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Should LLC Members Opt-in, Opt-out, or Do Nothing with Respect to the New LLC Statute?

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On April 15, 2022, Governor Tony Evers signed Act 258 into law (the "New LLC Law"), repealing and recreating Chapter 183 the Wisconsin Uniform Limited Liability Company Law, which governs limited liability companies ("LLC"). The New LLC Law's provisions will apply to LLCs formed on or after January 1, 2023 (the "effective date").

Existing LLCs have the option to opt-in to the New LLC Law prior to the effective date by filing a Statement of Applicability (Form 399/599) with the Wisconsin Department of Financial Institutions (the "WDFI"). By opting into the New LLC Law, the LLC members gain clarity about which statutory frame work applies to the LLC, and the simplicity of complying with only that one set of statutes.

Alternatively, existing LLCs may also opt-out of the New LLC Law and continue to be subject to the prior law (Ch. 183, 2019 stats., the "Old LLC Law") by filing a Statement of Nonapplicability (Form 398/598) with the WDFI prior to the effective date. By opting out, the LLC members (hopefully) gain the peace of mind that the rules they have put in place for their LLC will be honored by courts in the future and the simplicity of not having to learn a new statutory paradigm.

A third option is for the LLC members to do nothing, neither opt-in nor opt-out of the New LLC Law. By doing nothing, the LLC members create the benefit of putting forth the least amount of time and effort into the management of the LLC. However, as will be discussed, little else is certain.

The fundamental question, then, is **when should an LLC formed prior to January 1, 2023 decide to opt-in, opt-out, or do nothing with respect to the application of the New LLC Law?**

For single-member LLCs (those LLCs with only one equity holder), the decision is fairly inconsequential. Whether governed by the Old LLC Law or the New LLC Law, the management rules for the LLC itself are relatively unchanged by the New LLC Law and because there is only one member in the LLC, there should theoretically be very few conflicts amongst the member. Doing nothing (neither opting-in nor opting-out) will result in the single-member LLC becoming governed by the New LLC Law as of January 1, 2023 and virtually nothing, practically speaking, will have changed for the member or the LLC.

Unfortunately, for multi-member LLCs, there is no bright-line rule or set of circumstances that guide LLC members as to how to proceed, and the decision of whether to opt-in, opt-out, or do nothing may actually have significant practical implications. Thankfully there are a few aspects of the new law that provide useful considerations for LLC members to discuss with their CPAs and attorneys.

The Presence of an Operating Agreement

No Written Operating Agreement

Under the Old LLC Law, if an LLC does ***not*** have a *written* operating agreement in place, the Old LLC Law simply provides the rules by which the LLC comes into existence, must operate, and eventually dissolve.

Under the New LLC Law, if a *written* operating agreement does ***not*** exist, courts are empowered, and in fact required, to create an operating agreement on behalf of the LLC members. Such construction will be based on the LLC members' course of actions, communications, and writings, regardless of whether such actions, communications, and writings explicitly indicate an intention to affect or create governing rules for the LLC. Those terms which are not established by the LLC's constructed operating agreement will be provided by the New LLC Law, but what provisions of the New LLC Law will apply versus what will be imposed by a court might be a very difficult process.

Therefore, if the LLC members are familiar and comfortable with the Old LLC Law, they will want to opt-out of the New LLC Law. The LLC members will (theoretically) only need to be familiar with the Old LLC Law's provisions unless and until they take some sort of action to become governed by the New LLC Law (such as by adopting an actual written operating agreement after January 1, 2023, or by filing a Statement of Applicability after said date).

Conversely, if the LLC members are comfortable with the provisions of the New LLC Law, and no written operating agreement is in place, they can either do nothing or explicitly opt-in. In either case, the New LLC Law will govern.

A Written Operating Agreement Exists

The presence of a written operating agreement somewhat complicates this decision tree. Again, as of January 1, 2023, if an LLC does nothing (neither opts-in nor opts-out of the New LLC Law), the New LLC Law will govern the LLC. However, buried in Section 183.0110(2)(d)(2) is essentially a "savings provision" that reads, "[a]ny provisions of an operating agreement that were valid and in effect immediately prior to this chapter [the New LLC Law] becoming applicable with respect to the limited liability company shall continue to be valid and applicable to the extent allowed under prior law." So, for LLC members who have spent time drafting and becoming familiar with their existing operating agreement (let's call them "Informed Members"), doing nothing is a viable option because courts should theoretically honor the agreed-upon terms of the LLC members...assuming those terms were lawful under the old law.

However, doing nothing also carries with it a significant amount of unknowns. For example, the operating agreement, drafted to conform with the Old LLC Law, will not be able to rely on case law applicable to the Old LLC Law. Rather, the operating agreement's provisions will be interpreted by current courts using the New LLC Law for guidance. Moreover, amendments to and restatements of the operating agreement will also be interpreted under the New LLC Law, so it's unclear whether or how such amendments or restatements will affect terms that were unchanged and which might conflict with provisions of the New LLC Law. Besides the unknown, doing nothing carries the burden of forcing courts (and the members) to be familiar with the Old *and* New LLC Law. Such requirements may be more than most LLC members, even Informed Members, care to handle.

Alternatively, for Informed Members, opting-out of the New LLC Law should theoretically simplify LLC governance and insure that the Informed Members' negotiated and thought-filled terms are honored in the future. There are numerous provisions of the New LLC Law (some of which will be discussed below) which deviate from the Old LLC Law. For Informed Members, failing to opt-out of the New LLC Law could result in a court either applying an unforeseen precedent to its interpretation of the operating agreement. Gaining certainty by opting-out (or at least statutory assurance) that the LLC operating agreement as-drafted will be honored by the courts holds real value.

For LLC members who have ***not*** spent time drafting and becoming familiar with their existing operating agreement, such as those who have never read their operating agreement or who put it in place 50 years ago and haven't looked at it since (let's call them "Passive Members"), the decision tree is virtually the same but likely holds even greater risk. For one, any LLC member who is unfamiliar with the governing terms of the LLC is at a disadvantage compared to Informed Members. But more importantly, Passive Members who fail to opt-out may someday need to be familiar with both the Old and New LLC Law and upon such occurrence, will have a steeper hill to climb than an Informed Member (one who is already familiar with at least the Old LLC Law) as far as understanding where they stand in any given dispute.

Specific Statutory (and Operating Agreement) Topics of Concerns

Fiduciary Duties of Members and Managers

In Wisconsin, LLCs can either be "manager-managed" or "member-managed." Under a "manager-managed" LLC, a specific "Manager" is appointed by the members and this Manager is responsible for the day to day affairs of the LLC, with major decisions being authorized by the members. In a "member-managed" LLC, either all of the Members have authority to act on behalf of the LLC in all aspects, or a "Managing-Member" is named, similar to a "Manager."

Under the Old LLC Law, Managers and Members owed the LLC itself and the other Members certain obligations, called "fiduciary duties" (e.g., the duty of loyalty and duty of care, along with the contractual obligations of good faith and fair dealing). Under the Old LLC Law, Managers and Members could, via the operating agreement, waive these duties to each other. For example, the members of an LLC formed to make investments in restaurants might decide to appoint a restauranteur as its Manager, with instructions to invest LLC funds into new restaurants that have growth potential. If the restauranteur-Manager already operates other restaurant ventures, they might violate their duty of loyalty to the LLC by virtue of entering into contracts on behalf of their other restaurant ventures. Such violation could expose the restauranteur-Manager to liability to the LLC and its other members. To avoid this liability, the members may wish to waive this obligation on the front end.

The New LLC Law imposes greater restrictions on fiduciary duty requirements for LLC managers and members. Both can no longer simply disclaim the fiduciary duties of loyalty and care. Rather, under the new law, members and managers can prescribe the scope of the fiduciary duties and the mechanisms for the members and managers to approve conduct that would otherwise violate those obligations.

Therefore, where Informed Members have diligently negotiated and crafted the parameters of the member and manager fiduciary duties, or where Passive Members simply have agreed over time as to the scope of said duties, such LLCs should opt-out of the New LLC Law to gain the strongest assurances that their desires will be respected by the courts in the event of a dispute.

Articles of Organization and Apparent Authority
Under the Old LLC Law, the Articles of Organization ("Articles") filed with the WDFI controlled whether the LLC was a manager-managed or member-managed LLC. Under the New LLC Law, the LLC's management is no longer determined by the Articles, but rather the New LLC Law assumes the LLC is member-managed unless its operating agreement provides in writing that it is manager-managed. If LLC members did not adopt such a written operating agreement and relied upon their filed Articles to communicate whether they are member-managed or manager-managed, this change in the law may result in confusion and conflicts with third-parties working with LLCs and between members as to who has authority to act on behalf of the LLC. Opting out should theoretically permit the LLC to maintain its management election and have courts respect that decision moving forward.

Also, under the Old LLC Law, in a member-managed LLC (the default formulation), unless altered by the operating agreement, all members have actual and apparent authority to act on behalf of the LLC, binding the LLC as each member sees fit. Under the New LLC Law, the concept of apparent authority is tossed aside: members are not agents of an LLC solely by reason of being a member. For LLCs without a written operating agreement and where members are comfortable acting on behalf of the LLC as they see fit, this new authority paradigm could lead to uncertainty and disputes between members and between the LLC and third-parties. Under the New LLC Law, an LLC may (but does not have to) file with WDFI a "Statement of Authority" identifying the authority of any position or any specific person, or identifying limitations on any such position or person, with such filings being effective for 5 years.

Derivative Claims/Member Disputes
One of the benefits of the new law is that it basically clarifies and rejects the conclusions reached by the Wisconsin Supreme Court (WI SC) in *Marx vs. Morris* as far as when members can bring actions directly vs. derivative actions against each other. Under the Old LLC Law, the WI SC said that members have significant opportunities to directly sue other members for matters relating to the LLC without getting the approval of the LLC itself. The new law explicitly adopts the corporate derivative action requirements (notice to the LLC, voting by the members, etc.) thereby telling the WI SC to ignore *Marx vs. Morris*. This new statutory clarity (and directive to the WI SC) better matches the intentions of the Old LLC Law's drafters, and is a general reason for LLC members to consider opting into the New LLC Law or doing nothing.

Final Take-Away

This significant statutory change from the Old LLC Law to the New LLC Law could inadvertently impose operating agreement provisions which conflict with the members' understanding or agreement, or at a minimum come as a surprise to the LLC members. Therefore, if a multi-member LLC does not currently have an operating agreement in place, it is recommended to adopt an operating agreement and either opt-in or opt-out of the New LLC Law (or, in the case of an opt-in preference, simply draft the operating agreement and execute it after January 1, 2023).

For those LLCs with operating agreements drafted, Informed Members likely will want to opt-out of the New LLC Law, whereas Passive Members may want to review their current operating agreement and then decide, with their legal counsel, whether to opt-in, opt-out, or do nothing.

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