

The Duty of Loyalty and Arkansas' New Uniform Limited Liability Company Act



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In a recent [Mitchell Williams Blog](#) we highlighted Arkansas' enactment of the Uniform Limited Liability Company Act (the "ULLCA"), and pointed out some of the differences between the ULLCA and Arkansas' existing Small Business Entity Tax Pass Through Act (the "Old Act").

One of those differences is the statutory duty of loyalty contained in the ULLCA at Ark. Code Ann. §4-38-409. Pursuant to §4-38-409(a), a member of a member-managed LLC owes to the company and the other members the duties of loyalty (set out in §4-38-409(b) and care (set out in §4-38-409(c)).

Ark. Code Ann. §4-38-409(b)(3) provides that the fiduciary duty of loyalty of a member in a member-managed LLC includes the "duty to refrain from competing with the company in the conduct of the company's activities and affairs before the dissolution of the company."

Ark. Code Ann. §4-38-409(i), provides that in a manager-managed LLC, the duties listed in §4-38-409(b) apply to the manager or managers and not the members, and further provides that the duty in §4-38-409(b)(3), the duty of non-competition, continues until winding up is completed.

Ark. Code Ann. §4-38-409(f) provides that all the members of a member-managed LLC or a manager-managed LLC may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty. Ark. Code Ann. §4-38-409(i)(5) states/re-states that in a manager-managed LLC the power to ratify under subsection (f) applies only to the members.

Ark. Code Ann. §4-38-105 provides that the LLC's operating agreement, if any, governs the relations between the members, managers and the LLC, and the activities and affairs of the LLC. To the extent the operating agreement does not provide for a particular matter (including if there is no operating agreement), the provisions of the ULLCA govern. Ark. Code Ann. §4-38-105(d).

Ark. Code Ann. §4-38-105 goes on to provide at subsection (e) that an operating agreement may not vary certain provisions under the ULLCA. §4-38-105(e)(5) provides that an operating agreement may not alter or eliminate the duty of loyalty or the duty of care, except as otherwise provided in subsection (f).

Ark. Code Ann. §4-38-105(f)(3) provides that if not manifestly unreasonable, the operating agreement may:

- (A) alter or eliminate the aspects of the duty of loyalty in §4-38-409(b) and (i);
- (B) identify specific types or categories of activities that do not violate the duty of loyalty;
- (C) alter the duty of care, but may not authorize conduct involving bad faith, willful or intentional misconduct, or knowing violation of law; and
- (D) alter or eliminate any other fiduciary duty.

So, per the ULLCA, neither a member (in a member-managed LLC) nor a manager (in a manager-managed LLC) may engage in an activity outside the LLC that is in competition with the activity of the LLC, unless either:

- (1) all of the members authorize or ratify, after full disclosure of all material facts, the specific activity that otherwise would violate the duty of loyalty (per Ark. Code Ann. §4-38-409(f); or
- (2) the LLC's operating agreement specifically allows for such competition, provided that allowing such competition is not manifestly unreasonable (per Ark. Code Ann. §4-38-105(f) (3)).

The effective date of Arkansas' ULLCA is September 1, 2021. Effective September 1, 2021, all limited liability companies formed under Arkansas law, whether formed before or after September 1, 2021, are governed under Arkansas's ULLCA. Ark. Code Ann. §4-38-110(b). The Old Act, previously contained at Ark. Code Ann. 4.32-101, et. seq. is repealed.

You or a client may be a member or a manager of a pre-September 1, 2021 limited liability company, and simultaneously engage in an activity that may be determined to be in competition with that LLC. However the LLC's existing operating agreement may not specifically permit the member or manager to engage in an activity that is in competition with the LLC, as that was not required under the Old Act. As of September 1, 2021, the member or manager may be in violation of his or her or its duty of loyalty under Ark. Code Ann. §4-38-409(b)(3).

For example – Joe and Larry are members of South Development, LLC, created in 2020 under the Old Act, and the LLC's business is to acquire real estate, develop a subdivision and sell residential lots. Joe is also a member of North Development, LLC, created in early 2021 under the Old Act, and that LLC's business is similarly to acquire real estate, develop a subdivision and sell residential lots. Both LLCs are member-managed LLCs and neither South Development, LLC nor North Development, LLC's operating agreement includes a provision authorizing Joe to engage in similar businesses in competition with that LLC.

Effective September 1, 2021, Joe may be determined to be in violation of his duty of loyalty to each LLC. To remedy this breach, the members of each LLC should either (1) unanimously adopt a resolution that provides full disclosure of all material facts and specifically ratifies and authorizes the activity that is in competition with the activity of the LLC, or (2) adopt an amendment to the operating agreement of each LLC altering the duty of loyalty, allowing Joe to engage in an activity that is in competition with the LLC (presumably, acquiring and developing real estate in different business relationships would not be manifestly unreasonable).

Similarly, if either or both of Joe's LLCs are created on or after September 1, 2021, Joe needs to ensure that as part of the organizational documents, that either a resolution authorizing the activity that is in competition with the activity of the LLC is unanimously adopted, or that the operating agreement permits the activity.