May 17, 2016

Major Changes Underway for the Connecticut Limited Liability Act

Gov. Malloy signed into law the first major revision of the Connecticut Limited Liability Company Act[1] since its passage in 1993. The new law, the Connecticut Uniform Limited Liability Company Act (the Act), was signed on May 12 and will take effect on July 1, 2017. It is patterned after the Revised Uniform LLC Act (the Uniform Act) approved by the American Bar Association.

The Act is intended to create a more business-friendly legal environment for LLCs formed under Connecticut law or formed under another state's law but doing business in Connecticut. The new Act contains many of the provisions of the Uniform Act, thereby creating more legal precedent for interpretation of the Act. The Act supersedes the current LLC law, but it does not affect actions taken before the effective date of the current law.

Below are some highlights of the new law. This list is not exhaustive. Clients are advised to review their current LLC operating agreements with counsel to discuss whether any amendments are required to their agreements and to understand how the Act will affect the operation of their existing LLCs.

1. **Terminology Changes.**

    a. Certificate of Organization:[2] The name of an LLC's organization document will be changed from "articles of organization" to "certificate of organization."

    b. Registered Agent: The title of the LLC's designated person to receive legal process in Connecticut on its behalf will be changed from "statutory agent for service" to "registered agent."

    c. Certificate of Merger: The document the LLC must file with the Secretary of the State after a merger is approved will be changed from "articles of merger" to "certificate of merger."

2. **Prohibited Contents of Operating Agreement** - The provisions of the Act apply when the LLC's operating agreement is silent on a particular matter. The Act, however, prohibits an operating agreement from:

    a. Applying another state's law to govern a Connecticut domestic LLC;

    b. Eliminating the implied contractual obligation of good faith and fair dealing under the Act; and

    c. Relieving or exonerating a person from liability for conduct involving bad faith, willful or intentional misconduct, or knowing violation of the law.

3. **Certificate of Organization.**

    a. The Act requires that the LLC's operating agreement state whether the LLC will be manager-managed. The current requirement that the articles of organization state whether management is vested in managers, rather than members, will be repealed.

    b. Unlike the current law, the Act does not require the certificate of organization to state the nature of the LLC's business or purposes.

    c. Like the current law, the Act requires that the certificate of organization state the name and business and residence address of at least one member or manager. The Secretary of the State will continue to have

discretion to allow only a business address if there is good cause, such as risk to the person's personal security.

4. **Professional Services LLCs** - A few changes were made to the provisions for LLCs formed to render professional services, like LLCs for doctors, accountants and architects. The Act continues the requirement that each member of the LLC must be licensed or otherwise authorized by law in Connecticut or another jurisdiction to render such professional services. The LLC may render its professional services in Connecticut only through its members, managers, employees and agents who are licensed or otherwise legally authorized to render such professional services in Connecticut. Under the Act:

a. An LLC formed to render professional services must include "professional limited liability company," "P.L.L.C." or "PLLC" in its name. That applies only to professional LLCs formed on or after the effective date of the Act.

b. Physician assistants will be added to the professions that can be part of a professional services LLC.[3]

c. A professional services LLC may be formed by members of two or more of the following professions: (1) psychology, marital and family therapy, social work, nursing, and psychiatry; (2) medicine and surgery, occupational therapy, social work, and alcohol and drug counseling; and (3) medicine and surgery, and chiropractic.

d. Domestic LLCs may merge with foreign LLCs that render professional services under the same circumstances.

5. **Fiduciary Duties of Members/Managers.**

a. The Act allows an operating agreement, if not manifestly unreasonable, to:

i. Alter or eliminate a member's or manager's duty of loyalty;[4]

ii. Identify specific types or categories of activities that do not violate the duty of loyalty;

iii. Alter the duty of care, but not authorize conduct involving bad faith, willful or intentional misconduct, or a knowing violation of law; and

iv. Alter or eliminate any other fiduciary duties.

b. As under the current law, a member or manager must discharge his or her duties in good faith with the care that an ordinarily prudent person would use in similar circumstances in the LLC's best interests.

c. Members in a member-managed LLC and managers in a manager-managed LLC also have a duty of loyalty and are required to discharge their duties and obligations under the Act or the operating agreement consistent with the implied contractual obligations of good faith and fair dealing. A member who is not acting as a manager does not violate these obligations solely because of conduct that furthers his or her own interest.

d. The Act permits a majority in interest of disinterested members (but not a majority of managers) to approve any breach of the duty of loyalty after full disclosure of all material facts.

e. Members of existing Connecticut LLCs will want to consider whether to amend their operating agreements to reduce or eliminate fiduciary duties, to the extent permitted by the Act.

6. **Distributions.**

a. As under the current law, a member or other person entitled to a distribution becomes a creditor of the LLC with respect to the amount due. The LLC's obligation to make the distribution can be offset by amounts the recipient owes the LLC. The Act eliminates specific provisions on distributions when a member dissociates.

b. The Act imposes personal liability on a member or manager who consents to a distribution that would leave the LLC insolvent on its balance sheet or unable to pay its debts as they become due. The liability is for the

amount by which the distribution exceeds the amount that could have been distributed without violating the Act's distribution restrictions.

7. **Voting** - Unless the operating agreement otherwise provides, unanimous member approval is required for amendments to the certificate of organization or operating agreement. The current law requires the approval of a majority in interest of members for amendments to the articles of organization and a two-thirds in interest for amendments to the operating agreement. Approval of two-thirds in interest is required for any act outside the LLC's ordinary course of affairs and for approving a transaction under the Connecticut Entity Transactions Act.[5]

8. **Mergers and Acquisitions.**

a. The Act makes changes to the provisions governing mergers between LLCs, including mergers with foreign LLCs. These changes generally make the merger and interest exchange (transactions involving exchanging interests to merge businesses without merging the entities) provisions similar to those in the Connecticut Entity Transactions Act.

b. The Act requires approval of a plan of merger by a vote of at least two-thirds in interest of the members unless otherwise provided by the certificate of organization or operating agreement.

c. If a current operating agreement is silent, and if the members prefer a majority vote for fundamental transactions like mergers and sales of assets, the operating agreement should be amended to so provide.

9. **Effect of Repealing Existing Law** - The repeal of the current law governing LLCs does not affect:

a. The operation of statutes or actions taken under them before their repeal;

b. Any ratification, right, remedy, privilege, obligation or liability acquired, accrued or incurred under the statute before its repeal;

c. Any violation of a statute, penalty, forfeiture or punishment incurred before its repeal; or

d. Any proceeding, reorganization or dissolution begun under a statute before its repeal that may be completed in accordance with the statute as if it had not been repealed.

10. **Members as Agents of LLC** - Unlike the current law, in which every member in a member-managed LLC is an agent of the LLC, the Act does not make a member an agent of an LLC solely by reason of being a member. Further, being a member does not prohibit other applicable laws from imposing liability on an LLC because of the member's conduct.

11. **Admitting Members** - Under the Act, a person becomes a member after formation (1) as provided in the operating agreement, (2) as a result of a transaction under the Connecticut Entity Transactions Act, (3) with the unanimous consent of the members (versus a majority in interest of members under the current law), or (4) with the consent of transferees with the right to receive the majority of distributions when the LLC has no members.

12. **Member, Manager and Officer Liability Protection** - The Act, like the current law, allows an LLC to indemnify and hold harmless someone for acting as a member or manager, other than liability for improper distributions, or breach of the duty of care or loyalty to the LLC. It also extends these protections to officers.

13. **Freedom of Contract** - The act continues the "freedom of contract" found in the current Connecticut LLC law and in Connecticut's other entity statutes. This states that the policy of the act is to give maximum effect to the principle of freedom of contract and to the enforceability of LLC agreements.

The business lawyers at Day Pitney would be glad to discuss the application of the new Act to existing Connecticut limited liability companies and to foreign LLCs doing business in the state. In particular, our attorneys can advise on recommended changes to the LLC operating agreement.

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[1] Conn. Gen. Stat. § 34-100 *et seq.*

[2] For LLCs formed before July 1, 2017, the articles of organization will automatically be deemed a certificate of organization.

[3] Under current law, professional services are limited to the professional services rendered by dentists, naturopaths, chiropractors, physicians and surgeons, doctors of dentistry, physical therapists, occupational therapists, podiatrists, optometrists, nurses, nurse-midwives, veterinarians, pharmacists, architects, and professional engineers, or jointly by architects and professional engineers, landscape architects, real estate brokers, insurance producers, certified public accountants and public accountants, land surveyors, psychologists, attorneys-at-law, licensed marital and family therapists, licensed professional counselors, licensed or certified alcohol and drug counselors, and licensed clinical social workers.

[4] The fiduciary duty of loyalty includes these duties: (1) to account to the company and to hold as a trustee for it any property, profit or benefit derived by the member: (A) In the conduct or winding up of the company's activities and affairs; (B) from a use by the member of the company's property; or (C) from the appropriation of a company opportunity; (2) to refrain from dealing with the company in the conduct or winding up of the company's activities and affairs as or on behalf of a person having an interest adverse to the company; and (3) to refrain from competing with the company in the conduct of the company's activities and affairs before the dissolution of the company.

[5] The Connecticut Entity Transactions Act governs mergers, interest exchanges and other transactions between different types of business entities. (Conn. Gen. Stat. § 34-600 *et seq.*).

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