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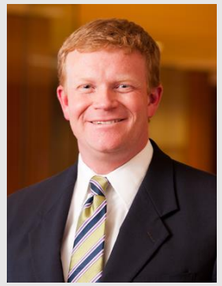

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Note from the Editor: Effective as of January 1, 2014, Utah has adopted the Utah Revised Uniform Limited Liability Company Act, which provides sweeping changes to the laws governing Utah limited liability companies. As a courtesy to our clients and other readers, we are dedicating this entire issue of our Tax & Business Newsletter to the new Act. We appreciate our affiliation with each of you and wish you the very best this upcoming holiday season.

Utah's New Limited Liability Company Act

By Mark A. Cotter & Christopher N. Nelson

Summary. Effective as of January 1, 2014, Utah has a new and updated limited liability company statute: the Utah Revised Uniform Limited Liability Company Act (the "New LLC Act"). The New LLC Act is a complete revision of Utah statutes governing limited liability companies, and includes new filing requirements, new fiduciary duties and standards, new constructive notice of authority/limitations of authority provisions, new merger and consolidation provisions, new provisions regarding duties to "refrain from competing", etc.

In some respects, the New LLC Act takes a pro-member (owner) stance by imposing stronger and better defined fiduciary duties on management, greater ability to constrain the legal authority of management relative to third parties, and more protection of the underlying business enterprise through default non-compete provisions. From that perspective, members (owners) have greater protections under the New LLC Act.

On the other hand, the New LLC Act permits its default provisions to be superseded by pro-management provisions in the LLC's Operating Agreement. Thus, while closely-held, family-controlled LLCs may well be comfortable with many of the New LLC Act's default provisions, investor-driven, venture-backed and joint-ventured LLCs will want to focus carefully on the terms of the Operating Agreement in order to allocate rights, duties and risks in a more management- and investment-friendly manner.

Transition Period. While the New LLC Act is effective as of January 1, 2014, pre-existing LLCs will generally have a two (2) year grace period ending December 31, 2015 to "opt in" to the New LLC Act (by amending their Operating Agreements to adopt the New LLC Act). Thus, the current Utah Revised Limited Liability Company Act (the "Current Act") will continue in effect for existing LLCs during that transition period (unless and until an LLC affirmatively adopts the New LLC Act).

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Certificate of Organization. The New LLC Act streamlines filing requirements for new LLCs, which may now be formed using a simple Certificate of Organization with minimal information requirements. This regime is similar to the Delaware entity "notice" filing requirements and moves nearly all of the important governance provisions to the LLC's Operating Agreement.

Statements of Authority. Because the Certificate of Organization does not contain any information about the governance structure or persons authorized to act on behalf of the LLC, the New LLC Act permits (but does not require) the filing of one or more Statements of Authority ("SOAs"). SOAs may prescribe the authority, or limitations on authority, of any position in the LLC or of a specific person to act on behalf of the LLC. In general, a limitation on the authority of a person or a position in an SOA does not, by itself, confer constructive notice of such limitation on third parties (but is constructive notice to "all persons" if recorded in real property records). However, in general, third parties can rely on grants of authority in SOAs if (1) the third party gives value in reliance on a filed SOA with no knowledge to the contrary, or (2) in the case of a real property transfer, a certified copy of the SOA has been duly recorded in the applicable county recorder's office. In some cases, LLCs may want to opt in to the New LLC Act in order to take advantage of more robust provisions for limiting authority of management with respect to real property assets.

Risks of Oral Operating Agreements. As mentioned above, the New LLC Act mandates that nearly all important governance provisions be set forth in an Operating Agreement and confers broad latitude to modify the default provisions of the New LLC Act in an Operating Agreement (other than certain provisions, such as duties of loyalty, care and good faith and fair dealing). Significantly, and in contrast to the Current Act requirement for written Operating Agreements, the New LLC Act permits Operating Agreements which are oral and/or inferred from the members' course of dealing – thus increasing the risk of disagreements among members as to the provisions of the Operating Agreement and making it difficult for third parties to determine the terms of Operating Agreements. Because persons that become members of an LLC are deemed to assent to the Operating Agreement under the New Act, ascertaining its specifics carries an increased importance for new members. Well-advised LLC's should have written Operating Agreements with "merger" provisions and strong amendment requirements that make clear that the written agreement is the exclusive source of Operating Agreement provisions.

Increased Due Diligence Required by Third Parties. With the streamlined filing requirements for LLCs, the public record will frequently consist solely of the LLC's name and the fact that it exists. Investors, financial institutions, acquirers, contract counterparties, etc. desiring to deal with LLCs will need to undertake additional due diligence to ascertain the identity and authority of those persons authorized to act on behalf of the LLC. In certain transactions, this will require a review of the LLC's Operating Agreement, with certifications from members and/or managers as to the LLC's Operating Agreement, as amended, that there are no other oral or implied agreements contradicting such Operating Agreement, etc. The scope of due diligence will significantly increase if no written Operating Agreement exists. Additionally, third parties may require LLC's to file updated SOAs which can be relied upon before engaging in significant transactions. Lastly, relative to the duty to "refrain from competing" duty, managers (of manager-managed LLCs) and members (of member-managed LLCs) will need to affirmatively address this issue or risk adverse consequences if this duty is asserted against them.

Statutory Non-Compete Clauses ("Deemed Assent"). The New LLC Act includes a duty "to refrain from competing with the limited liability company in the conduct of the company's activities and affairs before the dissolution of the company" (and continuing "until winding up is completed" for a manager-managed LLC). This "refrain from competing" duty is part of the duty of loyalty and applies to members (of member-managed LLCs) or managers (manager-managed LLCs). Surprisingly, this duty "to refrain from competing" can be enforced not only by the LLC itself but also by other members (if they can plead and prove an actual or threatened injury that is not solely the result of an injury or threatened injury to the company). Without question, this provision will be quite a surprise for members or managers (e.g., a new member, such as an investor or an employee granted restricted units/membership interests, who is deemed to "assent" to the Operating Agreement which does not expressly override this "refrain from competing" duty), particularly where the duty is broad in application (e.g., there are no geographic restrictions or "carve outs" for permitted activities).

Increased Confidentiality Protections. The New LLC Act provides important protections for trade secrets and other confidential information by permitting management to impose reasonable restrictions on disclosure and use of such information by members – despite statutory inspection rights under which members would otherwise have access to such information. The Current Act is lacking in this regard, since members' statutory inspection rights are not permitted to be restricted or limited by an LLC's Operating Agreement, thus potentially exposing sensitive company information to inspection by members (which may include former employees as to which the LLC failed to secure, or exercise, appropriate redemption rights upon termination of employment).

Fiduciary Standards Applicable to Management. The New LLC Act expressly provides for duties of loyalty and care, as well as an obligation of good faith and fair dealing, applicable to members (of member-managed LLCs) and managers (of manager-managed LLCs). The duty of loyalty is defined to include, among other things, an obligation to account to the LLC for benefits derived from use of LLC property and an obligation to refrain from competing with the LLC (as discussed above). The duty of care, on the other hand, is defined only in the negative: don't engage in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law. While one might argue that this duty of care is a lower standard of care than normally applicable in the duty of care context, it at least provides the member or manager with more certainty (i.e., it is easier to gain comfort that there is no gross negligence than it is to determine whether one is acting in a manner similar to that of a reasonably prudent person in like circumstances). On the other hand, the obligation of good faith and fair dealing is not defined, leaving management and members with an uncertain standard (e.g., based on court decisions) that might expose an LLC and its management to disruptive claims and potential litigation.

Ability to Specify Fiduciary Standards. While the New LLC Act imposes more certain fiduciary duties on management (for the most part), including a member or manager duty not to compete, the New LLC Act does permit the Operating Agreement to affirmatively specify the applicable standards in a manner appropriate to the LLC and its members and managers (so long as the duties of care, loyalty and good faith/fair dealing are not eliminated and the specified standards are not unconscionable or against public policy). This presents an important opportunity to place an LLC on a business- and investment-friendly footing (or otherwise as circumstances dictate).

Disclosures to Members/Duty of Candor. The New LLC Act affirmatively specifies that whenever a matter is presented to members for consent or approval, the LLC must provide all material information to the members, meaning that by statute the New LLC Act now includes the duty of candor that has long existed under the General Corporation Law of the State of Delaware. Thus, matters presented to members will now need to be supported by affirmative disclosures of all material facts (in some cases in substance similar to Information Statements or other disclosure documents normally used in mergers or other business combination transactions governed by federal and state securities laws).

RQ&N Practical Insights. As a practical matter, most small, closely-held LLCs (including family-controlled holding company LLCs) have little reason to rush to adopt the New LLC Act, but will need to do so (and amend relevant Operating Agreements) prior to the expiration of the two-year transition period. However, LLCs with operating businesses or an unaffiliated and/or potentially contentious ownership base (e.g., investor-driven, venture-backed and joint-ventured LLC's) have valid reasons to promptly adopt the New LLC Act (and amend their Operating Agreements) in order to take advantage of its fiduciary duty, confidentiality and other provisions. In either case, the failure to address non-compete issues and broad inspection rights in favor of, and duties of disclosure to, members can result in materially adverse consequences for both LLCs and their members.

About Ray Quinney & Nebeker's Corporate, Securities and Tax Section: *We believe our Corporate, Securities and Tax group is the largest transactional practice in the State of Utah (comprised of 21 attorneys) but more importantly includes a range and depth of experience which enables RQ&N to represent corporations, LLCs and other business entities throughout their life cycle and for all stages of growth and development, including formation, financing, taxation, licensing, development and distribution agreements, as well as merger, acquisitions, joint ventures or other business combination or "exit" transactions. We regularly represent issuers and investors in seed, early-stage, angel and venture capital financings.*