OHIO REVISED CODE CHAPTER 1706: WHAT'S NEW AND WHY IT MATTERS

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For the first time since its adoption in 1994, Ohio is completely restating its limited liability company act by way of the "Enact Ohio Revised Limited Liability Company Act" ("New Act"). Rather than just editing the existing provisions of Ohio Revised Code ("O.R.C") Chapter 1705, the New Act creates an entirely new chapter in O.R.C. 1706, effective January 1, 2022. The New Act is based largely on the Prototype LLC Act developed by the LLCs, Partnerships and Unincorporated Entities Committee of the American Bar Association Section of Business Law. The changes in the New Act are so comprehensive that they cannot be covered in one article, but I attempt to highlight the most important aspects below.

Overarching Comments

The New Act strikes a balance between incorporating modern concepts and retaining familiar characteristics of Ohio LLC law. One of the beauties of LLC law is the extent to which operating agreements embrace freedom to contract over traditional corporate formalities. The New Act takes this to a whole new level and expressly gives "maximum effect to the principles of freedom of contract and to the enforceability of operating agreements." This places an even greater importance on the careful drafting of an operating agreement.

What didn't Change?

Conveniently, the New Act maintains existing Ohio LLC terminology that is not present in the Prototype Act (e.g., "articles of organization" vs. "certificate of formation"), so that existing LLCs will not be forced to revise their current documents. More importantly, any operating agreement provision enforceable under the current LLC act is also enforceable under the New Act. And, thankfully, Ohio still does not require LLCs to file an annual report, nor does it require LLCs to disclose their managers or members through the New Act, each of which is commonplace in other jurisdictions.

What Cannot Change?

In almost each section, the current LLC act provides a default rule "except as otherwise modified by the LLC's operating agreement" or "except as otherwise provided in the articles of organization." O.R.C. 1706.08 removes this repetitive qualifying language and provides a comprehensive list of provisions which cannot be modified by an operating agreement (e.g., certain fiduciary duties, obligations to make capital contributions).

Management Structure and Authority (O.R.C 1706.18)

The current act allows LLCs to be managed by either their members or their manager(s). The New Act eliminates this dichotomy to provide additional flexibility for an LLC's management, a recurring theme throughout the New Act. Under the New Act, a person's ability to act as an agent and to bind the LLC can be authorized by (1) the operating agreement (including managers and officers, but also permitting concepts like Boards of Directors or oversight committees); (2) the decisions of members in accordance with the operating agreement; (3) a "statement of authority" filed with the Ohio Secretary of State pursuant to O.R.C. 1708.09; or (4) the New Act's default rules.

Under the New Act, default management of the LLC is vested in a "majority of the members" (with certain actions requiring unanimous approval). The New Act does not define a "majority of the members," but one plausible interpretation is that this means a majority of the persons designated as members of the LLC, or a *per capita* right, irrespective of their percentage interest in, or capital contributions to, the LLC. This is probably not what most owners would intend, and therefore careful operating agreement drafting is extremely important in this context.

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Series LLCs (O.R.C. 1706.76 to 1706.7613)

Perhaps the most novel concept introduced, the New Act authorizes the formation of "Series LLCs." Ohio is the 15th state to permit Series LLCs. For reference, a Series LLC is a form of LLC that can, through its operating agreement, establish one or more series of assets and liabilities organized under the parent (or "umbrella") LLC. Subject to compliance with the rules in O.R.C 1706.76 et seq., liabilities of one series are not enforceable against the other series, nor are they enforceable against the parent LLC. The inverse is also true — the liabilities of a parent LLC are not enforceable against a series.

Each series in an Ohio Series LLC must have either (1) separate rights, powers, or duties with respect to specified property or obligations of the LLC or profits and losses associated with specified property or obligations, and/or (2) a separate purpose or investment objective. In addition, at least one member must "be associated" with each series, and only those such members can manage that series or share in its economic rights. The New Act further requires that the assets and records of each series must be kept separate, that the operating agreement must employ specific statutory language, and that the Articles of Organization (not the operating agreement) authorize the LLC to create series.

Theoretically, Series LLCs can be useful for asset protection, particularly with respect to real estate investment companies, investment funds, or a business with multiple product lines. Whether and how businesses (and lenders) embrace the Series LLCs will be interesting to monitor. Equally important considerations are how courts treat this statute and whether or not the Series LLC is more efficient.

Fiduciary Duties (O.R.C. 1706.08, 1706.31, & 1706.311)

The New Act permits an LLC's operating agreement to limit or eliminate fiduciary duties among its members, managers, and officers. In fact, the only non-waivable fiduciary duty is the implied covenant of good faith and fair dealing (which is technically a contractual concept). This provides additional flexibility to contract around traditional concepts of equity. And, practically speaking, it makes more attractive investments in LLCs by allowing an investor to limit its duties to those expressly within the terms of a contract and allowing investors and management to dabble in other potentially competitive businesses. By contrast, other investors will need to carefully consider their recourse against the other members and management of the LLC.

Penalties for Members' Failure to Perform (O.R.C. 1708(B))

The New Act permits an operating agreement to penalize its members for their failure to perform certain obligations or upon the occurrence of certain events. Among other consequences, these include (i) reducing or even forfeiting a member's interests or (ii) broadly, "any other penalty or consequence." Practical examples of these occurrences include breaches of restrictive covenants or capital calls. All parties should carefully consider these provisions through their respective lenses.

Member and Contractual Rights

Two provisions in the New Act grant rights to people not traditionally included in operating agreements: O.R.C. 1706.27(C) allows a person to become a member without making any contribution to and without having any economic interest in the LLC; and O.R.C. 1706.082(B) allows the operating agreement to give rights to someone who is not a party to the agreement. These seem most applicable in the context of a single-purpose entity for real estate financing, whereby the operating agreement grants a lender voting or veto rights over the entity's use of the property. Whether this is necessary is debatable. But these two provisions again increase the flexibility of an LLC's structure and operations beyond the currently available options.

Foreign LLCs (O.R.C. 1706.51 to 1706.515)

The current LLC act has only one section on foreign LLCs. Under the New Act, however, six new sections more thoroughly address the issue. So, while Ohio continues to welcome foreign entities to do business, the New Act places greater importance on the registration of those foreign entities.

In conclusion, Ohio LLCs have been granted a long runway to adapt to the changes in the New Act, and counsel should consider whether and how those changes will impact their counsel or their clients' businesses. Although the New Act may not require immediate changes to the operating agreements of many LLCs, it does grant business owners more flexibility to operate their businesses going forward in Ohio's "modern" age of LLCs. If ever there was a time to revisit your form operating agreement, this is the time.

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