

# Arkansas Repeals its LLC Laws and Adopts the Uniform Limited Liability Company Act



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Arkansas recently became the 20th state to enact the Uniform Limited Liability Company Act (the “ULLCA”) as the governing law for the formation and operation of limited liability companies in the state. On April 30, 2021, Governor Hutchinson signed SB601 into law, now known as Act 1041 of 2021, which repeals the Small Business Entity Tax Pass-Through Act and replaces it with the ULLCA. The new Act will take effect on September 1, 2021, although companies formed prior to September 1 may elect to be governed by the ULLCA.

Adoption of the ULLCA was supported by the Arkansas Bar Association and encouraged by business legal professors and commenters.<sup>[1]</sup> Generally, the ULLCA is intended to reduce compliance risks and costs to small businesses, streamline administration by states, and promote consistency across state lines. Specifically in Arkansas, replacing the Small Business Entity Tax Pass-Through Act (the “Old Act”) with the ULLCA will clarify certain formation and documentation issues, resolve a handful of ambiguities in the Old Act, and strengthen protections for LLC members.

A few of the most notable differences between the Old Act and the ULLCA are discussed below.

1. **Formation.** The ULLCA replaces the concept of “Articles of Organization” with a “Certificate of Organization.” Besides the change in name, the ULLCA also simplifies the timing of formation of LLCs, providing that an entity will be formed when the “certificate of organization becomes effective and at least one person has become a member or manager.”<sup>[2]</sup> This is a welcome change from the Old Act, which provides that a limited liability company is formed “when the articles of organization are delivered to the Secretary of State for filing, even if the Secretary of State is unable at the time of delivery to make the determination [that the articles satisfy the requirements for filing].”<sup>[3]</sup> Because the old Act merely required delivery for formation, it was possible for an entity to be formed before the Secretary of State’s office had a chance to review whether the entity’s filing conformed to the statutory requirements. This possible gap in the formation process does not exist in ULLCA, as the entity is not formed until the certificate is properly filed.

In terms of contents, the Certificate of Organization will also require less information under the ULLCA. Filers will now only need to include the name of the LLC, the address of the company’s principal office, and the name and address of the company’s Registered Agent. Organizers will no longer be required to state whether the LLC will be member-managed or manager-managed in the certificate at the outset. Instead, this designation will be made in the Operating Agreement.<sup>[4]</sup> Unless the operating agreement specifically states that the LLC is manager-managed, LLCs created under ULLCA will be member-managed by default.<sup>[5]</sup>

2. Operating Agreements. Another important divergence of the ULLCA from the Old Act is the fact that LLCs are no longer required to have a written operating agreement. The Old Act states that a written operating agreement “shall be entered into among all of the members.”<sup>[6]</sup> The ULLCA, on the other hand, does not require LLC members to enter into an Operating Agreement at all, providing instead that the standard provisions of the ULLCA will govern the operation of the company in the absence of an agreement to the contrary.<sup>[7]</sup> Further, the ULLCA states that LLC members may enter into an Operating Agreement orally, by implication, in a record, or any combination thereof.<sup>[8]</sup>

Although it is certainly still wise for all LLCs to have a written Operating Agreement, the enactment of the ULLCA eliminates a substantial trap for unwary LLC owners that are either unaware of the need to have an operating agreement or under the false assumption that their “handshake” agreement among members is binding.<sup>[9]</sup> Under the Old Act, LLC members without a written operating agreement are not only susceptible to a “piercing the veil” argument, but are also prone to disagreements among members regarding enforcement of oral or implied agreements.<sup>[10]</sup>

3. Standards of Conduct for Members and Managers. The ULLCA also cleans up ambiguity regarding standards of conduct required for LLC members and managers.<sup>[11]</sup> Although the Old Act addresses certain duties of members and managers, the provisions lack clarity and fail to directly label the duties imposed as “fiduciary” obligations.<sup>[12]</sup> The Old Act also fails to address whether the members of an LLC may waive such duties in an operating agreement.<sup>[13]</sup>

By contrast, the ULLCA sets forth default fiduciary standards of conduct for LLC members and managers. Ark. Code Ann. § 4-38-409 of the ULLCA imposes fiduciary duties of loyalty and care on members of a member-managed LLC and managers of a manager-managed LLC. The duty of loyalty requires members or managers to account to the LLC and hold as trustee any property, profit or benefit derived by the member or manager, as well as to refrain from acting adverse to or competing with the company.<sup>[14]</sup> The duty of care requires members or managers to refrain from grossly negligent or reckless conduct, willful or intentional misconduct, or knowing violation of the law.<sup>[15]</sup> The ULLCA also imposes the contractual obligation of good faith and fair dealing on members and managers in carrying out their duties.<sup>[16]</sup> Unlike the Old Act, the ULLCA specifically provides that these minimum standards of conduct may not be eliminated through the operating agreement, although it does allow for certain modifications.<sup>[17]</sup>

4. Removal of a Member. The Old Act is surprisingly silent on the ability of an LLC or its members to remove a member from the company. Even in a scenario where it would be impossible or unlawful to continue the business of the LLC with a person continuing as a member (for example, if an attorney or physician member were to lose their license), the only remedy provided by the Old Act is to dissolve the company.<sup>[18]</sup>

The ULLCA addresses this issue by allowing for the removal of a member in limited circumstances.<sup>[19]</sup> Under the ULLCA, a person can be expelled as a member upon the vote of all other members if (a) it is unlawful to carry on the LLC business with the person as a member; (b) the member has transferred all of its interest in the company (with certain exceptions); or (b) in certain situations, a member entity has dissolved.<sup>[20]</sup> Further, an LLC or any member may petition the court for removal of a member if the member has engaged in wrongful conduct, has committed a material breach of the operating agreement, or has engaged in conduct that makes it impracticable to carry on the activities and affairs of the company with the person as a member.<sup>[21]</sup>

In addition to these particular issues, the ULLCA adds several new or substantially revised concepts to Arkansas’s LLC statutory scheme. For example, the ULLCA clarifies the procedures for enforcement of charging orders against an LLC member, expands on the procedures for derivative actions by members, and adds a specific provision for domestication of foreign LLCs to Arkansas and vice versa.<sup>[22]</sup>

Overall, enactment of the ULLCA will bring the state more in conformity with other states' LLC acts, and as enumerated above, will shore up a number of shortcomings of the Old Act. The ULLCA also provides a more solid foundation of standard provisions applicable in the absence of a robust operating agreement. Although a change in the governing law of the most popular business entity in the state will inevitably come with some growing pains, it appears to be a positive step for business in Arkansas.

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[1] See Carol Goforth, *Making the Case for the Uniform Limited Liability Company Act (2013) in Arkansas*, 40 U. Ark. Little Rock L. Rev. 187, 198 (2017) (hereinafter, "Goforth").

[2] Ark. Code Ann. § 4-38-201.

[3] Ark. Code Ann. § 4-32-206(a).

[4] Ark. Code Ann. § 4-38-407.

[5] *Id.*

[6] Ark. Code Ann. § 4-32-102(11).

[7] Ark. Code Ann. § 4-38-105(d).

[8] Ark. Code Ann. § 4-38-102(13).

[9] See Goforth at 198-199.

[10] *Id.*

[11] See *Id.* at 200-202.

[12] Ark. Code Ann. § 4-32-402.

[13] Goforth at 204.

[14] Ark. Code Ann. § 4-38-409(b).

[15] Ark. Code Ann. § 4-38-409(c).

[16] Ark. Code Ann. § 4-38-409(d).

[17] Ark. Code Ann. § 4-38-105(e)(5); (f).

[18] See Ark. Code Ann. § 4-32-802; 902.

[19] Ark. Code Ann. § 4-38-602.

[20] Ark. Code Ann. § 4-38-602(5).

[21] Ark. Code Ann. § 4-38-602(6).

[22] See Ark. Code Ann § 7-38-503; 802; 1051.