Tucker Ellis LLP

CLIENT ALERT

OHIO ADOPTS NEW LIMITED LIABILITY COMPANY ACT

FEBRUARY 2021

On January 8, Ohio Governor Mike DeWine signed into law the Ohio Revised Limited Liability Company Act (the "New Act"). The New Act completely replaces the existing Ohio Limited Liability Company Act (Chapter 1705 of the Ohio Revised Code) with new Chapter 1706 of the Ohio Revised Code. The New Act significantly updates Ohio's codified law governing limited liability companies, providing increased opportunities and flexibility for the operation and management of an LLC, and making Ohio a potential home for an LLC with features previously available only in other states.

Effective Date

The New Act will become effective on April 12, 2021, but it is not applicable to LLCs until January 1, 2022. On and after January 1, 2022, the New Act will govern all LLCs formed (or qualified to do business as foreign LLCs) in Ohio, regardless of whether the LLC was formed or qualified before or after that date. No changes to an LLC's organizational documents will be necessary or available before that date in order for an LLC to take advantage of the opportunities available in the New Act.

Business owners, investors, and practitioners should begin to familiarize themselves with the contents of the New Act to prepare for the transition that will occur on January 1, 2022 and to consider whether any of their organizational or management documents should be modified in light of the changes.

Important Highlights of the New Act

The New Act both revises prior concepts addressed in Ohio's existing LLC law and incorporates several new concepts, which are intended by the Ohio legislature, in part, to address some of the ambiguities in the existing law since, at the time of its enactment, LLCs were a relatively new form of legal entity. Selected highlights of the New Act include:

- **Default Nature of Provisions:** The New Act emphasizes that its contents are generally "default" provisions, which will be applicable only to an LLC that has not adopted an operating agreement with contradicting terms (with limited exceptions). The result is that business-owners and investors will have greater flexibility to negotiate and structure an LLC by contract, with fewer circumstances where the statute would override a contractual provision that the members of the LLC, or certain other parties, have agreed to.
- **Governance Structure Flexibility:** Ohio's existing LLC law contemplates that an LLC will be either member-managed or manager-managed. The New Act eliminates this distinction and allows an LLC's operating agreement to describe the governance structure of the LLC without categories. For example, under the New Act, an LLC may implement a form of governance body more akin to that of a for-profit corporation or partnership, such as a board of directors or an oversight committee.
- **Ability to Eliminate Fiduciary Duties:** Under Ohio's existing LLC law, an LLC cannot entirely eliminate the fiduciary duties of members, managers, or officers. The New Act permits an LLC to more comprehensively limit or eliminate entirely all fiduciary duties of members, managers, and officers. The only non-waivable fiduciary duty is that the members, managers, and officers must abide by the implied covenant of good faith and fair dealing. One practical implication of this for business-owners is that they will have additional flexibility to structure LLCs on a non-arm's-length basis, where one member may want to provide additional flexibility to another member or management-level individual to devote time to another business and/or compete directly with the LLC.

- **Penalties for Failure to Perform:** The New Act permits an LLC to set forth specified penalties and consequences in its operating agreement that will apply if a member breaches the operating agreement or upon the occurrence of a certain event. Examples of these penalties include, but are not limited to: (i) reducing or eliminating a defaulting member's interest in the LLC, (ii) forcing a sale of a defaulting member's interest in the LLC, or (iii) fixing a value of the defaulting member's interest in the LLC by formula or appraisal and forcing a redemption or sale of the member's interest in the LLC at that value. Business-owners should take note of this drafting flexibility as it allows them to contractually penalize certain actions as a method of maintaining control over the ownership and operation of an LLC, especially when the members of an LLC own their interests disproportionately to one another (e.g., an 80%-20% ownership scenario). Some common situations where such penalties may be useful arise in the context of calls for additional capital contributions or the exercise of a "call option" where the LLC and/or other members have the option to purchase the interests of a member upon the occurrence of certain events.
- **Ability of Operating Agreement to Confer Rights to Person Without Economic Interest:** Unlike Ohio's current LLC law, the New Act permits a person to be a member of an LLC without making any asset or capital contribution to the LLC or having any economic interest in the LLC. The New Act also permits an operating agreement to provide enforceable rights to third parties who are not members of the LLC. These concepts are likely to be most significant in establishing "special purpose entities" in which creditors insist on having the consent of "independent" persons in order for the LLC to take certain actions.
- **Series of Limited Liability Companies:** For business-owners who desire to have capital or other assets invested in different segments of an LLC and have those assets protected from claims against or liabilities incurred by other segments of the LLC, a dramatic aspect of the New Act is that it allows an LLC to establish "series" in which the assets of each series are protected from claims against and liabilities incurred by another series or the LLC as a whole. This aspect is particularly useful in the context of investment funds and may be helpful in other situations as well. The "series" concept is akin to a parent LLC that desires to form and maintain one or more subsidiary LLCs with the same or different investors holding an ownership interest in each series. The formation of an LLC with series may help ease the administrative burden placed on the business-owner seeking to form such a relationship; however, the real utility of an LLC with series versus separate parent-subsidiary LLCs has been debated by both academics and practitioners.
- **Protections Against Creditors of Members:** The New Act also includes provisions designed to allow an LLC to protect itself from any claims by creditors of a member, including situations where a creditor claims a security interest in a member's interest in the LLC.
- **Ability to Bar Claims after Dissolution:** Under the New Act, an LLC will have a means to cut off claims of creditors after a certain period of time following the LLC's dissolution. In order to gain such protection, the LLC must: (i) provide notices to known creditors at the time of winding up stating that each creditor must bring any claim it may have by a certain deadline, which cannot be less than 120 days from the effective date of the notice; and/or (ii) publish a notice on the LLC's website (if maintained) and provide a copy of the notice to the Ohio Secretary of State for publishing on its website for the purpose of notifying unknown or potential creditors that any claim not brought by them against the LLC within two years of the publication date will be barred. This ability provides LLCs an opportunity for certainty and repose at the end of its life cycle that did not exist under Ohio's current LLC law.

This Client Alert is only a high-level summary of certain important aspects of the New Act. Accordingly, this Client Alert is not intended to be all encompassing. Tucker Ellis has a team devoted to monitoring the impact of the New Act as well as any additional legislative or other commentary that is published on the subject. Over the next several months leading up to the binding applicability of the New Act on January 1, 2022, Tucker Ellis intends to publish additional materials on specific aspects of the New Act, which will endeavor to take a deeper dive into specific topics included in the New Act as they relate to business-owners and investors. In the meantime, should you have any questions or need any assistance, please contact the one of the attorneys listed below for more information.

ADDITIONAL INFORMATION

For more information, please contact:

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