

Stop Delaying: The Need for An Operating Agreement Under the Revised MN LLC Act



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There is effectively only four months (effective January 1, 2018) before the Minnesota Revised Limited Liability Company Act is in full force and effect for all existing Minnesota limited liability companies. The Operating Agreement, which can be written, verbal, implied or a combination of all three,¹ is the centerpiece of a member's rights under Minnesota Chapter 322C (the "Revised LLC Act"). There are many important "rules" under the Revised LLC Act that can be addressed upfront and agreed upon by the members in an Operating Agreement. Some would argue that without a written Operating Agreement, an LLC with more than a single member is taking unnecessary and undue risk. Thus, it would be well-advised to prepare an Operating Agreement for all existing Minnesota LLCs with more than a single member prior to January 1, 2018.

For example, under the Revised LLC Act, unless the Operating Agreement expressly provides otherwise, newly formed LLCs are considered member-managed. Minn. Stat. § 322C.0407, subd. 1. In a member-managed LLC, the LLC is to be managed by the members equally, again, unless the Operating Agreement provides otherwise. In other words, each member has one vote, regardless

of the ownership percentage of that member. "A difference arising among members as to a matter in the ordinary course of the activities of the company may be decided by a majority of the members." Minn. Stat. § 322C.0407, subd 2(2) and 2(3).

As a second example, the Operating governs the relations among members, and can vary the rights and duties owed greatly, adding additional protections provided by statute or limiting protections provided by statute. Minn. Stat. § 322C.0110, subd. 2 provides that where the Operating Agreement is silent with respect to the relations among the members as members and between the members and the limited liability company (among other matters described in subd. 1), the statute governs.

Section 322C.0110, subd. 3 places restrictions on what an Operating Agreement can and cannot do. Among other things, the Operating Agreement cannot be read to:

(a) Be governed by another state's laws; subd. 3(2)

(b) Generally eliminate the duty of loyalty, the duty of care, or any other fiduciary duty; subd. 3(4)

(c) Eliminate the contractual obligation of good faith and fair dealing; subd. 3(5)

(d) Vary the power of a court to order dissolution where appropriate for member oppression; subd. 3(7)

(e) Unreasonably restrict a member's right to bring a direct or a derivative action. subd. 3(9).

Certain other terms of an Operating Agreement are allowed if not "manifestly unreasonable." Minn. Stat. § 322C.0110, subd. 4. The court shall make its determination of whether an Operating Agreement term is manifestly unreasonable "as of the time the challenged term became part of the operating agreement and by considering only circumstances existing at that time." *Id.* at subd. 8. Further, the court may invalidate the term only if, in light of the purposes and activities of the LLC, it is readily apparent that the objective of the term is unreasonable or

the term is an unreasonable means to achieve its objective. *Id.*

At least for purposes of evaluating the conduct of members (in any LLC under the Revised LLC Act), the Operating Agreement expressly includes an obligation of good faith and fair dealing, including a requirement that members act in a manner, in light of the Operating Agreement, that is honest, fair, and reasonable. This obligation cannot be eliminated.

Importantly, for Minnesota LLCs formed prior to August 1, 2015, the LLC's existing articles of organization, any bylaws, and operating or member control agreement will operate as if the language in those governing documents were in the "Operating Agreement" under the Revised LLC Act effective on January 1, 2018. Minn. Stat. § 322C.1204, subd. 3. Moreover, subject to the specific terms of the "Operating Agreement," certain protections and rights set forth in Chapter 322B will carry over to Minnesota LLCs that were formed prior to August 1, 2015 after January 1, 2018, such as company information retention, dissenters' rights and allocation of profits and losses, among other rights and obligations.

Because of the significance of the Operating Agreement under the Revised LLC Act, LLCs should be communicating with experienced counsel, carefully considering the operations and governance of the LLC and ensuring that they are protected from unfair terms and/or that the terms of the "Operating Agreement" are consistent with the member's expectations.

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