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Ohio Adopts Modernized Limited Liability Company Act

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On January 7, 2021, Ohio adopted a new statute governing limited liability companies (LLCs) in Ohio. LLCs are a very popular type of legal entity for business organizations. The new Ohio LLC act is in new Chapter 1706 of the Ohio Revised Code, replacing the current Ohio LLC act in Chapter 1705 of the Ohio Revised Code. The new LLC act will be effective January 1, 2022 for all Ohio LLCs and all non-Ohio LLCs conducting business in Ohio.

The new LLC act was a product of several years of work by the LLC Subcommittee of the Ohio State Bar Association's Corporation Law Committee, according to Russ Rosler, a Vorys partner and the current chair of the LLC Subcommittee. Rosler stated that the new LLC act is based in large part on the Prototype LLC Act developed by the LLCs, Partnerships and Unincorporated Entities Committee of the American Bar Association Section of Business Law. Ohio's current LLC act dates back to 1994, when limited liability companies were a new form of legal entity, and has been amended numerous times. When the LLC Subcommittee was charged with a comprehensive review of the current LLC act and making recommendations for improvements, they recommended a wholesale replacement of the current LLC act to more closely align Ohio's LLC laws with the prototype act, to leverage the best practices reflected in the prototype act.

Although the new LLC act is based on the prototype act, it largely retains the terminology used in Ohio's current LLC act, and there are other differences from the prototype act that retain some aspects of Ohio's current LLC act.

The new LLC act does include several important new or different concepts, some of which are highlighted below.

Formation of "Series" LLCs

One major change relates to so-called "series" LLCs. The new LLC act now permits an LLC to establish, through its operating agreement, one or more separate **series** of assets and liabilities organized under the parent, or umbrella, LLC. Each series 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. Additionally, at least one member must be associated with each series. Notably, a series is permitted to carry on *any* activity, whether for- or non-profit.

Permitted in at least 15 other states, the series LLC structure can help an entity alleviate risk and limit exposure to liabilities with respect to certain assets. Liabilities with respect to a particular series are enforceable against the assets of that series *only*, and are not enforceable against the assets of the parent LLC or against any other series. Similarly, the liabilities of the parent LLC are generally not enforceable against any sub-series. However, in order to take advantage of this limitation, the assets of the LLC, and each series, must be kept separate (and separate records must be kept). In addition, the LLC's operating agreement must contain a statement to the effect of the limitations, and the LLC's articles of organization must contain a statement that the LLC may have one or more series of assets subject to these limitations.

As a practical matter, a series LLC structure is useful only in a very limited set of circumstances. However, the new LLC act not only permits Ohio LLCs to use the series structure, but formalizes and clarifies Ohio's treatment of non-Ohio series LLCs conducting business in the State of Ohio, which represent significant improvements.

Management Structure and Authority

Under the current LLC act, LLCs can be structured as either member-managed or manager-managed. Throughout the current LLC act, members' and managers' authority to take certain actions on behalf of the LLC is specifically delineated (generally subject to modification in an LLC's operating agreement).

By contrast, the new LLC act eliminates the explicit distinction between member-managed and manager-managed LLCs, and the authority of both members and managers to act under each type of structure. The new LLC act provides instead that a person's ability to act as an agent, and bind the LLC, can be authorized by either: (1) the operating agreement, (2) decisions of the members in accordance with the operating agreement; (3) a "statement of authority" filed with the Ohio Secretary of State; or (4) the new LLC act's "default" rules. This change provides relief from some of the organizational constraints (and, in some cases, ambiguity) of the current LLC act concerning the respective roles of members and managers, providing additional flexibility for the management of each LLC to be structured in the manner most appropriate for that LLC.

Cancellation for Failure to Maintain a Statutory Agent

In contrast to the current LLC act, the new LLC act imposes statutory penalties on LLCs that fail to continuously maintain, or fail to update the name or address of, their statutory agent. The new LLC act directs the Secretary of State to cancel an Ohio LLC's articles, or a foreign LLC's Ohio registration, after providing the LLC with notice and a 30-day opportunity to cure. However, the new LLC act also provides a process for reinstatement upon the appointment of a new statutory agent, whereby a cancelled LLC can apply for reinstatement, on a form prescribed by the Secretary of State, in addition to paying a fee.

“Default” Rules Versus the Operating Agreement

Under the current LLC act, an LLC’s operating agreement generally controls the entity’s structure and operations. However, Section 1705.081 of the current LLC act provides a comprehensive listing of provisions that *cannot* be modified by an LLC’s operating agreement. For example, an operating agreement cannot eliminate the obligation of good faith and fair dealing in a member’s dealings with the LLC or other members, nor can the operating agreement restrict certain third-party rights afforded by law. Outside of these statutorily-prescribed prohibitions, the current LLC act’s provisions serve as “default” rules, which an LLC is free to modify, through its operating agreement, to the extent it chooses.

The new LLC act adopts a similar approach, reflecting that while an LLC’s operating agreement largely controls, certain provisions, listed in a new Section 1706.08, cannot be changed. However, the new LLC act goes a step further, eliminating extraneous language, such as “unless otherwise provided in the operating agreement” and similar phrasing, that is included in the current LLC act (which, in some cases, resulted in ambiguity when such override language was not included). This deletion throughout the new LLC act expressly clarifies that, to the extent that a certain provision is *not* included in Section 1706.08, an LLC is permitted to modify such provision through its operating agreement.

Lawyers and others who work with LLCs in Ohio will need to familiarize themselves with the new LLC act and consider how it may affect existing LLCs and newly formed LLCs. Because each LLC is governed by its own operating agreement, the new LLC act will affect different LLCs differently. Please contact one of the authors or your regular Vorys attorney for more information.