otherwise obtains the information. This subsection preserves the obligation post-dissociation. (In a manager-managed LLC, any obligations of a non-manager member viz–a–viz proprietary information would be a matter for the operating agreement, the obligation of good faith and fair dealing, or other law.)

ARTICLE 7
DISSOLUTION AND WINDING UP

A.R.S. § 29-3701. EVENTS CAUSING DISSOLUTION.

Arizona Comment
(Rev. 2/23/2024)

The dissolution of a limited liability company is sometimes misunderstood to mean the termination of its existence. To the contrary, a limited liability company continues to exist after its dissolution under this section, but is required to wind up its activities and affairs (*see* A.R.S. § 29-3702) unless and until the dissolution is rescinded in accordance with A.R.S. § 29-3703. This section describes the events that cause dissolution and departs from RULLCA in multiple ways.

Subsection (A)(2) – RULLCA provides that dissolution may occur at any time with the affirmative vote or consent of all of the members, which creates the potential for two problems that the Drafting Subcommittee desired to avoid. First, this subsection in the Act departs from RULLCA by requiring that the necessary consents be contained in a record signed by the members to avoid misunderstandings and uncertainty that can arise from oral statements. The formality of a signed record is appropriate where the company's ongoing operations are at stake. A vote taken at a physical or virtual meeting of the members, even if it is recorded or if minutes are taken (or both), will not suffice for this purpose unless the recording or the minutes have been signed by the requisite number of members. *See* A.R.S. § 29-3102(25) for the definition of "sign".

Second, RULLCA's requirement for unanimity gives a veto right to each member and too much power on the part of a minority member to frustrate the will of the majority. Instead of unanimity, this subsection in the Act requires consent from a majority of the members in both of two different categories: (i) those who hold a majority of the interests in the company's profits (a "Majority in Interest") *and* (ii) those who are entitled to receive more than one half of the value of all liquidation distributions during the winding up of the company. Those two categories are similar to the member consent requirements under the Prior Act. Note that each member's interest in the company's profits is described in the definition of "Majority in Interest" in A.R.S.§ 29-3102(12).

> EXAMPLE 1: Member A contributes $1 million in exchange for a 45% interest in the profits of a limited liability company. Member B, the founder and the manager of the company, holds the remaining 55% interest in profits. The members expect that $2 million in net liquidation proceeds will be available for distribution after the company's debts have been paid. Under the operating agreement, the net liquidation proceeds of $2 million will be distributed first to the return of A's $1 million contribution and then to the members in accordance with their interests in profits. So A is entitled to receive $1,450,000 and B is entitled to receive $550,000 of the liquidation distributions. Even though B holds a Majority in Interest, the consent of both A and B will be necessary to dissolve the company under subsection (A)(2) because A is entitled to receive more than half of the expected liquidation proceeds.

> EXAMPLE 2: Member A contributes $1 million for a 40% interest in profits and member B contributes $500,000 for a 20% interest in the profits of a limited liability company. Member C, the founder and manager of the company, holds the remaining 40% interest in the company's profits. The members expect that $2 million in net liquidation proceeds will be available for distribution after the company's debts have been paid. Under the operating agreement, the net liquidation proceeds of $2 million will be distributed first to return the contributions of A and B, and then to the members in accordance with their interests in profits. So A is entitled to receive

$1,200,000 ($1 million plus 40% of $500,000); B is entitled to receive $600,000 ($500,000 plus 20% of $500,000); and C is entitled to receive $200,000 (40% of $500,000). Any two of the members will comprise a Majority in Interest in satisfaction of the first category of required consents. A will control the second category of consents because A alone is entitled to more than one half of expected liquidation distributions. Accordingly, A together with either B or C will be necessary to cause dissolution under subsection (A)(2).

Subsection (A)(3) – This subsection requires dissolution of a limited liability company if it ceases at any time to have any members, unless the transferees then holding interests in the company take appropriate action to avoid dissolution. Subsection (A)(3) in the Act departs from RULLCA in three substantive ways governing the actions required to be taken by the transferees:

- The deadline for taking the required action is 180 days rather than the 90 days after the company has no members.
- The consent to admit a new member must be contained in a signed record.
- As a matter of clarification, the necessary consent must be obtained from one or more transferees who are entitled to receive more than one half of the value of the proceeds of liquidation of the company's assets. RULLCA's version of this subsection merely referred to transferees entitled to receive a majority of distributions without referring to liquidation or the value of distributed assets.

Depending upon the number of transferees, obtaining the necessary consents may be very difficult. To avoid these problems, the operating agreement may provide an alternative procedure for the designation of a new member to continue the company if the last remaining member should die or otherwise cease to exist, or be adjudicated bankrupt or incompetent to manage his or her affairs.

Subsection (A)(4) – This subsection prescribes the grounds upon which a member may apply for a judicial order dissolving a limited liability company. Subsection (A)(4) in the Act departs from RULLCA in three substantive ways.

First, the court may order dissolution of the company if the managers or members are deadlocked in management *and either* (i) irreparable injury to the company is threatened or being suffered or (ii) the company's activities and affairs cannot be conducted to the advantage of the members (collectively) because of the deadlock. Clearly, some management deadlocks will not justify dissolution. For example, if the two members of a member-managed limited liability company disagree on whether to expand the company's profitable business, such a deadlock typically does not threaten irreparable injury to the company or prevent the company from conducting its existing business to the advantage of the members.

Second, illegal or fraudulent acts on the part of the controlling managers or members will not justify dissolution under the Act unless those acts (i) are related to the activities and affairs of the company *and* (ii) cause or threaten a material and adverse effect on the company or the member applying for the dissolution. RULLCA does not add those two requirements. For example, judicial dissolution is not available merely because a manager is involved in an unrelated illegal business or cheats on travel expense reimbursements in immaterial amounts. (In the latter case, a member may bring a derivative action against the manager to recover the excess reimbursements.)

Third, the Act does not allow judicial dissolution if the managers or the members in control of the company have acted or are acting in a manner that is oppressive and harmful to the member applying for a judicial dissolution. The Drafting Subcommittee determined that RULLCA's oppression standard is too vague and subjective to support a remedy as drastic as dissolution of the company, especially where the aggrieved member has alternative remedies based upon breach of the contractual obligation of good faith

and fair dealing (which cannot be eliminated or waived under the operating agreement) or breach of the duty of loyalty. To improve the stability of the limited liability company, the Act substitutes two narrower and more specific standards in place of the oppression standard. Under subsection (A)(4)(d)(ii) and (iii) of the Act, a member may obtain a judicial order of dissolution if the managers or members in control of the company either:

- Have wilfully or persistently breached the operating agreement or the duty of loyalty causing or threatening a material and adverse effect of the company or the member; or
- Have wasted, misapplied, or diverted substantial assets of the company for purposes unrelated to its activities and affairs, causing or threatening a material and adverse effect on the company.

Mandatory Provisions. Under A.R.S. § 29-3105, most of the events that cause dissolution of a limited liability company under this section may be varied or eliminated by the terms of the operating agreement. A.R.S. § 29-3105(C)(8) identifies only two of the statutory dissolution events that are mandatory: (i) the impracticability of conducting the company's activities and affairs in conformity with its articles of organization and operating agreement under subsection (A)(4)(b) and (ii) the commission's signing and filing of a statement of administrative dissolution under subsection (A)(5). In this respect, the Act departs dramatically from RULLCA, which prohibits any variation of each of the grounds for judicial dissolution described in subsection (A)(4). *See* the Arizona Comment to A.R.S. § 29-3702(B) regarding the extent to which a dissolved company's obligation to wind up is a mandatory or a default rule.

The relative freedom of contract under the Act to modify or eliminate most of the statutory events of dissolution raises two drafting issues. First. The mandatory dissolution event based upon the impracticability of conducting activities in accordance with the articles and operating agreement is, by its terms, dependent on their contents and, in particular, on the "purpose" paragraph in the operating agreement. If the members desire to minimize the risk that the company will be dissolved under this mandatory rule, they can provide that the company's purposes include every business and activity permitted to be conducted by a limited liability company under the Act. On the other hand, a passive investor member may desire a purpose clause that is tailored to a specific business or activity at a particular location.

Second, operating agreements commonly include a section that describes various events that will cause dissolution, but many fail to clearly indicate whether the described events are intended to displace the default dissolution events under A.R.S. § 29-3701. For example, if the operating agreement lists all of the statutory events of dissolution except for the deadlock of the managers or members under subsection (A)(4)(c), it is unclear whether the members intended to eliminate that event. To eliminate the ambiguity in situations where the members intend that result, the drafter may state that the company will dissolve ***only*** on the occurrence of an event described in the operating agreement.

Subsection (B) – This subsection is substantively the same as in RULLCA § 701 and allows the court, in a judicial proceeding for dissolution of a limited liability company, to order a remedy other than dissolution. *See* the final two paragraphs of the Modified RULLCA Comment to § 701 regarding the members' ability to override subsection (B) in their operating agreement.

Modified RULLCA Comment
(Rev. 2/23/2024)

"Dissolution" has been a term of art in the law of unincorporated business organizations since at least the time of Roman law. JOSEPH STORY, COMMENTARIES ON THE LAW OF PARTNERSHIP § 266, at 408 (2d ed. 1850) ("The Roman law . . . declared, that partnership might be dissolved in various ways . . .

."). Dissolution does not end a limited liability company's existence but rather changes the purpose of that existence: "A dissolved limited liability company shall wind up its activities and affairs and . . . the company continues after dissolution only for the purpose of winding up." Section 29-3702(A~~a~~). The company may, but need not, file~~d~~ a notice of winding up~~statement of dissolution~~. Section 29-3702(B~~b~~)(2)(a~~A~~). The limited liability company terminates when articles of termination are filed (except for the limited purposes described in A.R.S. § 29-3702(I))~~winding up is complete~~. The company must ~~may, but need not,~~ file ~~a~~ articles ~~statement~~ of termination after all of its known property and assets have been applied and distributed in accordance with the Act. Section 29-3702(H~~b~~)~~(2)(F)~~.

Except for Paragraphs (A~~a~~)(4)(b) and (A)(5), this section comprises default rules. Paragraph (A)(5) is fully mandatory, Section 29-3105(C~~c~~)(3)(b~~B~~); Paragraph (A)(4)(b) ~~4~~ is mandatory only with regard to the stated grounds for dissolution. *See* the comment to Section 29-3105(C~~c~~)(8~~9~~). Moreover, an operating agreement can provide additional causes of dissolution. *See* Subsection (A~~a~~)(1). Variations to the statutory causes of dissolution are commonplace.

Section 29-3703 permits rescission of dissolution in some circumstances. In some circumstances, an amendment to the operating agreement might avert dissolution (*e.g.*, by revising an agreed-upon deadline for selling the LLC's assets and winding up the business). A retroactive amendment may also be possible. *See Kindred Ltd. P'ship v. Screen Actors Guild, Inc.*, CV082220PSGPJWX, 2009 WL 279080, at *5–6 (C.D. Cal. Feb. 3, 2009) (giving effect to an amendment that retroactively eliminated an event of dissolution; noting that UPA (1997) § 802(b) permitted a partnership to rescind dissolution).

Subsection (A~~a~~)(4)—The operating agreement cannot vary the causes of dissolution stated in paragraph (b) of this subsection~~this provision~~. However, the operating agreement may contain a forum selection clause or change the forum from "the appropriate court" to binding arbitration. Section 29-3105(c)(8~~9~~), cmt. The other causes of dissolution in subsection (A)(4) are default rules.

As to whether the court of another jurisdiction can properly order dissolution of a limited liability company formed under this A~~a~~ct, the majority rule is clearly no. "[T]he courts of several states have held that jurisdiction to dissolve a corporation rests only in the courts of the state of incorporation." *In re Blixseth*, 484 B.R. 360, 370 (B.A.P. 9th Cir. 2012) (citing cases, including a case involving an LLC). *But see In re Mercantile Guar. Co.*, 238 Cal. App. 2d 426, 430–33 (Cal. Ct. App. 1965) (explaining that "[w]e are . . . required to determine whether the courts of a state in which a foreign corporation has done business and in which its assets are there located have jurisdiction to wind up its affairs, even though the corporation was organized in another state," stating that "the question is not one of jurisdiction or power in the court of the state which is not the legal domicile of a foreign corporation, but it is a question . . . of the balance of convenience, of whether considerations of public policy, efficiency, expedience and justice to all parties interested demand that jurisdiction be retained in the foreign court, or that it be declined under the rule of forum *non conveniens*," and holding that "[t]he circumstances of the case at bench require a holding that the California courts assume jurisdiction of the winding up of [a Delaware corporation's] affairs preparatory to a dissolution").

Subsection (A~~a~~)(4)(b~~B~~)—The standard stated here is conventional, deriving originally from the law of limited partnerships. *See, e.g.*, *Kirksey v. Grohmann*, 754 N.W.2d 825, 828–30 (S.D 2008) (discussing cases and noting that "cases interpreting language similar to our statutory terminology, whether involving a partnership or a limited liability company, are instructive"). For discussion of the meaning of the standard, *see Venture Sales, L.L.C. v. Perkins*, 86 So. 3d 910, 914–15 (Miss. 2012) (discussing cases); *In re 1545 Ocean Ave., LLC*, 72 A.D.3d 121, 129–30 (N.Y. 2010) (same).

The court-ordered expulsion of a miscreant member can negate a claim for dissolution. *Dunbar Grp., LLC v. Tignor*, 267 Va. 361, 367-68, 593 S.E.2d 216, 219 (2004) ("Although Tignor's actions in

[the] capacities [of member and manager of Xpert] had created numerous problems in the operation of Xpert, his expulsion as a member changed his role from one of an active participant in the management of Xpert to the more passive role of an investor in the company. The record fails to show that after this change in the daily management of Xpert, it would not be reasonably practicable for Xpert to carry on its business pursuant to its operating authority.”).

However, where grounds exist for both dissociation and dissolution, a court has the discretion to choose between the alternatives. *Robertson v. Jacobs Cattle Co.*, 830 N.W.2d 191 201–02 (Neb. 2013). “[T]here is no textual basis for imposing a higher burden of proof for dissociation than dissolution.” *Brennan v. Brennan Assocs.*, 977 A.2d 107, 121 (Conn. 2009) (general partnership).

This provision has an analog among the grounds for dissociation. *See* Section 29-3602(5~~6~~)(c).

~~**Subsection (a)(4)(C)** – The provision’s reference to “those members in control of the company” implies that such members have a duty to avoid acting oppressively toward fellow members.~~

~~The act does not define “oppressively,” but “oppression” is a concept well-grounded in the law of close corporations. *See, e.g.*, *Kiriakides v. Atlas Food Sys. & Servs., Inc.*, 541 S.E.2d 257, 264–66 (S.C. 2001); Robert B. Thompson, *The Shareholder’s Cause of Action for Oppression*, 48 BUS. LAW. 69, 70 (1993) (referring to then “evolving cause of action of shareholder oppression”). In many jurisdictions the concept equates to or at least includes the frustration of the plaintiff’s reasonable expectations. *Baur v. Baur Farms, Inc.*, 832 N.W.2d 663, 670 (Iowa 2013) (stating that “perhaps the most widely adopted [approach] links oppression to the frustration of the reasonable expectations of the corporation's shareholders”). (This concept of reasonable expectations is entirely separate from the “fruits of the bargain” and “reasonable expectations” language sometimes used in explaining the implied contractual obligation of good faith and fair dealing.)~~

~~Courts have extrapolated close corporation doctrine to unincorporated organizations. *See, e.g.*, *Alloy v. Wills Family Trust*, 944 A.2d 1234, 1262–64 (Md. Ct. Spec. App. 2008) (discussing cases). Indeed many cases simply conflate the two contexts. *E.g. Kohannim v. Katoli*, 08-11-00155-CV, 2013 WL 3943078, at *9 (Tex. Ct. App. July 24, 2013) (“A member oppression claim may exist when: (i) a majority shareholder's conduct substantially defeats the minority’s expectations that objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture; or (ii) burdensome, harsh, or wrongful conduct, a lack of probity and fair dealing in the company's affairs to the prejudice of some members, or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.”); *Pinnacle Data Servs., Inc. v. Gillen*, 104 S.W.3d 188, 196 (Tex. Ct. App. 2003) (explaining oppression of “members” in terms of shareholder oppression).~~

~~However, applying close corporation law to limited liability companies requires some caution. Close corporation law developed in part because the standard corporate governance structure exalts majority power and does not presuppose contractual relationships among the shareholders.~~

~~In contrast, while an LLC depends on the sovereign for legal existence and the all-important liability shield, LLC governance is fundamentally contractual. Therefore, in most situations, the operating agreement should reflect and comprise members’ reasonable expectations. As a result, a court considering a claim of oppression by an LLC member should consider, with regard to each reasonable expectation invoked by the plaintiff, whether the expectation: (i) contradicts any term of the operating agreement or any reasonable implication of any term of that agreement; (ii) was central to the plaintiff’s decision to become a member of the limited liability company or for a substantial time has been centrally important in the member’s continuing membership; (iii) was known to other members, who expressly or impliedly~~

~~acquiesced in it; (iv) is consistent with the reasonable expectations of all the members, including expectations pertaining to the plaintiff's conduct; and (v) is otherwise reasonable under the circumstances. *See* the comment to Sections 102(13) ("[T]he definition [of 'operating agreement'] puts no limits on the form of the operating agreement. To the contrary, the definition contains the phrase 'whether oral, implied, in a record, or in any combination thereof.'"), Section 105(a)(4), cmt. (explaining how a written operating agreement, if properly drafted, can provide that amendments must be in writing and signed to be effective).~~

> ~~EXAMPLE: From its formation, Work-Here, LLC has had three members, been member-managed, involved all three members in company operations, and allocated distributions in part in reference to the members' work for the company. The operating agreement is brief, informal, contains no integration clause, and makes no reference to a member's right to work for the company.~~
>
> ~~After ten years, two of the members: (i) take a vote; (ii) purport to oust the third member from any continuing role in company operations; and (iii) announce that the third member's distributions will be substantially reduced.~~
>
> ~~The ousted member has at least three theories of recovery:~~
>
> ~~Article I. breach of an implied-in-fact term of the operating agreement, under which each member is entitled to work for the company and be compensated for the work;~~
>
> ~~Article II. violation of Section 407(b)(4)(A) (requiring "[t]he affirmative vote or consent of all the members . . . to . . . undertake an act outside the ordinary course of the activities and affairs of the company"); and~~
>
> ~~Article III. oppression under Section 701(4)(C)(ii).~~
>
> ~~On the limited facts stated, these theories are undoubtedly plausible, although of course not necessarily persuasive. *See* Section 409(d) (incorporating "the contractual obligation of good faith and fair dealing").~~

Subsection (A~~a~~)(5)—The operating agreement may not vary this provision.

Subsection (B~~b~~)—In the close corporation context, many courts have reached this position without express statutory authority, most often with regard to court-ordered buyouts of oppressed shareholders. *See, e.g.*, *Kirtz v. Grossman*, 463 S.W.2d 541, 545 (Mo. Ct. App. 1971) (per curiam); *Brenner v. Berkowitz*, 634 A.2d 1019, 1031 (N.J. 1993); *N.D. ex rel. Heitkamp v. Family Life Servs.*, 616 N.W.2d 826, 838 (N.D. 2000); *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 394–96 (Or. 1973); *Davis v. Sheerin*, 754 S.W.2d 375, 380 (Tex. Ct. App. 1988). *Contra White v. Perkins*, 189 S.E.2d 315, 320 (Va. 1972).

This subsection saves courts and litigants the trouble of re-inventing that wheel in the LLC context. However, unlike Subsection (A~~a~~)(4)(b), Subsection (B~~b~~) can be overridden by the operating agreement. Thus, the members may agree to restrict or eliminate a court's power to craft a lesser remedy, even to the extent of confining the court (and themselves) to the all-or-nothing remedy of dissolution.

A.R.S. § 29-3702. WINDING UP.

Arizona Comment
(Rev. 2/23/2024)

Subsection (A) – This subsection is substantively the same as RULLCA and requires a dissolved limited liability company to wind up its affairs (unless dissolution is rescinded pursuant to A.R.S. §29-3702). Note that winding up is required irrespective of the cause of dissolution, including an

administrative dissolution that has not been reinstated within the time periods specified in A.R.S. § 29-3709. Whether and the extent to which the members may override all or part of subsection (A) in their operating agreement depends upon the specific cause of the company's dissolution and other circumstances.

Subsection (A) is not specifically identified as a mandatory rule in A.R.S. § 29-3105 (C) or (D). However, A.R.S. § 29-3105(C)(8) prohibits the members from varying or eliminating an administrative dissolution by the commission or a judicial order of dissolution based upon a finding that it is not reasonably practicable to carry on the company's activities and affairs in conformity with the operating agreement. Furthermore, the same two causes of dissolution are excluded from the right of members to rescind dissolution (by unanimous vote) under A.R.S. § 29-3703(A). By necessary implication, then, the company's obligation to wind up its affairs is a mandatory rule in the case of these two causes of dissolution, and the members by agreement cannot avoid the obligation to wind up. A contrary opinion would render meaningless the two mandatory causes of dissolution under A.R.S. § 29-3105(C)(8).

In the case of any other cause of dissolution, the question of whether subsection (A)'s obligation to wind up is a default rule is rather academic because the other causes of dissolution arise in situations where there are no members or at least one of the members has initiated dissolution. In the unlikely event that the members have overlooked or forgotten about an event of dissolution specified in the operating agreement, the members (by unanimous vote) may rescind the dissolution under A.R.S. § 29-3703 whenever they discover the dissolution. There is no time limit for a rescission under that section. However, A.R.S. § 29-3703(C)(3) protects the rights of third parties arising out of conduct in reliance on the dissolution before they receive notice of the rescission, and A.R.S. § 29-3105(C)(12) prevents the members from restricting those third-party rights in the operating agreement.

Subsection (B) – Subsection (B)(1) specifies the actions that must be taken by a dissolved limited liability company to wind up its activities and affairs. Subsection (B)(2) lists several activities that are permitted to be taken by a dissolved company during its winding up. For example, subsection (B)(2)(b) allows the company to continue its ordinary business activities (such as ordering inventory and replacing employees) for a reasonable time to preserve its activities and property as a going concern. The list of permitted activities under subsection (B)(2) is not exhaustive.

Subsection (B) is substantively the same as RULLCA with two exceptions. First, the name of the public filing that is permitted upon dissolution is a "notice of winding up" rather than a "statement of dissolution" to avoid the common misunderstanding that dissolution means the company has ceased to exist. Second, the company must file "articles of termination" under subsection (H) when all of its known assets have been applied or distributed in accordance with the Act. RULLCA calls this filing a "statement of termination" under subsection (B) and makes its filing optional rather than mandatory. Although the filing of a statement of winding up is optional, filing (along with publication) is a prerequisite to limiting the period of enforcement of unknown claims against the company under A.R.S. § 29-3705. On the other hand, filing a notice of winding up may have adverse effects on the company. For example, if a supplier of inventory learns of the dissolution, it may insist that future deliveries must be paid by cash on delivery. Note also that the filing of a notice of winding up will prevent the limited liability company from obtaining a good standing certificate under A.R.S. § 29-3211(B)(1)(c) unless and until the members unanimously vote to rescind the company's dissolution and a statement of correction has been filed pursuant to A.R.S. § 29-3703(B).

To what extent, if any, will the company's winding up obligations affect the management rights and authority of the managers (in a manager-managed company) or the members (in a member-managed company) under the Act's default rules? Subsection (B)(2)(b) provides a "safe harbor" that allows a dissolved company, during the course of winding up, to preserve the company's activities and property as

a going concern for a reasonable time, so the managers' and members' authority to act for the company in the ordinary course of its activities should not be affected by dissolution (at least, not for a reasonable time). But what about contractual commitments and capital expenditures outside the "ordinary course" that are intended to expand the company's business activities or its production capacities? For example, a company that owns and operates a franchised restaurant may receive a right of first refusal from the franchisor to purchase an additional franchise at a nearby location. Or a manufacturing company may receive an inquiry from a customer for the purchase of a new product that is related to the company's existing product line, but that will require an extraordinary investment in new manufacturing equipment. Does the company's obligation to wind up its affairs imply a restriction on the authority of a majority of the managers, or a majority in interest of the members, to engage in those kinds of transactions under the default management rules of A.R.S. § 29-3407(C)(3)(a) or A.R.S. § 29-3407(B)(3)(a)? Subsection (E) of A.R.S. § 29-3407 provides that the dissolution of a limited liability company does not affect the applicability of that section's default management rules, so the managers' and members' management rights under A.R.S § 29-3407 with respect to extraordinary transactions remain in effect during winding up (with one exception that is not relevant under the Act's default rules). (*See* the Arizona Comment to A.R.S § 29-3407(E) for an explanation of why that exception cannot exist under the Act's default rules.)

If a member or a transferee is dissatisfied with the slow progress of the controlling managers or members in completing the winding up, he or she may apply for judicial supervision of the winding up under subsection (E) of this section.

Subsections (C) and (D) – These subsections provide helpful rules governing who is responsible for winding up the limited liability company if the dissolved company has no members. These rules differ from RULLCA in several ways:

- The last person to have been a member, in addition to the legal representative of that person, is given responsibility for winding up. This change allows, for example, a debtor in bankruptcy to have this role, whereas RULLCA's reference to only the legal representative of the last member seems to be based on the assumption that the last member has died or otherwise ceased to exist.
- If the last member (or its legal representative) declines to take responsibility for winding up, a person may be designated by one or more transferees who are entitled to receive more than one half of the value of all distributions in liquidation of the company. RULLCA merely refers to transferees who own a majority of the rights to receive distributions without specifying that the calculation is to be based on the value of liquidation distributions.
- For drafting convenience, the Act refers to the person responsible for winding up as the "liquidating agent", regardless of how that person is determined. The use of this term makes agency law applicable with respect to the indemnification rights, fiduciary duties, and other rights and duties of the person who winds up the company.
- The Act expressly allows transferees to remove and replace the liquidating agent at any time, by the same consent requirement applicable to the agent's appointment.

The term "legal representative" is not defined in RULLCA or the Act. However, the term is also used in A.R.S. § 29-3504, and the RULLCA comment to that section states only that it refers to the legal representative of a deceased member's estate. In the case of a member who has dissociated because of the appointment of a guardian or general conservator or an adjudication of the member's incompetence under A.R.S. § 29-3602(6)(b) or (c), the legal representative is likely the guardian or general conservator. In the case of a member who has dissociated because it is a debtor in bankruptcy under A.R.S. § 29-3602(7)(a), the trustee of the bankruptcy estate (if one has been appointed) is likely the legal representative. If the member is a debtor in possession without the appointment of a trustee, the debtor member may be the

liquidating agent. In the case of a legal entity that has dissociated because it has ceased to exist, it is unclear who will act as the liquidating agent. If uncertainties or disputes should arise regarding who is the liquidating agent, subsection (D) provides that ultimate control over the designation of a liquidating agent lies in the hands of one or more transferees who are entitled to receive more than half of the value of all liquidation distributions. Of course, all of subsections (C) and (D) are default rules under A.R.S. § 29-3105, so the members are free to provide in the operating agreement a different method for selecting a liquidating agent if there are no members at the time the company dissolves.

Subsection (E) – This subsection governs judicial supervision of winding up and is substantively the same as RULLCA with two exceptions. First, the court's supervision encompasses the replacement as well as the appointment of the liquidating agent. Second, any transferee may apply for judicial supervision for "good cause" and is not limited to situations where there has been unreasonable delay in appointing a liquidating agent or in completing the winding up.

Subsection (F) – This subsection provides that, on the appointment of a liquidating agent, any person who is then a manager shall cease to be a manager, and any members will cease to have management authority, except as otherwise provided in an order of judicial supervision. This subsection has no counterpart in RULLCA and is intended to avoid conflicting authority between the liquidating agent and the company's managers and members.

Subsection (G) – This subsection requires the liquidating agent to file an amendment to the company's articles of organization disclosing, among other things, the name and address of the liquidating agent, the name and mailing address of each member (if any), and that the company has no managers. By comparison, the filing required under RULLCA requires a statement that the company has no members (which may not be true in the case of a judicial dissolution) and fails to disclose the absence of managers. Subsection (G) is a mandatory rule under A.R.S. § 29-3105(C)(3)(b).

Subsection (H) – This subsection prescribes the contents of the articles of termination that must be filed when all of the company's known property and assets have been applied and distributed in accordance with the Act. RULLCA does not require a filing at that time (or at any other time). Note that the payment of all of the company's liabilities is not necessary prior to filing articles of termination, so long as all of the company's known properties and assets have been applied to the payment of its liabilities (rather than distributed to members) during winding up. Accordingly, the signing and filing of articles of termination do not constitute a representation that all of the company's liabilities have been paid. Subsection (H) is a mandatory rule under A.R.S. § 29-3105(C)(3)(b).

Subsection (I) – This subsection extends the existence of a limited liability company after the filing of articles of termination for limited purposes. It has no counterpart in RULLCA. Nicknamed the "zombie provision" by some members of the Drafting Subcommittee, this subsection is intended to enable the company to dispose of property that was overlooked when articles of termination were filed and to pursue, defend and discharge claims that were not resolved at that time. These limited purposes include engaging in lawsuits and other proceedings and in other activities that are reasonably appropriate for such purposes. So long as these activities are reasonably related to winding up the company's affairs, the limited liability of the members and managers under the Act will not be affected, and the liquidating agent will not incur personal liability. These activities will be under the control of the company's managers or liquidating agent (whichever is applicable) at the time the articles of termination were filed or, if none, by the company's members at that time.

Modified RULLCA Comment
(Rev. 2/23/2024)

Under the default rules of this A~~a~~ct, dissolution does not change governance arrangements. However, dissolution does change the context for determining, with regard to a member-managed LLC, whether a matter is in or outside "the ordinary course of the activities of the company." Section 29-3407(B~~b~~)(2~~3~~)~~, (4)~~.

As for determining the post-dissolution power of a member or manager to bind the LLC, this Act, supplemented by ~~other law, primarily~~ agency law, supplies the rules. Thus, dissolution does not change the applicable source of law for determining actual and apparent authority. Section 29-3301, Arizona Comment~~emt~~.

Subsection (A~~a~~)—*See* the comment to Section 29-3701(A~~a~~).

Subsection (B~~b~~)—The particular circumstances determine how long winding up may continue without giving "good cause" for court intervention under Section 29-3702(E~~e~~). The case law is partnership law and applies by analogy. There is no "hard and fast" rule. *See, e.g.*, *Mathis v. Meyeres*, 574 P.2d 447, 450 (Alaska 1978) (stating that we are aware of [no authority] requiring that deadlines be set in the winding up of a partnership"); *8182 Md. Assocs., Ltd. P'ship v. Sheehan*, 14 S.W.3d 576, 581 (Mo. 2000) ("The Uniform Partnership Law contemplates that dissolved partnerships may continue in business for a short, long or indefinite period of time ….") (quoting *Schoeller v. Schoeller*, 497 S.W.2d 860, 867 (Mo. Ct. App. 1973)).

"Winding up usually entails the time necessary for the partners to finish old business, collect and pay debts, and finally distribute remaining assets to the partners." *Gibson v. Deuth*, 270 N.W.2d 632, 635 (Iowa 1978). "Generally the best interests of the partnership will be served by winding up the partnership affairs as quickly as possible." *Doting v. Trunk*, 259 Mont. 343, 349, 856 P.2d 536, 540 (1993). However, in some circumstances, a long period of winding up is not only appropriate but necessary. *Lebanon Trotting Ass'n v. Battista*, 306 N.E.2d 769, 772 (Ohio Ct. App. 1972) ("[I]f the only means of availing the partners of the benefit of the value of the lease would be to continue to operate under such lease until its expiration, then such operation may continue as part of the winding up of the partnership affairs after dissolution. It is not necessary that a partnership, in the absence of the consent of all the partners, abandon a valuable asset upon dissolution merely because it may have no ready market value, but the value of such asset can continue to inure to the benefit of the partners through the continuation of the partnership after dissolution.")

Subsection (B~~b~~)(2)(a~~A~~) and subsection (H~~F~~)—For the constructive notice effect of a notice of winding up ~~statement of dissolution~~ or articles of termination, *see* Sections 29-3103(D~~d~~)(1~~2~~)~~(A)~~ and (2~~B~~) ~~and 302(h)~~.

Subsection (C~~c~~)—Section 29-3304 provides a shield for managers as well members against automatic, vicarious liability for an LLC's debts, obligations, and other liabilities. Section 29-3407(C) provides default rules for a manager's actual authority. Some of those rules provide for consent by members. *See* Section 29-3407(C~~c~~)(4~~3~~). Because the limited liability company has no members, t~~T~~hose rules are inapposite in the circumstances contemplated by this subsection.

Section 29-3409 does not apply to a liquidating agent ~~person~~ appointed under this section. Such person will inevitably be an agent of the dissolved limited liability company, and may be acting pursuant to a contract. Thus, agency and contract law will determine the liquidating agent~~person~~'s duties.

Subsection (Dd)(1)—*See* the comment to Subsection (Ce).

Subsection (Ee)—Section 29-3409 does not apply to a liquidating agent person appointed under this section. The applicable standards of conduct might come from any or all of these sources: the court order, state law pertaining to receiverships, agency law, and contract law.

Subsection (Ee)(1)—Managers do not have standing under this provision. If a non-member manager has so lost control of the limited liability company as to desire dissolution, the non-member manager's remedy is to: (i) seek court enforcement of the relevant provisions of the operating agreement, management agreement, or both; or (ii) resign.

A.R.S. § 29-3703. RESCINDING DISSOLUTION.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 703 except that, unlike RULLCA, it also allows the rescission of dissolution (and the appointment of a new member) by unanimous consent of the transferees if the limited liability company has no members. The Act departs from RULLCA by using different terminology to refer to various filed documents: articles of termination (rather than statement of termination), notice of winding up (rather than statement of dissolution), and statement of correction (rather than statement of rescission). Note that there is no time limit for rescission under this section. Note also that the members have no right of rescission under this section in the case of an administrative dissolution, but the company has six years to apply for reinstatement under A.R.S. § 29-3709.

Modified RULLCA Comment
(Rev. 2/23/2024)

The Harmonization Project (which amended RULLCA in 2011 and 2013) added this section, which is based on UPA (1997) § 802(b)(1) permitting the partners to "waive the right to have the partnership's business wound up and the partnership terminated" after which "the partnership resumes carrying on its business as if dissolution had never occurred").

Subsection (Aa)—The first exclusion results inevitably from the effect of a articles statement of termination (*i.e.*, the limited liability company ceases to exist). A "dead" entity lacks both the capacity and power to bring itself back from the dead and may engage in only the limited activities contemplated by A.R.S. §29-3702(I).

The second and third exclusions pertain to dissolutions eaffected by outsiders (*i.e.*, the court and the filing office).

Subsections (Bb)(1)—The requirement of unanimous consent protects any vested rights of, or reliance by, members. However, the operating agreement may vary this provision.

Subsection (Ce)(3)—This paragraph protects third parties. *E.g.*, *Neurobehavorial Assocs., P.A. v. Cypress Creek Hosp., Inc.*, 995 S.W.2d 326, 331 (Tex. Ct. App. 1999) ("If the Hospital had the right to terminate the Agreement when it did because the Association was then dissolved, then even though the Association can revoke articles of dissolution and have that relate back to the date of dissolution, it would be grossly unfair to let the Association assert its ex post facto change as a defense. Surely the Association would be estopped from doing so, having created the very conditions that gave the Hospital the correct impression that it was then dissolved.").

A.R.S. § 29-3704. KNOWN CLAIMS AGAINST DISSOLVED LIMITED LIABILITY COMPANY.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 704 except for the addition of subsection (E), which has no counterpart in RULLCA. Subsection (E) expressly provides that compliance with the section's procedures and requirements to bar known claims will not affect or prevent:

- The enforcement of any mortgage, pledge, or other lien on the limited liability company's property; or
- Any proceeding to establish the company's liability for which it is protected by liability insurance, but only to the limits of the insurance protection.

Modified RULLCA Comment
(Rev. 2/23/2024)

Sections 29-3704 through 29-3706 provide rules under which a dissolved limited liability company may achieve finality with regard to claims.

This section is derived almost verbatim from Model Business Corporation Act section 14.06.

A.R.S. § 29-3705. OTHER CLAIMS AGAINST DISSOLVED LIMITED LIABILITY COMPANY.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 705 with two exceptions. First, subsection (E) contains the same protections with respect to the enforcement of liens and insured claims as set forth in subsection (E) of A.R.S. § 29-3704. Second, to start the three-year clock to bar unknown claims, a dissolved limited liability company must file a notice of winding up with the commission in addition to publishing the notice required under subsection (B).

Modified RULLCA Comment
(Rev. 2/23/2024)

This section is derived almost verbatim from Model Business Corporation Act section 14.07.

Subsection (D~~d~~)(2)—Liability under this paragraph extends to those who have received distributions under a charging order. *See* the comment to Section 502(a) (explaining that the beneficiary of a charging order is a transferee). ~~Unlike Section 406(c) (recapture of improper distributions), ~~T~~t~~his paragraph contains no "knowledge" element.

A.R.S. § 29-3706. COURT PROCEEDINGS.

Arizona Comment
(Rev. 2/23/2024)

This section enables (but does not require) a dissolved limited liability company to apply for a judicial determination of the form and amount of security the company must provide to assure payment of claims that are reasonably expected to arise during its winding up, as well as unknown or contingent claims. If the company complies with the requirements of this section, such claims may not be enforced against a member or transferee on account of distributions received during winding up of the company's activities and affairs. This section is substantively the same as RULLCA § 706, except that the company must file with the commission (as well as publish) a notice of winding up in accordance with A.R.S. § 29-3705.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section is derived almost verbatim from Model Business Corporation Act section 14.08.

A.R.S. § 29-3707. DISPOSITION OF ASSETS IN WINDING UP.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 707. As explained in the Modified RULLCA Comment to this section, the priority payment right of each company creditor under subsection (A) is a mandatory rule under A.R.S. § 29-3105(C)(12) and cannot be altered by the members in their operating agreement. Although the statutory language of subsection (A) does not specifically so provide, the clear implication of this priority is that distributions to members (including so-called "tax distributions" to fund their estimated quarterly income tax liabilities) must be suspended after the company's dissolution until all creditors have been paid, or the dissolution has been rescinded under A.R.S. § 29-3703 or reinstated under A.R.S. § 29-3709. Note that judicial proceedings under A.R.S. § 29-3706 are available to allow distributions only with respect to the company's contingent liabilities, unknown liabilities, and liabilities that are expected to arise after dissolution, and will not protect a recipient of distributions from the claims of non-contingent creditors that are known to exist at the time of dissolution.

See the Modified RULLCA Comment to § 707 regarding the extent to which the provisions of subsections (B), (C), and (D) may be overridden by the members' operating agreement.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (A~~a~~)—This subsection is non-waivable as to creditors who are not members. *See* Section 29-3105(C~~e~~)(12~~15~~) (stating that the operating agreement may not "restrict the rights under this chapter ~~[act]~~ of a person other than a member or manager"). However, if a creditor is willing, a dissolved limited liability company may certainly make agreements with the creditor specifying the terms under which the LLC will "discharge its obligations" to the creditor.

Subsections (B~~b~~), (C~~c~~) and (D~~d~~)—For the most part, these subsections state default rules. For example, operating agreements often provide for different distribution rights upon liquidation than during

operations. However, distributions under these subsections (or otherwise under the operating agreement) are subject to Section 29-3503 (charging orders). As to the extent the operating agreement can be amended to affect the distribution rights of persons already transferees, *see* Section 29-3107(B~~b~~).

A.R.S. § 29-3708. ADMINISTRATIVE DISSOLUTION.

Arizona Comment
(Rev. 2/23/2024)

Subsection (A) lists the various grounds for administrative dissolution of a limited liability company and departs from RULLCA in the following respects:

- The Act removes the failure to pay a tax or interest owed to the commission from RULLCA's list of grounds for administrative dissolution because the Act does not require any company to pay a tax or interest.
- The Act removes the failure to file an annual report from RULLCA's list of grounds for administrative dissolution because the Act does not require any company to file an annual report.
- The Act contains several grounds for administrative dissolution not found in RULLCA, including failure to have a principal (mailing) address, failure to notify the commission of a change in its statutory agent or principal address, failure to amend its articles of organization or to file a statement of change when required under A.R.S. § 29-3202, and failure to respond to the commission's interrogatories under A.R. S. § 29-3212.

The remaining subsections are substantively the same as RULLCA except that, under subsections (B) and (C), the commission is directed to deliver specified notices to a limited liability company's statutory agent or principal address rather than using the alternative methods of service permitted under A.R.S. § 29-3210. These provisions highlight the importance of keeping the company's principal address and statutory agent information accurate and up to date in the commission's records, to make sure that the company actually receives notice of an administrative dissolution. If the company is not aware of its administrative dissolution for more than six months, it may lose the right to its name under A.R.S. § 29-3709(B). If the company remains unaware for more than six years, it will lose its right to reinstatement under A.R.S. § 29-3709(A) and must wind up its affairs. Also, any distributions made after administrative dissolution will violate the implied rights of existing creditors under A.R.S. § 29- 3707(A), even though the company is unaware of the dissolution. *See* Arizona Comment to A.R.S. § 29-3707.

Modified RULLCA Comment
(Rev. 2/23/2024)

Many failures to comply with statutory requirements that may give rise to administrative dissolution occur because of oversight or inadvertence and are usually corrected promptly when brought to the entity's attention. Subsections (B~~b~~) and (C~~c~~) therefore provide a mandatory notice by the filing office to each limited liability company subject to administrative dissolution and a sixty-day grace period following the notice before the statement of administrative dissolution may be filed.

In most instances, the issue whether the limited liability company is subject to administrative dissolution will not be controverted. If a limited liability company is administratively dissolved, it may petition the filing office for reinstatement under Section 29-3709 and, if reinstatement is denied, the company may appeal to the courts under Section 29-3710.

As a practical matter, administrative dissolution permits the filing office to clear the record of "dead wood" and free up names.

A.R.S. § 29-3709. REINSTATEMENT.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as RULLCA § 709 with two exceptions. First, subsection (A) allows reinstatement up to six years (rather than RULLCA's two years) after the effective date of administrative dissolution.

Second, subsection (B) allows an administratively dissolved limited liability company to keep its name so long as it applies for reinstatement within six months after the effective date of administrative dissolution. (RULLCA releases the company's name for use by third parties immediately on the effective date of dissolution.) If another company has adopted the name after the expiration of the six-month period, subsection (D) requires the company to amend its articles of organization to change its name, and to submit the amendment with its application for reinstatement.

Note that a company's name is released to third parties (after expiration of six months) only in the case of an administrative dissolution. (In the case of a company that dissolves for any other reason, its name is not released until articles of termination are filed.) When forming a new limited liability company, before using the name of a company that has been administratively dissolved, the better practice is to make sure that six months have elapsed after the effective date of dissolution.

If a company is administratively dissolved because of an oversight in filing required information or in responding to the commission's interrogatories, each manager under A.R.S. § 29-3407(C)(2) (or each member in a member-managed company under A.R.S. § 29-3407(B)(2)) has the authority to remedy the oversight and apply for reinstatement as a matter within the ordinary course of the company's affairs.

Modified RULLCA Comment
(Rev. 2/23/2024)

Some states require that reinstatement be sought within two years of administrative dissolution. Other states provide a longer time, or do not impose any time limit. Imposing no limit risks abuse by unscrupulous people seeking to reinstate and appropriate for improper ends a dormant limited liability company that has been abandoned by its members. On the other hand, reinstatement is intended as a safety net for the inattentive (*i.e.*, for people in charge of a limited liability company who have neglected to file a statement of change ~~an annual report~~ or otherwise subjected the LLC to administrative dissolution). If the deadline comes too soon, the safety net may be gone before the inattentive even learn that administrative dissolution has occurred.

Subsection (D~~a~~)~~(1)~~—This provision will apply if, after six months following the effective date of administrative dissolution and before the limited liability company is reinstated, another entity has taken the company's name. *See* subsection (B) of this section~~Section 112(b)(1)~~.

Subsection (G~~d~~)(3)—This paragraph provides an exception to the retroactive effect provided by this subsection's Paragraphs (1) and (2). The exception could preclude a reinstated LLC's use of its own name. *See* subsection (B) of this section ~~Section 112(b)(1)~~ (~~indirectly~~ permitting a limited liability company to use the name of an LLC that has failed to apply for reinstatement within six months after it

has been administratively dissolved). Comparable provisions exist in other uniform acts pertaining to entities. *E.g.*, UPA (1997) (Last Amended 2013) § 902(c)(2).

A.R.S. § 29-3710. JUDICIAL REVIEW OF DENIAL OF REINSTATEMENT.

Arizona Comment
(Rev. 2/23/2024)

Subsection (A) is substantively the same as RULLCA § 710(A) except that it requires the commission to deliver notice of its reasons for denial of reinstatement to the statutory agent or principal address of a limited liability company rather than using the alternative methods of service under A.R.S. § 29-3210.

Subsection (B) departs from RULLCA by allowing an administratively dissolved limited liability company up to six months (rather than thirty days) to seek judicial review of the commission's refusal to reinstate the company. In addition, this subsection specifies that the court must determine the action as a trial *de novo,* with the burden of proof on the company.

Modified RULLCA Comment
(Rev. 2/23/2024)

Because the grounds for administrative dissolution under Section 29-3708 are limited and straight-forward, it is unlikely there will be a dispute about whether a limited liability company has corrected the reasons for its administrative dissolution. If a dissolved limited liability company disagrees with a determination by the filing office to deny the company's application for reinstatement, this section gives the company a limited right to seek judicial review of the denial of reinstatement.

ARTICLE 8
ACTIONS BY MEMBERS

A.R.S. § 29-3801. DIRECT ACTION BY MEMBER.

Arizona Comment
(Rev. 2/23/2024)

This section differs from the Prior Act and Section 801 of RULLCA. These differences allow a member of a limited liability company to bring a direct action to enforce the member's rights under the operating agreement or the Act even if the member's damages are solely the result of an injury suffered by the limited liability company (an "indirect injury"). Consequently, it is no longer necessary for the plaintiff member in a direct action to plead and prove an injury (or a threatened injury) that is separate from or in addition to an injury suffered by the limited liability company (a "direct injury"). Note, however, that the court has the power to treat a direct action as a derivative action under the circumstances described in A.R.S. § 29-3807.

This departure from the Prior Act and RULLCA is consistent with the principle that an operating agreement is a contract among the members, the breach of which should be enforceable by a direct action against the breaching member. The intended purpose of this departure is to overturn the result in *Rose Goodyear Properties, LLC v. NBA Enterprises Limited Partnership*, 235 Ariz. 339 (App. 2014) and *Leroy v. Seattle Funding Group of Arizona, LLC*, 2012 WL 745644 (App. Memo. 2012). In each of those cases, decided under the Prior Act, the court applied corporate law to dismiss a direct action because it determined that the plaintiff member's injury was indirect, i.e., the injury resulted from injury suffered by the limited liability company. The Drafting Subcommittee believed that the distinction between direct and indirect injury is often a close question and that dismissal of a meritorious claim may be too harsh a penalty for failure to correctly discern the distinction. The vast majority of limited liability companies are closely held by only a few members, so the policies underlying a preference for derivative actions are less weighty and the procedural requirements applicable to a derivative action may lead to unfair results. For example, after dismissing the plaintiff's direct claims in *Rose Goodyear*, the court also dismissed the derivative claims because the plaintiff had failed to properly word its demand before filing the action. Furthermore, in circumstances where the members in control of a company have injured the company through their (or their affiliate's) wrongful conduct, a derivative action that enables the controlling members to impede the litigation by appointing a special litigation committee or, worse yet, to control the ultimate award of damages payable to the company, may not lead to a just result. All of these considerations support the view that a direct action should be permitted to recover damages for indirect as well as direct injury, subject to the court's power to treat a direct action as a derivative action under A.R.S. § 29-3807.

The provisions of this section are default rules. A.R.S. § 29-3105(C)(9) expressly allows the members in their operating agreement to restrict direct actions to cases where the plaintiff can plead and prove an injury (or threatened injury) that is not solely the result of an injury to the company. The operating agreement may restrict direct and indirect actions in other respects so long as the restrictions are not unreasonable. *See* Arizona Comment to A.R.S. § 29-3105(C)(9).

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (A) – ~~A member's rights under this subsection are subject to the rule of standing stated in Subsection (b).~~The phrase "protect the member's interests" pertains to remedies and creates no additional causes of action.

The last phrase of this subsection ("or arising independently . . . ") does not create any new rights, obligations, or remedies, and is included merely to emphasize that a person's membership in an LLC does not preclude the person from enforcing rights existing "independently of the membership relationship" (e.g., as a creditor).

Subsection (B) – To override the default rule, a~~A~~n operating agreement may expressly require a member maintaining a direct action under A.R.S. § 29-3801 to plead and prove an actual or threatened injury that is not solely the result of any injury suffered or threatened to be suffered by the company. *See* A.R.S. § 29-3105(C)(9). In such cases, a member maintaining a direct action will be subject to ~~This subsection codifies~~ the rule of standing that predominates in entity law. *See, e.g.*, *PacLink Commc'ns Int'l, Inc. v. Superior Court*, 109 Cal. Rptr. 2d 436, 441 (Cal. Ct. App. 2001) (noting that, "[i]n determining whether an individual action as opposed to a derivative action lies, a court looks at 'the gravamen of the wrong alleged in the pleadings'"; holding that "[a] contextual reading of [plaintiffs'] complaint makes clear that they are not suing based upon a claim that as members of the LLC they were entitled to a distribution which was not made, but instead are suing for financial injury caused by fraudulent transfer of the company's assets") (quoting *Nelson v. Anderson*, 84 Cal. Rptr. 2d 753. (Cal. Ct. App. 1999)); *Mallia v. PaineWebber, Inc.*, 889 F. Supp. 277, 282 (S.D. Tex. 1995) ("[T]o bring a direct representative action against a general partner, a limited partner must demonstrate either direct injury or an injury that exists independently of the partnerships.'"); *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004) (expressly disapproving "both the concept of 'special injury' and the concept that a claim is necessarily derivative if it affects all stockholders equally;" stating that "a court should look to the nature of the wrong and to whom the relief should go;" requiring that any "claimed direct injury . . . be independent of any alleged injury to the [entity]"); *Tzolis v. Wolff*, 884 N.E.2d 1005, 1008 (N.Y. 2008) (holding that derivative actions exist under New York LLC law and referring to "the traditional line between direct and derivative claims"); *see also CML V, LLC v. Bax*, 6 A.3d 238, 245 (Del. Ch. 2010) (noting that issues of standing viz-a-viz direct and derivative claims are comparable regardless of whether the entity is a limited partnership, a limited liability company, or a corporation), *aff'd*, 28 A.3d 1037 (Del. 2011).

If the operating agreement restricts direct actions to cases of direct injury, t~~T~~he distinction between direct and derivative claims protects the operating agreement. If any member can sue directly over any management issue, the mere threat of suit can interfere with the members' agreed-upon arrangements.

Although in ordinary contractual situations it is axiomatic that each party to a contract has standing to sue for breach of that contract, within a limited liability company whose operating agreement restricts direct actions to cases of direct injury, different circumstances typically exist. Pursuant to such an operating agreement, a~~A~~ member does not have a direct claim against a manager or another member merely because the manager or other member has breached the operating agreement. Likewise a member's violation of this act does not automatically create a direct claim for every other member. To have standing in his, her, or its own right, a member plaintiff must be able to show a harm that occurs independently of the harm caused or threatened to be caused to the limited liability company.

EXAMPLE: Through grossly negligent conduct, in violation of A.R.S. § 29-3409(K)~~Section 409(c)~~, the manager of a manager-managed LLC reduces the net assets of an LLC by fifty percent, which in turn~~s~~ decreases the value of Member A's investment by $3,000,000. Under the default rules of A.R.S. § 29-3801, Member A may bring a direct action against the manager to recover the loss of value of the member's interest. If the operating agreement restricts a direct action to cases of direct injury, Member A has no standing to bring a direct claim; the damage is

merely derivative of the damage first suffered by the LLC. Member A may, however, bring a derivative claim. A.R.S. §§ ~~Sections~~ 29-3802–806.

EXAMPLE: Same facts, except in addition to violating A.R.S. § 29-3409(K)~~Section 409(c)~~, the manager's conduct breaches an express provision of the operating agreement to which Member A is a signatory. The analysis and the result are the same.

EXAMPLE: An operating agreement defines "distributable cash" and requires the LLC to periodically distribute that cash among all members. The LLC's manager fails to distribute the cash. Each member has a direct claim against the manager and the LLC.

~~The reference to "threatened injury" is to encompass potential claims for preventative relief, such as a temporary restraining order or preliminary injunction.~~

This section's standing rule is subject to reasonable alterations by the operating agreement. *See* the comment to Section 105(C~~c~~)(9~~11~~).

A.R.S. § 29-3802. DERIVATIVE ACTION.

Arizona Comment
(Rev. 2/23/2024)

Paragraph (1) – This section departs from RULLCA to allow a member to initiate a derivative action on the expiration of 90 days after demand is made upon the other members or managers, as applicable. Expiration of the 90-day waiting period is not required if the demand is rejected by the company, or if the statute of limitations will expire within the 90-day period, or irreparable injury to the company would occur prior to the expiration of the 90-day period. In contrast, Section 802 of RULLCA allows the filing of a derivative action after a "reasonable time" has elapsed following demand.

Modified RULLCA Comment
(Rev. 2/23/2024)

Paragraph (1) – The demand requirement recognizes that, presumptively at least, the decision to cause a limited liability company to bring suit is a business decision, to be made by those who manage the business. Deborah A. DeMott, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE § 5.9 (Westlaw, November 4, 2012) (Demand on directors—Rationales for demand).

Paragraph (2) – Some jurisdictions have a "universal demand" requirement, but the approach stated here is by far the majority one. Deborah A. DeMott, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE § 5.12 (Westlaw, November 4, 2012).

A.R.S. § 29-3803. PROPER PLAINTIFF

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as Section 803 of RULLCA.

Modified RULLCA Comment
(Rev. 2/23/2024)

The rule stated here is conventional in both the law of unincorporated entities and corporate law. Persons dissociated as members have no standing to bring a derivative action. *A fortiori*, mere transferees have no standing. *See* the comments to ~~Sections~~ A.R.S. §§ 29-3107(B~~b~~) and 502.

Paragraph (2)—This paragraph will be inapposite if the limited liability company has only two members, one of whom is the derivative plaintiff. In that limited circumstance, the plaintiff's death would cause the derivative action to abate. The "pick your partner" principal enshrined in ~~Section~~ A.R.S. § 29-3502 would prevent the decedent's heirs from succeeding to plaintiff status in the derivative action (except in the unlikely event that the remaining member consents to the heirs becoming members). The analysis and result will be the same if the derivative plaintiff is an entity whose existence terminates.

This act takes no position on whether:

- the death of member abates a direct claim against the LLC or a fellow member; and
- bringing a direct claim precludes a person from being a proper plaintiff for a derivative claim.

As to the latter issue, *see*, *e.g*., *Cordts-Auth v. Crunk, L.L.C.*, 815 F. Supp. 2d 778, 793–94 (S.D.N.Y. 2011) (discussing the potential conflict of interest), *aff'd*, 479 F. App'x 375 (2d Cir. 2012).

A.R.S. § 29-3804. PLEADING.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as Section 804 of RULLCA.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section parallels ~~Section~~ A.R.S. § 29-3802. The pleading requirement first appeared in a uniform act in 1976. ULPA (1976) § 1003.

A.R.S. § 29-3805. SPECIAL LITIGATION COMMITTEE.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as Section 805 of RULLCA with the following two exceptions:

Subsection (A) – The Arizona departures from RULLCA require the court to stay the entire derivative proceeding, not just discovery, pending the decision of, and the taking of specified action by, the special litigation committee.

Subsection (C)(1) – Consistent with other Arizona departures from RULLCA regarding weighted voting by majority in interest of the members, in a member-managed liability company the appointment of a special litigation committee must be approved by a majority in interest of the members not named as parties in the proceeding, rather than a "per capita" majority of such members.

Modified RULLCA Comment
(Rev. 2/23/2024)

Although special litigation committees are best known in the corporate field, they are no more inherently corporate than derivative litigation or the notion that an organization is a person distinct from its owners. An "SLC" can serve as an ADR mechanism, help protect an agreed upon arrangement from strike suits, protect the interests of members who are neither plaintiffs nor defendants (if any), and bring the benefits of a specially tailored business judgment to any judicial decision.

This section's approach corresponds to established law in most jurisdictions, modified to fit the typical governance structures of a limited liability company. Use of an SLC is optional. An operating agreement can preclude the use of SLCs, rendering this section inapplicable, but cannot otherwise vary this section. *See* ~~Section~~ A.R.S. § 29-3105(~~c~~C)(10~~2~~).

Subsection (A~~a~~)(1) – ~~Section~~ A.R.S. § 29-3410 pertains to information rights. On the availability of remedies pending the SLC's investigation, compare ~~Section~~ A.R.S. § 29-3410, with *Kaufman v. Computer Assocs. Int'l, Inc., No. Civ.A*. 699-N, 2005 WL 3470589, at *1 (Del. Ch. Dec. 21, 2005) (presenting "the question of whether to stay a books and records action under 8 Del. C. § 220 at the request of a special litigation committee when a derivative action encompassing substantially the same allegations of wrongdoing filed by different plaintiffs is pending in another jurisdiction"; concluding "[f]or reasons that have much to do with the light burden imposed by the plaintiff's demand in this case . . . that the special litigation committee's motion to stay the books and records action should be denied").

Subsection (E~~e~~) – The standard stated for judicial review of the SLC determination follows *Auerbach v. Bennett*, 393 N.E.2d 994 (N.Y. 1979) rather than *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), because the latter's reference to a court's business judgment has generally not been followed in other states. In essence, an SLC is intended to function as a surrogate decision-maker, allowing the limited liability company to make what is fundamentally a business decision. If a court determines that "the members of the committee were disinterested and independent and whether the committee conducted its investigation and made its recommendation in good faith, independently, and with reasonable care, with the committee having the burden of proof," it makes no sense to substitute the court's legal judgment for the business judgment of the SLC.

Houle v. Low, 556 N.E.2d 51, 58 (Mass. 1990) contains an excellent explanation of the court's role in reviewing an SLC decision:

> The value of a special litigation committee is coextensive with the extent to which that committee truly exercises business judgment. In order to ensure that special litigation committees do act for the [entity]'s best interest, a good deal of judicial oversight is necessary in each case. At the same time, however, courts must be careful not to usurp the committee's valuable role in exercising business judgment. . . . [A] special litigation committee must be independent, unbiased, and act in good faith. Moreover, such a committee must conduct a thorough and careful analysis regarding the plaintiff's derivative suit. . . . The burden of proving that these procedural requirements have been met must rest, in all fairness, on the party capable of making that proof—the [entity].

For an extensive discussion of how a court should approach the question of independence, *see Einhorn v. Culea*, 612 N.W.2d 78, 91 (Wis. 2000).

A.R.S. § 29-3806. PROCEEDS AND EXPENSES.

Arizona Comment
(Rev. 2/23/2024)

This section is substantively the same as Section 806 of RULLCA except for the addition of subsection (C), which allows the court to award reasonable attorney's fees and costs to the defendants if the court determines that a derivative action was brought without reasonable cause. RULLCA subsection (c) is now A.R.S. § 29-3806(D).

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (D~~c~~)—This provision is intended to prevent collusion.

A.R.S. § 29-3807. OTHER REMEDIES IN DIRECT AND DERIVATIVE ACTIONS.

Arizona Comment
(Rev. 2/23/2024)

A.R.S. § 29-3807 is not found in RULLCA or the Prior Act. Subsection (1) grants the court discretion to treat a direct action as a derivative action and to order recovery to be paid to the limited liability company if necessary (a) to avoid a multiplicity of actions, (b) to protect the interests of the company's creditors, or (c) to ensure a fair distribution of any recovery among interested persons. Similarly, subsection (2) grants the court the discretion to treat a derivative action as a direct action and order recovery to be paid to the plaintiff if the court finds that justice so requires. For example, if a court determines in a derivative action that the plaintiff's pre-litigation demand was defective, the court may treat the action as a direct action to avoid delay or dismissal of the action in a case where the statute of limitations has already expired. The court's discretion in any case would be subject to the limitations of subsection (1) applicable to direct actions.

Subsection (1) is derived from Principles of the Law of Corporate Governance: Direct and Derivative Actions Distinguished § 7.01(d) (Am. L. Inst. 1994). In cases where the plaintiff brings a direct action to recover damages for indirect injury under A.R.S. § 29-3801, it empowers the court to protect the interests of the defendant, third party creditors, and other members of the company that are not involved in the litigation under the circumstances described in subsection (1)(a), (b), or (c). In those cases, the court may order that damages be paid to the company as would be appropriate in a derivative action, instead of being paid to the plaintiff in a direct action. The Drafting Subcommittee determined that these protective provisions were useful to balance the right of a minority member to bring a direct action under A.R.S. § 29-3801 to recover damages solely for indirect injury against the rights of the defendant, third party creditors, and other members.

ARTICLE 9
FOREIGN LIMITED LIABILITY COMPANIES

A.R.S. § 29-3901. GOVERNING LAW.

Arizona Comment
(Rev. 2/23/2024)

This section is substantially the same as RULLCA Section 901, except for rules related to foreign series doing business in Arizona and the comparative rights and privileges of foreign limited liability companies and domestic limited liability companies, with respect to transactions in Arizona and relationships with persons in Arizona. A series limited liability company contains internal liability shields (sometimes referred to as "horizontal shields"), *i.e.,* asset partitions limiting creditors of that series to the assets of the series, and not assets of the limited liability company or other series generally. This new internal liability shield for series is different than the traditional liability shield protecting the owners of an entity from liability for the debts of the entity. That traditional liability shield is preserved in the Act in A.R.S. § 29-3304.

Like RULLCA, the Act does not allow the creation of series in limited liability companies formed in Arizona. However, the Act departs from RULLCA in its treatment of foreign series. Since the Drafting Subcommittee decided not to authorize domestic series in the Act, it also does not respect the internal liability shields among foreign series, with respect to transactions in Arizona and relationships with persons in Arizona. The reason for this is that the Act does not afford to foreign limited liability companies the privilege of internal liability shields not available to domestic limited liability companies. This result aligns with the principle under the Prior Act that Arizona's entity laws should not authorize foreign entities to have rights and privileges that are more expansive than domestic entities.

The Drafting Subcommittee concluded that creation of domestic series with internal liability shields would raise multiple problems, such as lack of public record of their identity and their assets. Also, legal uncertainties arise from the fact that series are treated as distinct legal persons for some purposes and not others.

All of the company records relating to which assets, liabilities, and businesses have been allocated among the various series within a foreign limited liability company are internally maintained by the company and are not transparent to third parties in public records. Accordingly, victims of business fraud or other torts and trade vendors will typically have no information to identify any of the series that exist within a limited liability company, to identify the assets held by each series, or to determine whether any series is solvent or undercapitalized. Judgments against a series may be difficult or impossible to enforce if assets of the series cannot be identified in public records or in records of third parties. Also, series as quasi-distinct legal persons would lead to many issues, including uncertainties in applying the law of licensing issued by governmental authorities, fraudulent transfers, and bankruptcy. For example, domestic series may be able to circumvent state licensing requirements of disclosure and qualifications, as in the case where a bond is required and there are insufficient public records to establish its association with a particular series, which could cause the same bond to be subject to claimants of multiple series. As another example, if series are not separate legal entities and therefore not "persons" under the Arizona Fraudulent Transfer Act, it is unclear whether the Arizona Fraudulent Transfer Act would prevent one insolvent series from transferring assets to another series. Similar legal uncertainties would exist under bankruptcy laws.

As an alternative to the use of foreign series, practitioners may consider forming a subsidiary of the foreign series and registering that subsidiary to do business in Arizona, rather than registering the

foreign series.

Subsection (A) —Subsection (A) is substantially the same as Section 901(a) of RULLCA except that it does not provide that the law of the jurisdiction of formation of a foreign limited liability company governs the liability of a series of the company, as stated in Section 901(a)(3) of RULLCA. The Act will not respect the internal liability shields created under the series provisions of another jurisdiction's limited liability company statute, pursuant to A.R.S. § 29-3901(D), with respect to transactions in Arizona and relationships with persons in Arizona.

Subsection (D) — This subsection retains the limitation found in the Prior Act at A.R.S. § 29-801(B), which states that, with respect to transactions in Arizona and relationships with persons in Arizona who are not managers or members, the law of the jurisdiction of formation of a foreign limited liability company shall provide no greater "rights and privileges" than those afforded to a domestic limited liability company. For example, domestic limited liability companies are prohibited under A.R.S. § 29-3108 from engaging in the business of banking or acting as an insurer (with specified exceptions). Likewise, foreign limited liability companies doing business in Arizona are subject to the same restrictions.

Additionally, the Act does not support the internal liability shields created under the laws of any foreign jurisdiction. Thus, foreign series, and the designating foreign company of those foreign series, are each liable for the debts, obligations, and liabilities of one another that arise out of transactions in Arizona or relationships with persons in Arizona.

Nothing in this subsection is intended to subject members of a series to liability for the debts, obligations, and liabilities of the series. "Piercing the veil" of the "vertical" liability shield between the series and its members is a matter to be determined under the law of the jurisdiction of formation of a foreign limited liability company, as stated in Subsection (A)(2).

Modified RULLCA Comment

(Rev. 2/23/2024)

Subsection (A~~a~~)—This subsection provides that the laws of the jurisdiction of formation of a foreign limited liability company, rather than the laws of Arizona~~this state~~, govern both the internal affairs of the foreign LLC and the liability of its members and managers for the obligations of the LLC. An operating agreement cannot change this provision. A.R.S § 29-3105(C)(12).~~Section 105(c)(15).~~

This subdivision parallels A.R.S. § 29-3104 ~~Section 104~~ (pertaining to the governing law for domestic LLCs). *See* the comment to A.R.S. § 29-3104~~Section 104~~.

~~**Subsection (a)(3)**—~~The LLC statutes of several states authorize limited liability companies to have asset-partitioning series. According to those statutes, if series are properly created, a debt, obligation, or liability associated with the property of a particular series is enforceable only against property of that series, and not against the property of the LLC generally or any other series thereof.

This ~~a~~Act does not provide for the creation of asset-partitioning series. ~~However, under this provision, the law of this state will respect the "internal shields" created under the series provisions of another jurisdiction's limited liability company statute.~~ This provision does *not* address the myriad of other unsettled issues pertaining to series.

~~For an explanation of how the asset-partitioning concept of series differs from the traditional concept, *see* Section 1031, comment.~~

Subsections (Bb) and (Cc)—These sections together make clear that, although a foreign limited liability company may not be denied registration simply because of a difference between the laws of its jurisdiction of formation and the laws of Arizonathis state, the foreign limited liability company "may not engage in any activity or exercise any power that a limited liability company may not engage in or exercise in Arizonathis state." A.R.S. § 29-3901(C).Subsection (c).

A.R.S § 29-3902. REGISTRATION TO DO BUSINESS IN THIS STATE.

Arizona Comment
(Rev. 2/23/2024)

This section is substantially the same as RULLCA Section 902 except that it specifically requires that foreign series register to do business in Arizona. Regarding the treatment of internal liability shields of foreign series, *see* A.R.S. § 29-3901.

Modified RULLCA Comment
(Rev. 2/23/2024)

Subsection (Aa)—Following a long-established tradition, this aAct does not state what constitutes "do[ing] business in this state." Instead, A.R.S. § 29-3905Section 905 provides a non-exhaustive list of "[a]ctivities of a foreign limited liability company which do not constitute doing business in this state."

Subsection (Bb)—The purpose of this subsection is to induce foreign limited liability companies to register without imposing harsh or erratic sanctions. Often the failure to register is a result of inadvertence or bona fide disagreement as to the scope of A.R.S. § 29-3905Section 905, which is necessarily imprecise. Thus, the imposition of harsh sanctions in those situations is inappropriate. The sanction of closing the courts of the state to suits brought by foreign LLCs that should have registered is not a punitive one. If a foreign LLC should have registered and failed to do so, it may still enforce its contractual and other rights simply by registering.

However, if a court dismisses a case under this subsection rather than staying the proceedings pending the foreign LLC's registration, a statute of limitations problem may occur. *See Corco, Inc. v. Ledar Transport, Inc.* 946 P.2d 1009, 1010 (Kan. Ct. App. 1997) ("[T]he proper remedy was to dismiss [the unregistered entity's] counterclaim without prejudice rather than with prejudice. This would leave [the entity] the opportunity to comply with the statutes and then reassert its claim against [the defendant]. On the other hand, it would also leave the risk that the statute of limitations might run against [the entity].").

This subsection does not prevent a foreign LLC that has failed to register from "defending" an action or proceeding. The distinction between "maintaining" an action or proceeding under this subsection and "defending" an action or proceeding under A.R.S. § 29-3902(C) Subsection (c) is determined on the basis of whether affirmative relief is sought. A nonregistered foreign LLC may interpose any defense or permissive or mandatory counterclaim to defeat a claimed recovery, but may not obtain an affirmative judgment based on the counterclaim without first registering.

Subsection (Cc)—In addition to permitting a non-registered foreign LLC doing business in Arizonathis state to defend (but not maintain) an action or proceeding, this section makes clear that failure to register does not impair the validity of a foreign LLC's acts.

Subsection (Dd)—This subsection preserves the effectiveness of a foreign LLC's liability shield

applicable under the LLC's governing law. The effectiveness of a liability shield of a foreign series, however, is subject to A.R.S. § 29-3901(D).

A.R.S. § 29-3903. FOREIGN REGISTRATION STATEMENT.

Arizona Comment
(Rev. 2/23/2024)

Subsection (A) — The Act requires additional information beyond those categories contemplated by RULLCA in connection with foreign registration statements, information which aligns with A.R.S. § 29-3201 to form domestic limited liability companies, including designation of whether management of the company is vested in its members or managers and the name and address of each member if the company is member-managed or, if manager-managed, the name of each member who owns a twenty percent or greater interest in the capital or profits of the company.

Subsection (B) — Foreign series must disclose on a foreign registration statement that the registrant is a foreign series and must provide all of the information required under Subsection (A). Additionally, foreign series must disclose the same information relating to the designating foreign company of the foreign series, other than its principal address and statutory agent.

Subsection (C) — In addition to the information required in foreign registration statements, the registrant must submit to the commission a certified copy of its organizational documents and certain proof of its existence in the foreign state or country.

Modified RULLCA Comment
(Rev. 2/23/2024)

The foreign registration statement provides certain basic information about the foreign limited liability company to ensure that citizens of the state have access to that information in their dealings with the foreign limited liability company. The statement also facilitates making the foreign company subject to the jurisdiction of the courts of the state.

~~Once registered, a foreign limited liability company must file an annual/biennial report. Section 212.~~

A.R.S. § 29-3904. AMENDMENT OF FOREIGN REGISTRATION STATEMENT.

Arizona Comment
(Rev. 2/23/2024)

This section is substantially the same as RULLCA Section 904, but it requires a registrant to file an amendment or statement of change if there is any change to the information provided under A.R.S. § 29-3903, which includes those additional categories of information required under the Act. Unlike RULLCA, but consistent with the Prior Act, annual or biennial reports are not required, but registrants are required to file amendments pursuant to A.R.S. § 29-3904 or statements of change pursuant to A.R.S. § 29-3116. Failure to properly update a foreign registration statement may lead to termination of registration pursuant to A.R.S. § 29-3910(A)(5).

Modified RULLCA Comment
(Rev. 2/23/2024)

This section works ~~in tandem with the annual/biennial report required by Section 212~~ to keep up to date the information of record in the office of the filing office about a registered foreign limited liability company.

A.R.S. § 29-3905. ACTIVITIES NOT CONSTITUTING DOING BUSINESS.

Arizona Comment
(Rev. 2/23/2024)

This section is substantially identical to RULLCA Section 905, adding appropriate references to foreign series.

Modified RULLCA Comment
(Rev. 2/23/2024)

This ~~a~~Act does not attempt to formulate an inclusive definition of what constitutes doing business in a state. Rather, the concept is defined in a negative fashion by A.R.S. § 29-3905(A) and (B)~~Subsections (a) and (b)~~, which state that certain activities do not constitute doing business.

In general terms, any conduct more regular, systematic, or extensive than that described in A.R.S. § 29-3905(A)~~Subsection (a)~~ constitutes doing business and requires the foreign limited liability company to register to do business. Typical conduct requiring registration includes maintaining an office to conduct local intrastate business, selling personal property not in interstate commerce, entering into contracts relating to the local business or sales, and owning or using real estate for general purposes. But the passive owning of real estate for investment purposes does not constitute doing business. *See* A.R.S. § 29-3905(A)(10)~~Subsection (a)(10)~~.

The test of "doing business" defined in a negative way in A.R.S. § 29-3905(A) and (B)~~Subsections (a) and (b)~~ applies only to the question whether a foreign limited liability company's contacts with the state are such that it must register under this section. The test is not applicable to other questions such as whether the foreign LLC is amenable to service of process under state "long-arm" statutes or liable for state or local taxes. Whether ~~A~~a foreign LLC that has registered (or is required to register) will generally be subject to suit and state taxation in the state is beyond the scope of the Act.~~, while a~~A foreign LLC that is subject to service of process or state taxation in a state will not necessarily be required to register.

Subsection (A~~a~~)—The list of activities set forth in this subsection is not exhaustive.

Subsection (A~~a~~)(1)—A foreign limited liability company is not "doing business" solely because it resorts to the courts of the state to recover an indebtedness, enforce an obligation, recover possession of personal property, obtain the appointment of a receiver, intervene in a pending proceeding, bring a petition to compel arbitration, file an appeal bond, or pursue appellate remedies. Similarly, a foreign LLC is not required to register merely because it files a complaint with a governmental agency or participates in an administrative proceeding within the state.

Subsection (A~~a~~)(2)—A foreign limited liability company does not "do business" within a state under this section merely because some of its internal affairs occur within a state. Thus, a foreign LLC may hold meetings of its managers or members within a state without first registering. A foreign LLC also

may maintain offices or agencies within a state relating solely to the transfer, exchange or registration of its interests without registering. Other activities relating to the internal affairs of the foreign LLC that do not constitute doing business under this section include having officers or representatives who reside within or are physically present in the state; while there, the officers or representatives may make executive decisions relating to the internal affairs of the foreign LLC without imposing on the foreign LLC the requirement that it register, if these activities are not so regular and systematic as to cause the residence to be viewed as a business office.

Subsection (A~~a~~)(5)—Under this paragraph, a foreign limited liability company need not register if it sells goods in the state through independent contractors. These transactions are viewed as transactions by the independent contractors, not by the foreign LLC itself even though the foreign LLC sets some limits or ground rules for its contractors. If these controls are sufficiently pervasive, however, the foreign LLC may be deemed to be selling for itself in intrastate commerce, and not through the independent contractors and therefore engaged in doing business in the state.

Subsection (A~~a~~)(7) and (8)—The mere act of making a loan by a foreign limited liability company that is not in the business of making loans does not constitute doing business in the state in which the loan is made. On the same theory, a foreign LLC may obtain security for the repayment of a loan, and foreclose or enforce the lien or security interest to collect the loan, without being deemed to be doing business. Similarly, a refunding or "roll over" of a loan or its adjustment or compromise does not involve doing business.

Subsection (A~~a~~)(9)—The concept of "doing business" involves regular, repeated, and continuing business contacts of a local nature. A single agreement or isolated transaction within a state does not constitute doing business if there is no intention to repeat the transaction or engage in similar transactions. This act does not impose the limitation found in some statutes, such as section 15.01(b)(10) of the Model Business Corporation Act, that the isolated transaction be completed within thirty days. A foreign LLC should not be required to register simply because it engages in an isolated transaction that takes longer than thirty days to complete.

Subsection (A~~a~~)(11)—A foreign limited liability company is not "doing business" within the meaning of this section if it is transacting business in interstate commerce. *See* A.R.S. § 29-3905(A)(6)~~Subsection (a)(6)~~ (stating that soliciting or obtaining orders that must be accepted outside the state before they become contracts is not "doing business" within the meaning of this section).

These exclusions reflect the provisions of the United States Constitution that grant to the United States Congress exclusive power over interstate commerce, and preclude states from imposing restrictions or conditions upon this commerce. This subsection should be construed in a manner consistent with judicial decisions under the United States Constitution. Under those decisions, a foreign entity is not required to register even though it sells goods within the state if they are shipped to the purchasers in interstate commerce. Thus, a foreign LLC need not register even if it also does work and performs acts within the state incidental to the interstate business (*e.g.*, if it takes or enforces a security interest incidental to these transactions). Nor is it required to register merely because it sends traveling salespeople or solicitors into a state so long as contracts are not made within the state. Similarly, an office may be maintained by a foreign LLC in Arizona~~this state~~ without registering if the office's functions relate solely to interstate commerce. Purchases of goods may of course be in interstate commerce as readily as sales. Thus, the purchase of personal property in Arizona~~this state~~ by a foreign limited liability company for shipment in interstate commerce out of the state does not require the entity to register.

A.R.S. § 29-3906. NONCOMPLYING NAME OF FOREIGN LIMITED LIABILITY COMPANY.

Arizona Comment
(Rev. 2/23/2024)

This section is substantially the same as RULLCA Section 906, adding appropriate references to foreign series. The Act deletes the provision in RULLCA that would permit noncompliance with the state's fictitious name statute if the foreign limited liability company adopted an alternate name.

Modified RULLCA Comment
(Rev. 2/23/2024)

A foreign limited liability company must register under its true name if that name satisfies the requirements of A.R.S. § 29-3112~~Section 112~~. If the true name is unavailable because it is not distinguishable upon the records of the filing office from a name already in use or reserved or registered, the foreign LLC may use an alternate name.

A foreign limited liability company that registers to do business in the state may do business under a fictitious name to the same extent as a domestic entity.

A.R.S. § 29-3907. RESERVED.

Arizona Comment
(Rev. 2/23/2024)

RULLCA Section 907 was omitted from Article 9 of the Act, as it concerns the withdrawal of a foreign limited liability company upon conversion to a domestic limited liability partnership or to a domestic entity whose formation requires the public filing of a record, which is addressed by the Arizona Entity Restructuring Act at A.R.S. § 29-2406(F).

Modified RULLCA Comment
(Rev. 2/23/2024)

~~When a registered foreign limited liability company has converted to a domestic "filing entity" or domestic limited liability partnership, information about the entity in its capacity as a domestic entity will continue to be of record in the filing office. At that point, there is no further reason for the entity to be registered as a foreign LLC, and this section automatically treats its prior registration as withdrawn.~~

A.R.S. § 29-3908. WITHDRAWAL ON DISSOLUTION.

Arizona Comment
(Rev. 2/23/2024)

This section is substantially the same as RULLCA Section 908 relating to withdrawal on dissolution. Those provisions concerning withdrawal on conversion to a domestic or foreign entity whose formation does not require the public filing of a record were omitted because the topic is addressed by the Arizona Entity Restructuring Act at A.R.S. § 29-2406(F). This section also adds appropriate references to foreign series.

Modified RULLCA Comment
(Rev. 2/23/2024)

When a registered foreign limited liability company has dissolved and completed winding up, ~~or has converted to a "nonfiling entity" other than a limited liability partnership,~~ there is no further reason for information about the entity to appear in the records of the filing office. This section thus requires delivery of a statement of withdrawal for the purpose of removing the foreign LLC from the rolls of registered foreign entities.

~~**Subsection (a)** – The exclusion of limited liability partnerships from this provision is merely technical; Section 907 covers conversion to a domestic LLP.~~

A.R.S. § 29-3909. RESERVED.

Arizona Comment
(Rev. 2/23/2024)

RULLCA Section 909 was omitted from Article 9 of this Act, as it concerns transfer of registration in connection with a merger or conversion. RULLCA allows for the merging or converting foreign limited liability company to apply for the transfer of its foreign registration to the surviving entity, while the Arizona Entity Restructuring Act does not, e.g. A.R.S. § 29-2206(F) ("When a merger becomes effective, the authority, registration or other qualification granted by the appropriate filing authority to transact business or conduct affairs in this state of any foreign merging entity that is not the surviving entity is automatically revoked or canceled."); A.R.S. § 29-2406(F) ("When the conversion becomes effective, the authority, registration or other qualification granted by the appropriate filing authority to transact business or conduct affairs in this state of a converting entity that is a qualified foreign entity is automatically revoked or cancelled.") Such surviving entities that are not registered to do business in Arizona must comply with A.R.S. § 29-3902 and submit a foreign registration pursuant to A.R.S. § 29-3903.

Modified RULLCA Comment
(Rev. 2/23/2024)

~~The purpose of this section is to clarify the status of the foreign limited liability company in the public records of the state. A filing under this section has the two-fold effect of canceling the authority of the foreign LLC to do business in the state while at the same time reregistering the former foreign LLC as the new type of foreign entity. If the reregistered foreign entity subsequently wishes to cancel its registration to do business in the state, it may do so under the statute of this state pertaining to the registration of the new type of foreign entity.~~

A.R.S. § 29-3910. TERMINATION OF REGISTRATION.

Arizona Comment
(Rev. 2/23/2024)

This section authorizes the commission to terminate the registration of a foreign limited liability company or foreign series under certain circumstances and details the procedure. This section differs from RULLCA Section 910 with respect to the grounds for termination. This section omits the grounds for termination pursuant to RULLCA Section 910 for failure to deliver an annual report. This section adds grounds for termination for failure to have a principal address for at least sixty consecutive days, failure to notify the commission within sixty days after its statutory agent or principal address has changed or

within sixty days after its statutory agent has resigned, failure to amend its foreign registration statement as required by A.R.S. § 29-3904, and for failure to respond to interrogatories as prescribed in A.R.S. § 29-3212.

This section was also revised, as compared to RULLCA Section 910, to allow the commission to terminate foreign registrations upon receipt of a duly authenticated certificate stating that the foreign limited liability company or foreign series has ceased to exist.

Modified RULLA Comment
(Rev. 2/23/2024)

This section is analogous to the procedures for administrative dissolution under A.R.S. § 29-3708~~Section 708~~.

A.R.S. § 29-3911. WITHDRAWAL OF REGISTRATION OF REGISTERED FOREIGN LIMITED LIABILITY COMPANY.

Arizona Comment
(Rev. 2/23/2024)

This section is substantially the same as RULLCA Section 911, adding appropriate references to foreign series.

Modified RULLCA Comment
(Rev. 2/23/2024)

The statement of withdrawal must set forth an address where service of process may be made on the foreign limited liability company pursuant to A.R.S. § 29-3119~~Section 119~~. There is no limit on how long the withdrawn company must keep that address up to date.

A.R.S. § 29-3912. ACTION BY ATTORNEY GENERAL.

Arizona Comment
(Rev. 2/23/2024)

This section is substantially the same as RULLCA Section 912.

Modified RULLCA Comment
(Rev. 2/23/2024)

The authority stated here has been part of corporate law for more than a century and has been carried over into the law of unincorporated business entities. Nowadays, the authority is rarely if ever invoked in either realm of entity law.

ARTICLE 10
MERGER, INTEREST EXCHANGE, CONVERSION, DOMESTICATION AND DIVISION

Introductory Arizona Comment

(Rev. 2/23/2024)

In addition to drafting RULLCA, the Uniform Law Commission – in cooperation with the American Bar Association – drafted the Model Entity Transactions Act ("META"). A modified version of META, called the Arizona Entity Restructuring Act ("AERA"), located at A.R.S. § 29-2101 to 29-2703, was enacted in 2014 and deals comprehensively with entity-level transaction.

Under AERA, "entity-level" transactions are mergers, interest exchanges, conversions, domestications, and divisions.

- In a merger, two or more entities combine into one entity, referred to as the "surviving entity." The other participating entities cease to exist.

- In an interest exchange, one entity acquires all of one or more classes of interests in another entity.

- In a conversion, an entity of one type converts into an entity of a different type. For example, a limited liability company becomes a nonprofit corporation. Conversions include transactions in which the entity not only changes its type, but also its domicile. For example, an Arizona limited liability company becomes a Texas nonprofit corporation, or vice versa.

- In a domestication, an entity changes the jurisdiction under which it is organized. The entity does not change its type. For example, an Arizona limited liability company becomes a Texas limited liability company, or vice versa.

- In a division, an entity divides into two or more entities. The original entity might or might not continue as one of the resulting entities.

AERA sets forth the basic procedures and requirements for accomplishing each kind of transaction. These include the preparation of a transaction plan, the plan's approval by constituents as required by each participating entity's governing statute, and the filing of a transaction statement with the Commission or the Arizona Secretary of State, as applicable.

AERA (like META) is a stand-alone statute that governs entity-level transactions involving multiple types of domestic and foreign legal entities, not just limited liability companies. RULLCA was prepared on the assumption that META had not previously been adopted by the enacting state. Accordingly, RULLCA contains an Article 10 that is essentially a restatement of the parts of META applicable to mergers and other transactions by limited liability companies. Given that Arizona has adopted AERA, it is not necessary for the Act to contain those provisions. As a result, Article 10 of RULLCA was replaced with provisions to make appropriate references to AERA.

In adopting AERA, Arizona used a uniform approach in conforming the various statutes governing corporations, partnerships, limited liability companies, business trusts, and other types of entities. The Prior Act and each of the other entity statutes were amended to (a) harmonize certain definitions, (b) authorize a type of entity to engage in mergers and other transactions by means of compliance with the procedures set forth in AERA, (c) set forth the approvals that must be obtained

from the interest holders for that type of entity, such as members of a limited liability company, and (d) conform other provisions peculiar to certain entities, such as corporate shareholders' dissenters' rights.

Article 10 of the Act retains this approach. Because Article 10 of RULLCA was replaced in its entirety, the RULLCA comments to Article 10 are inapplicable and thus no Modified RULLCA Comments appear below.

A.R.S. § 29-4001. DEFINITIONS.

Arizona Comment
(Rev. 2/23/2024)

This section carries forward the corresponding provision of the Prior Act (A.R.S. § 29-751). The section harmonizes the Act's definitions with AERA's definitions regarding mergers, interest exchanges, conversions, domestications, and divisions. Many of the terms used in Article 10 are defined in AERA at A.R.S. § 29-2101.

A.R.S. § 29-4002. APPRAISAL RIGHTS.

Arizona Comment
(Rev. 2/23/2024)

This section is based on RULLCA Section 1006. In connection with a merger, interest exchange, conversion, domestication, or division, the only appraisal rights — sometimes referred to as "dissenters' rights" — contemplated by the Act are the contractual rights, if any, set forth in the company's operating agreement or in the entity-level transaction's plan. The operating agreement and the plan do not need to provide for appraisal rights.

As in RULLCA, there are no statutory appraisal rights arising under the Act's default rules. Accordingly, if neither the operating agreement nor the plan provides for appraisal rights, an interest holder does not have appraisal rights in connection with an entity-level transaction governed by Article 10 and AERA. Note, however, that the Act's default rules require that the plan for an entity-level transaction be subject to approval by unanimous vote of the members. *See* A.R.S. § 29-4004.

In this respect, the Act differs from the rights held by corporate shareholders under the Arizona Business Corporation Act, which is based in large part on the American Bar Association's Model Business Corporation Act (1984 version). The Arizona Business Corporation Act grants dissenters' rights to corporate shareholders in connection with certain transactions involving a domestic corporation. *See* A.R.S. §10-1302. Dissenters' rights are very important in the corporate context, as entity-level transactions are not subject to unanimous approval by the shareholders.

A.R.S. § 29-4003. ENTITY RESTRUCTURING TRANSACTIONS.

Arizona Comment
(Rev. 2/23/2024)

This provision carries forward the corresponding prior provision of the Prior Act (A.R.S. § 29-752), which was enacted in 2014 in connection with the enactment of AERA.

Subsection (A) empowers a domestic limited liability company to participate in a merger, interest exchange, conversion, domestication, or division. It also provides that the transaction must comply with AERA.

Subsection (B) provides that the effective time and date and the effect of the transaction are governed by AERA.

Subsection (C) clarifies that a limited liability company may acquire interests in another entity by a variety of means. In other words, an interest exchange under AERA is not the only means by which a limited liability company may acquire interests in another entity. For example, it may simply purchase the outstanding interests of another entity from the holder(s) who agree to sell those interests, without complying with AERA.

A.R.S. § 29-4004. ACTION ON PLAN.

Arizona Comment
(Rev. 2/23/2024)

This provision is based on the corresponding provision of the Prior Act (A.R.S. § 29-753), which was enacted in 2014 in connection with the enactment of AERA, as well as RULLCA Sections 1023(a)(1), 1033(a)(1), 1043(a)(1), and 1053(a)(1), dealing with approval of mergers, interest exchanges, conversions, and domestications, respectively.

Pursuant to this section, a plan is subject to approval by all the members of the company entitled to vote on or consent to any matter. Unanimity has been the default rule under both the Prior Act and under RULLCA. A.R.S. § 29-3105 does not restrict the members from modifying this requirement in their operating agreement. However, if the approval requirement is relaxed to require anything less than unanimity, consideration should be given to adding dissenters' rights to the operating agreement to protect the interests of minority owners.

A.R.S. § 29-4005. STATEMENT OF MERGER OR OTHER TRANSACTION; PUBLICATION OR POSTING.

Arizona Comment
(Rev. 2/23/2024)

This provision carries forward the corresponding provision of the Prior Act (A.R.S. § 29-754).

Subsection (A) clarifies that the statement of merger, conversion, domestication, or division filed with the Commission serves as "articles of termination" for a domestic limited liability company that is not the surviving or resulting business entity in such a transaction.

Subsection (B) addresses publication or posting of a statement of merger. *See* the Arizona Comment to A.R.S. § 29-3202(H) for further explanation of the publication requirement.

ARTICLE 11
PROFESSIONAL LIMITED LIABILITY COMPANIES

Introductory Arizona Comment
(Rev. 2/23/2024)

RULLCA does not contain a separate Article for professional limited liability companies. Rather, the drafters of RULLCA rely on each state to prepare provisions of its limited liability company act applicable to professional limited liability companies. Therefore, there are no RULLCA comments to Article 11 and thus no Modified RULLCA Comments appear below.

In the past, if attorneys or other professionals wished to practice through a corporation or limited liability company, they were required by their regulatory boards to use professional corporations or professional limited liability companies rather than regular corporation or limited liability companies. Nearly all boards have now removed this requirement, and physicians, attorneys, accountants, and most other professionals may now practice through regular limited liability companies. Thus, use of a professional limited liability company is now largely optional. The Act therefore removes or relaxes most of the special requirements and limitations that applied to professional limited liability companies under the Prior Act. With limited exceptions, professional limited liability companies are now subject to the same rules as regular limited liability companies. However, it is still possible that certain regulatory boards require the use of a professional limited liability company rather than a regular limited liability company, and so practitioners should be sure to check the applicable laws and regulations before deciding which type of entity to form.

A.R.S. § 29-4101. DEFINITIONS.

Arizona Comment
(Rev. 2/23/2024)

The Prior Act defined a "licensed person" as an individual who is duly licensed by at least one licensing authority to provide at least one of the categories of professional services rendered by the professional limited liability company. The Act changes "individual" to "person" and therefore includes entities within the definition of licensed person. The Prior Act also provided that a licensed person included a professional corporation or professional limited liability companies if certain requirements were satisfied. Since the Act no longer restricts the owners of professional limited liability companies to licensed persons, this definition was removed. Note, however, that ownership restrictions may be included in the operating agreement if the regulatory authority so requires for a particular licensed business.

A.R.S. § 29-4102. PROFESSIONAL LIMITED LIABILITY COMPANY FORMATION.

Arizona Comment
(Rev. 2/23/2024)

Subsection (A) simply provides that, to form a professional limited liability company, the company's articles of organization must, in addition to the information required to form a regular limited liability company under A.R.S. § 29-3201, include a statement that the company is a professional limited liability company and specify the type of professional services the company will provide.

Subsection (B) provides that a regular limited liability company may elect professional limited liability company status by amending its articles of organization to include the additional information required by Subsection (A).

A.R.S. § 29-4103. EXCLUSIONS FROM ARTICLE.

Arizona Comment
(Rev. 2/23/2024)

Subsection (A) makes clear that Article 11 does not alter the right of a licensed person to perform professional services in any other business form allowed by law.

Subsection (B) provides that a professional limited liability company may employ persons who are not licensed to perform the professional services rendered by the professional limited liability company if such persons work at the direction or under the supervision of a licensed person(s), do not hold themselves out as being authorized to perform such services, and are not otherwise prohibited from being so employed by the applicable licensing authority.

A.R.S. § 29-4104. APPLICATION OF GENERAL LIMITED LIABILITY COMPANY LAW.

Arizona Comment
(Rev. 2/23/2024)

This section simply states that professional limited liability companies are governed by the other provisions of the Act except if and insofar as the such provisions are limited or enlarged by, or contrary to, Article 11, in which case Articles 11 controls.

A.R.S. § 29-4105. SPECIAL RESTRICTIONS.

Arizona Comment
(Rev. 2/23/2024)

The Prior Act contained restrictions on the permitted owners of a professional limited liability company. For example, under the Prior Act, only 49% of the voting interests of a professional limited liability company could be owned by persons other than licensed persons.

Subsection (B) removes these restrictions. Under the Act, a professional limited liability company may issue an interest or admit as a member any person unless the professional limited liability company is prohibited from doing so by the applicable licensing authority. Under subsection (C), an interest in a professional limited liability company may be transferred to any person unless the transfer is prohibited by the licensing authority.

Subsection (C) also provides that a member who transfers a transferable interest in violation of these restrictions is deemed to have dissociated from the professional limited liability company. The rights and obligations of the dissociated member are governed by the general rules of the Act for dissociation. *See* A.R.S. § 29-3603. If the dissociated member was the only member of the professional limited liability company, then the company may be subject to dissolution under A.R.S. § 29-3701(A)(3).

A.R.S. § 29-4106. NAME.

Arizona Comment
(Rev. 2/23/2024)

Pursuant to this section, a professional limited liability company must comply with the general limited liability company naming requirements set forth in A.R.S. § 29-3112, except that the name must include the words "professional limited liability company" or the abbreviation "P.L.L.C.," "P.L.C.," "PLLC," or "PLC."

A.R.S. § 29-4107. PROFESSIONAL RELATIONS AND RESPONSIBILITY.

Arizona Comment
(Rev. 2/23/2024)

The Prior Act provided that each person performing professional services remains personally liable for any negligent or wrongful acts committed by him or her or by any person under his or her direct supervision and control. The Prior Act also stated that liability was several only, and the member was not vicariously responsible for the liability of another person unless the other person was acting under the member's direct supervision and control while performing professional services on behalf of the professional limited liability company.

The Act removes this language. This section expressly states that Article 11 does not alter any law applicable to the relationship between a person performing professional services and a person receiving the services, including liability arising out of those professional services. Although it makes no difference when determining the personal liability of a member or manager under the Act whether the person is a member or manager of a professional limited liability company or a regular limited liability company, it is possible that laws outside the Act might apply differently depending on the type of entity involved.

A.R.S. § 29-4108. DISCIPLINARY POWERS OF REGULATING LICENSING AUTHORITIES.

Arizona Comment
(Rev. 2/23/2024)

Subsection (A) states that a professional limited liability company may not perform any act that is prohibited by the applicable licensing authority. Similarly, subsection (B) states that each member, manager, officer, agent, and employee of a professional limited liability company who is a licensed person is subject to the rules and regulations and the disciplinary power of the licensing authority.

The Prior Act provided that if an interest in a professional limited liability company that is held by a licensed person is not acquired by a person or persons qualified to own such interest within one hundred eighty days following the death, insanity, bankruptcy, retirement, withdrawal, expulsion, or other legal disqualification of the member, the member shall be entitled to receive distributions in accordance with the provisions of the Act or the operating agreement governing the liquidation of the member's entire interest in the professional limited liability company. The Act removes this requirement. Thus, unless the professional limited liability company's operating agreement provides otherwise, the bankruptcy, etc. of a member will not require the liquidation of the member's interest. Under A.R.S. § 29-4105, if a transfer of a member's interest violates the requirements of the

applicable licensing authority, the member will be deemed to have dissociated from the professional limited liability company.

ARTICLE 12
MISCELLANEOUS PROVISIONS

Introductory Arizona Comment
(Rev. 2/23/2024)

This Article has been moved from Article 11 of RULLCA to Article 12 of the Act, because a new article covering professional limited liability companies has been inserted into Article 11 of the Act. Certain sections of Article 11 of RULLCA were not codified into the Act and instead corresponding provisions were included in SB 1353, the Senate bill that enacted the Act. In those cases, the headings below refer to the applicable section of RULLCA rather than a section of the Act.

A.R.S. § 29-4201. UNIFORMITY OF APPLICATION AND CONSTRUCTION.

Arizona Comment
(Rev. 2/23/2024)

This section, which is found in Section 1101 of RULLCA, states the general principal that in applying and construing the Act, consideration must be given to the need to promote uniformity of the law among other states that have enacted limited liability statutes based on RULLCA.

Although the Drafting Subcommittee made numerous changes to RULLCA, the Act is nonetheless based on the uniform act. One of the benefits of enacting a limited liability company statute based on a uniform act is the ability for Arizona courts and practitioners to seek nonbinding yet useful guidance to interpret the Act from other states that have enacted a version of RULLCA. Care must be taken, however, to disregard other states' case law interpreting provisions of RULLCA that were not incorporated into the Act.

No RULLCA comment exists for this section.

A.R.S. § 29-4202. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT.

Arizona Comment
(Rev. 2/23/2024)

This section is found in Section 1102 of RULLCA and is substantively the same as RULLCA.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section responds to specific language of the Electronic Signatures in Global and National Commerce Act and is designed to avoid preemption of state law under that federal legislation.

RULLCA § 1103. SAVINGS CLAUSE.

Arizona Comment
(Rev. 2/23/2024)

Section 1103 of RULLCA is not found in the Act, but rather in Section 6 of SB 1353. This section of SB 1353 clarifies that the Act does not affect actions commenced on or before the effective date of

August 31, 2019. This section of SB 1353 also clarifies that for limited liability companies formed on or before August 31, 2019, the rights and obligations of the company’s members and managers relating to events occurring before September 1, 2020, will be determined according to the law and terms of the operating agreement in effect at the time of event.

Modified RULLCA Comment
(Rev. 2/23/2024)

This section continues prior law after the effective date of this act with respect to rights accrued and proceedings. But for this section, the new law of this act would displace the old laws in some circumstances. The power of a new act to displace the old statute with respect to conduct occurring before the new act’s enactment is substantial. Millard H. Ruud, The Savings Clause—Some Problems in Construction and Drafting, 33 TEX. L. REV. 285, 286–93 (1955). A court generally applies the law that exists at the time it acts.

Eventually, this act will apply all to pre-existing limited liability companies—whether by choice under A.R.S. § 3110(A)(2)~~Section 110(a)(2)~~ (permitting an early opt-in), or without choice on the “all-inclusive date.” ~~Section~~ A.R.S. § 3110(B)~~110(b). In this context, the phrase “before [the effective date of this [act]]” should be understood as referring to the date upon which this act became applicable to the particular limited liability company at issue.~~ *See* Arizona Comment to A.R.S. § 29-3110 for an explanation of the exceptions to the “all-inclusive date.”

RULLCA § 1104. SEVERABILITY CLAUSE.

Arizona Comment
(Rev. 2/23/2024)

Section 1104 of RULLCA is not found in the Act. No RULLCA comment exists for this section.

RULLCA § 1105. REPEALS.

Arizona Comment
(Rev. 2/23/2024)

Section 1105 of RULLCA is not found in the Act. The equivalent provision is found in Section 3 of SB 1353, which repeals the Prior Act as of August 31, 2020. No RULLCA comment exists for this section.

RULLCA § 1106. EFFECTIVE DATE.

Arizona Comment
(Rev. 2/23/2024)

Section 1106 of RULLCA is not found in the Act. The equivalent provision is found in Section 5 of SB 1353, which establishes the Act’s effective date of August 31, 2019.

Modified RULLCA Comment
(Rev. 2/23/2024)

For the effect of the ~~a~~Act’s effective date on pre-existing limited liability companies, *see* A.R.S. § 3110~~Section 110~~.