

## Heads up! Arkansas has a new LLC Act.

Carol Goforth\*

I have previously written<sup>1</sup> about various flaws in the Arkansas statute authorizing Limited liability companies (“LLCs”), which was awkwardly titled the “Arkansas Small Business Entity Tax Pass Through Act,”<sup>2</sup> even though it was often referred to as the state’s LLC Act. (In this article, references to this statute will be to the old LLC Act.) This past legislative session Senate Bill 601, sponsored by Senator Jonathan Dismang, was enacted into law, becoming Ark. Act 1041 on April 30, 2021. This act repeals the old LLC Act<sup>3</sup> and adopts the Uniform Limited Liability Company Act (“ULLCA”), with minimal changes from the uniform language.<sup>4</sup>

This short piece is NOT designed as a thorough consideration of all the ways in which the new law differs from the old LLC Act, but instead points out some basic information about the Arkansas ULLCA and some of the major changes in Arkansas law applicable to LLCs. While lawyers will obviously need to consult the new statute when actual issues arise, this article should at least provide a “heads up” notice to practitioners with LLCs or their members and managers as clients.

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\*Carol Goforth is a University Professor and the Clayton N. Little Professor of Law at the University of Arkansas School of Law. Thanks to Senator Dismang for sponsoring the new act, and to all those who worked to facilitate the passage of the Arkansas ULLCA.

1. Carol Goforth, *Making the Case for ULLCA (2013) in Arkansas*, 40 U. ARK. LITTLE ROCK L. REV. 187 (2017); Carol Goforth, *Why Arkansas Should Adopt the Revised Uniform Limited Liability Company Act*, 30 U. ARK. LITTLE ROCK L. REV. 31 (2007).

2. This Act was codified at ARK. CODE ANN. §§ 4-32-101 to -1401 (repealed 2021).

3. Although the new act repeals the old LLC Act, it does not repeal the provisions relating to series LLCs, approved as part of the Uniform Protected Series Act. That Act is codified at ARK. CODE ANN. §§ 4-37-101 to -805 (2019).

4. The new act is codified at ARK. CODE ANN. §§ 4-38-101 to -1202 (2021).

## Effective Date

The first thing to note is that the effective date of the Arkansas ULLCA is September 1, 2021.<sup>5</sup> LLCs formed before that date but after the statute's enactment are given the right to elect to be subject to the new provisions by making an election to that effect "in the manner provided in its operating agreement or by law for amending the operating agreement."<sup>6</sup> However, on and after September 1, the Arkansas ULLCA governs all Arkansas LLCs,<sup>7</sup> effectively changing the law applicable to thousands of small businesses in the state.

## Organization of Arkansas ULLCA

The general organizational framework of the new statute should seem fairly familiar to Arkansas practitioners. The order of provisions follows the same general approach as the state's partnership statutes<sup>8</sup> and, for the most part, even the old LLC Act. Article 1 contains provisions of general applicability such as definitions, purposes, powers, naming requirements, and some important provisions relating to the operating agreement that will be mentioned in a little more detail later in this note. Article 2 explains the rules governing formation of LLCs and public filing requirements. Article 3 covers rules governing the relationship of members and managers with third parties dealing with the LLC, including rules about members'/managers' authority as agents. Article 4 focuses on the rules governing how to become a member, members' default rights and responsibilities, and the default member-management structure of LLCs, as well as how to elect changes to that option. Article 5 adopts the rule from partnership law that allows members to freely transfer their economic interest but not management power, and further covers the rights of transferees, including creditors who obtain and/or foreclose on charging orders. Article 6 outlines the rules

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5. ARK. CODE ANN. § 4-38-1108 (2021).

6. ARK. CODE ANN. § 4-38-110(a)(2) (2021).

7. ARK. CODE ANN. § 4-38-110(b) (2021).

8. See Arkansas Uniform Partnership Act, codified at ARK. CODE ANN. §§ 4-46-101 to -1207 (1996), and Arkansas Uniform Limited Partnership Act, codified at ARK. CODE ANN. §§ 4-47-101 to -1302 (2001).

applicable to a member's dissociation from an LLC. Article 7 covers dissolution of LLCs. Article 8, which has no corresponding provision in the old LLC Act, sets out rules for direct and derivative actions by members including the role of special litigation committees. Article 9 focuses on foreign LLCs, and Article 10 sets out rules for reorganizations, including merger, interest exchange, conversion, and domestication transactions. Article 11 contains miscellaneous provisions, including the statute's effective date.

### Formation of an Arkansas LLC

Some of the changes governing how an LLC is to be formed under Arkansas law are minor or relatively insignificant. For example, the old LLC Act required one or more persons to file articles of organization with the Secretary of State.<sup>9</sup> The Arkansas ULLCA also allows for one or more organizers, but it calls the organizational document a certificate of organization.<sup>10</sup>

The information required in the two documents is also slightly different. Articles of organization under the old LLC Act were required to include the name of the LLC, information about the company's registered agent, and "[i]f management of the limited liability company is vested in a manager or managers, a statement to that effect."<sup>11</sup> The Arkansas ULLCA does not provide for a designation of management structure in the filed document but does require the certificate to include the "street and mailing addresses of the company's principal office."<sup>12</sup> These distinctions, however, seem to be relatively minor.<sup>13</sup>

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9. ARK. CODE ANN. § 4-32-201 (repealed 2021).

10. ARK. CODE ANN. § 4-38-201 (2021).

11. ARK. CODE ANN. § 4-32-202 (repealed 2021).

12. ARK. CODE ANN. § 4-38-201(b)(2) (2021).

13. As of May 10, 2021, the Arkansas Secretary of State included a requirement that all initial filings by incorporators/organizers include an "incorporator/organizer and AT LEAST ONE OFFICER" on its Forms/Fees/Records Request. *Business and Commercial Services: Forms/Fees/Record Requests*, ARK. SEC'Y OF STATE JOHN THURSTON (May 1, 2021, 2:07 PM), [<https://perma.cc/EH8G-RQKY?type=image>]. Thus, in the online form suggested for Articles of Organization for a domestic LLC, the Secretary of State asked for the name and titles of at least one officer. There was no express authority for this requirement in the old LLC Act. The Arkansas ULLCA explicitly requires the Secretary of State to file records that satisfy the statute and also gives anyone filing a document the right to petition the circuit court to compel compliance in a summary proceeding. ARK. CODE ANN. § 4-38-210(a), (d) (2021).

The significant difference, however, is with regard to when the document becomes effective to form an LLC. Under the old LLC Act, “[u]nless a delayed effective date is recited in the articles of organization, 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 required for filing.”<sup>14</sup> If the Secretary of State declined to file because of non-compliance with the statute, the person forming the LLC had to be given notice of the deficiency, and if the articles were brought into conformity with the statute within 20 days of such notice, “the documents are deemed to have been filed at the time of delivery.”<sup>15</sup> Thus, it was not always possible to know if there was going to be a valid LLC or when it would be deemed to have been formed.

The Arkansas ULLCA says that a certificate of organization becomes effective when filed, or on a later effective date not more than 90 days after filing,<sup>16</sup> but the LLC is not formed until the certificate is effective “and at least one person has become a member or manager.”<sup>17</sup> If the plan is to have a single original member, they become a member on the terms that they and the organizer agree to; if there are to be multiple original members, they become members as they agree.<sup>18</sup> Although not adopted as part of the Arkansas ULLCA, the Uniform Law Commission (“ULC”) did include comments about this drafting choice in the model legislation. The comment to section 2.01 of the ULLCA notes that the earliest point in time for a person to become a member is when the certificate of organization becomes effective,<sup>19</sup> but it also points out that members may join later. The ULC decided against allowing creation of a “shelf” LLC (an entity with no members or managers), even though this means that it will not always be possible to definitively ascertain when (or if) the LLC has actually been formed based on public

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14. ARK. CODE ANN. § 4-32-206(a) (repealed 2021).

15. ARK. CODE ANN. § 4-32-1308(f)(2) (repealed 2021).

16. ARK. CODE ANN. § 4-38-207 (2021).

17. ARK. CODE ANN. § 4-38-201(d) (2021).

18. ARK. CODE ANN. § 4-38-401 (2021).

19. UNIF. LTD. LIAB. CO. ACT § 2.01 cmt. at 58 (amended 2013) (NAT’L CONF. OF COMM’RS ON UNIF. STATE L. 2006) (archived on May 1, 2021) [<https://perma.cc/WWW2-UKXL>].

records.<sup>20</sup> If subsequent documents are filed by members or managers, proof of formation could be inferred at that time.

The legal issues caused by these rules are likely to be more apparent than real, since if the LLC in question has neither members nor managers, it cannot act and therefore runs no risk of incurring debts or obligations. Once members or managers interact with others on behalf of the LLC, the uncertainty about the status of the business should disappear.

### The Operating Agreement

One of the simplest but potentially most significant changes in Arkansas law relates to operating agreements. Under the old LLC Act, an operating agreement was defined as “the written agreement which shall be entered into among all of the members as to the conduct of the business and affairs of a limited liability company.”<sup>21</sup> This language raised a number of issues. First, it made the adoption of an operating agreement mandatory. Second, it required the agreement to be in a writing signed by all members. It also appeared to require a singular agreement. Since many of the provisions of the old LLC Act could only be changed by the operating agreement, this language created a potential trap for the unwary, who might not have understood the need for a written agreement to establish or change default rules in what was supposed to be an informal form of business akin to a general partnership.

These issues have been resolved by the Arkansas ULLCA. The new definition of operating agreement is “the agreement, whether or not referred to as an operating agreement and whether oral, implied, in a record, or in any combination thereof, of all the members of a limited liability company, including a sole member, concerning the matters described in § 4-38-105(a). The term includes the agreement as amended or restated.”<sup>22</sup> The cross-referenced section deals with the scope, function and limitation of operating agreements. While it also spells out rules that are not subject to contrary agreement by the members, it generally

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20. *Id.* § 2.11 cmt. at 73.

21. ARK. CODE ANN. § 4-32-101(11) (repealed 2021).

22. ARK. CODE ANN. § 4-38-102(13) (2021).

provides that the operating agreement governs relations among members, managers, and “the activities and affairs of the limited liability company and the conduct of such activities and affairs, including without limitation the requisite votes or consents from members and any managers.”<sup>23</sup> This means that the decision of whether to have an agreement is up to the members, and it can reach most of the aspects of how the business is to be conducted. The agreement itself can be oral or established by conduct, and it can appear in multiple parts, all of which reflect what is likely to be the understanding of persons in a small, informal business enterprise.

A few other points are also worth making about the operating agreement under the Arkansas ULLCA. First, the new statute explicitly makes pre-formation operating agreements enforceable.<sup>24</sup> Second, just as is the case with a partnership agreement,<sup>25</sup> while the bulk of the act is subject to contrary agreement of the members, there is a list of things that cannot be modified by contrary agreement of members.<sup>26</sup> Third, it is the operating agreement rather than the certificate of organization that will determine whether an LLC is to be managed by its members or managers. Finally, the new act makes it clear both that an operating agreement is binding on the LLC even if the business has not formally adopted the agreement, and that a single member can create a binding operating agreement.

### Changes in Management Authority

Another set of rules that have been significantly changed by adoption of the Arkansas ULLCA involve the management structure of those in the business and the authority of members

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23. ARK. CODE ANN. § 4-38-105(a)(3) (2021).

24. ARK. CODE ANN. § 4-38-106 (2021).

25. *See* ARK. CODE ANN. § 4-46-103 (2000) (listing various rules that are not subject to contrary agreement in the case of general partnerships) and ARK. CODE ANN. § 4-47-105 (2007) (similar list of nonwaivable provisions in limited partnerships).

26. ARK. CODE ANN. § 4-38-105 (2021). In the old LLC Act, if a provision was subject to modification, the statute specifically noted that it could be modified by the operating agreement. *See, e.g.*, ARK. CODE ANN. § 4-32-401(b) (repealed 2021) (one of many sections beginning with “[u]nless otherwise provided in an operating agreement”). In line with the general structure of other business organization statutes promulgated by the ULC, the ULLCA accumulates the provisions that can and cannot be changed by agreement in this single section.

and managers. Probably the most significant change is that regardless of whether an LLC is member- or manager-managed, authority to take action binding on the business and others is determined by agency law and not by the LLC statute. As for members' authority, the Arkansas ULLCA is quite explicit on this point, stating that "[a] member is not an agent of a limited liability company solely by reason of being a member."<sup>27</sup> The statute does note that other law, such as basic agency principles, can result in the imposition of liability on the LLC as a result of a member's actions.<sup>28</sup> The Arkansas ULLCA does not contain similar limitations on managers' authority, but this would be a logical result of applying agency principles since appointment as a manager would presumptively convey some degree of authority.<sup>29</sup>

The clearest way to demonstrate the magnitude of this change is to consider the language in the old LLC Act. Under that statute, members in a member-managed LLC and managers in a manager-managed LLC were automatically given agency power that enabled them to bind the business by acts

including, but not limited to, the execution in the name of the limited liability company of any instrument, for apparently carrying on in the usual way the business or affairs of the limited liability company . . . unless the member [or manager] so acting has, in fact, no authority to act for the limited liability company in the particular matter, and the person with whom the member is dealing has knowledge of the fact that the member [or manager] has no such authority.<sup>30</sup>

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27. ARK. CODE ANN. § 4-38-301(a) (2021).

28. ARK. CODE ANN. § 4-38-301(b) (2021).

29. Under the Restatement (Third) of Agency, an agent has actual authority whenever it is reasonable for the agent to understand, based on a manifestation from the principal, that the agent is empowered to so act. RESTATEMENT (THIRD) OF AGENCY § 2.01 (AM. L. INST. 2006). Apparent authority would be created where the third party with whom an agent is interacting reasonably assumes that the agent has been authorized. *Id.* § 2.03. In the case of someone appointed as manager, there has been a manifestation from the LLC (or the other members) upon which it could be reasonable for the agent or third party to rely. This would therefore create some authority, although the extent of that authority is not set out definitively in the Arkansas ULLCA.

30. ARK. CODE ANN. § 4-32-301 (repealed 2021). Subsection (a) applied for members in member-managed LLCs, and (b)(2) applied for managers in manager-managed LLCs.

The default rules also included the same level of automatic actual authority for members or managers unless the operating agreement provided otherwise.<sup>31</sup>

The Arkansas ULLCA abandons this approach, and the new law means that rather than relying on the distinction between member- and manager-management to determine who has the legal power to bind the business, the question of authority will depend on a consideration of the same facts and circumstances that govern agency authority generally. Because this approach does not always involve clear-cut determinations, the Arkansas ULLCA also includes new provisions allowing statements of authority to be filed in the office of the Secretary of State and in the case of real estate, in the office where real estate records are kept.<sup>32</sup> Such statements, if properly filed and not cancelled, amended, or otherwise limited by subsequent filings, are deemed conclusive proof of authority in favor of persons who give value in reliance on the statement unless such persons have knowledge to the contrary.<sup>33</sup>

Before moving to the next topic, there is an additional wrinkle in the rules for determining how LLCs are to be managed. Under the old LLC Act, an election to be manager-managed had to be made in the articles of organization.<sup>34</sup> In contrast to that position, the Arkansas ULLCA says that the election to have managers is to be made in the operating agreement, and that this election must be “express,” using words like “manager-managed,” “managed by managers,” or the like.<sup>35</sup> Fortunately, pre-existing LLCs need not amend either their articles or operating agreement to effectively elect manager-management, because the transitional rules also provide that for LLCs in

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31. ARK. CODE ANN. § 4-32-401 (repealed 2021), provided that § 4-32-301 would control authority as to members “[u]nless otherwise provided in an operating agreement.” Because the operating agreement had to be in the signed document governing operation of the business, this made it difficult to remove actual authority to take acts that appeared to be carrying on the LLC’s business. *See* ARK. CODE ANN. § 4-32-101(11) (repealed 2021) (requiring the operating agreement to be in writing signed by all members).

32. ARK. CODE ANN. § 4-38-302 (2021).

33. Statements of authority may come to be referenced in Arkansas Title Standards, which will need to be updated to reflect the change in rules regarding power to bind Arkansas LLCs. *See* STANDARDS FOR EXAMINATION OF REAL EST. TITLES IN ARK. § 4.9 (ARK. BAR ASS’N 2018).

34. ARK. CODE ANN. § 4-32-301(b) (repealed 2021).

35. ARK. CODE ANN. § 4-38-407(a) (2021).

existence prior to September 1, 2021 (the date the Arkansas ULLCA becomes effective) for purposes of ascertaining whether the LLC is member- or manager-managed “language in the company’s articles of organization designating the company’s management structure operates as if that language were in the operating agreement.”<sup>36</sup>

### Explicit Fiduciary duties

The Arkansas ULLCA has also changed the law applicable to duties owed by members and managers in the course of representing and working for their LLC. The old LLC Act had no clear statement of the duty of care owed, saying only that

[a] member or manager shall not be liable, responsible, or accountable in damages or otherwise to the limited liability company or to the members of the limited liability company for any action taken or failure to act on behalf of the limited liability company unless the act or omission constitutes gross negligence or willful misconduct.<sup>37</sup>

As for the duty of loyalty, members or managers owed a duty to

hold as trustee for it any profit or benefit derived by that person without the consent of more than one-half (1/2) by number of the disinterested managers or members . . . from any transaction connected with the conduct or winding up of the limited liability company or any use by the member or manager of its property.<sup>38</sup>

Members without management authority in a manager-managed LLC had no duties at all.<sup>39</sup> One of the most piquant observations about this language came in 2007, from Professor Fendler, who noted that “[t]he most striking feature of this [language was] its stunning ambiguity.”<sup>40</sup>

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36. ARK. CODE ANN. § 4-38-110(c)(2) (2021).

37. ARK. CODE ANN. § 4-32-402(1) (repealed 2021).

38. ARK. CODE ANN. § 4-32-402(2) (repealed 2021).

39. ARK. CODE ANN. § 4-32-402(3) (repealed 2021).

40. Frances S. Fendler, *A License to Lie, Cheat, and Steal? Restriction or Elimination of Fiduciary Duties in Arkansas Limited Liability Companies*, 60 ARK. L. REV. 643, 678 (2007).

Despite Professor Fendler's suggestion that the courts should adopt expansive fiduciary duties for LLC members,<sup>41</sup> the Arkansas Supreme Court appeared to reject this approach in 2008. In *K.C. Properties of N.W. Arkansas, Inc. v. Lowell Inv. Partners, LLC*,<sup>42</sup> the court declined to impose a general obligation of good faith and fair dealing on LLC members, prompting Professor Fendler to complain that "[i]ndividuals should not be allowed to escape the strictures of fiduciary obligation through complicated superstructures of limited liability entities, when to do so defeats the justifiable expectations of their business partners (the term 'partner' here being used in its common, rather than its legal, meaning)."<sup>43</sup>

The Arkansas ULLCA resolves some of these issues by setting out explicitly a member's or manager's duties and obligations, although the listed obligations are not deemed to be the "only" fiduciary obligations that are owed. The statute says a member in a member-managed LLC owes not only the duty to account for benefits received from use of the company's property or usurpation of a business opportunity but also the duties to refrain from dealing as or on behalf of an adverse party or from competing with the company.<sup>44</sup> The duty of care is defined as the obligation "to refrain from engaging in grossly negligent or reckless conduct, willful or intentional misconduct, or knowing violation of law."<sup>45</sup> In addition, members have the responsibility of discharging obligations under the statute or operating agreement "consistently with the contractual obligation of good faith and fair dealing."<sup>46</sup> Even though these responsibilities are limited, they clearly exceed the requirements mentioned or suggested in the old LLC Act.

The Arkansas ULLCA also includes some additional clarification about how these principles operate in the context of LLCs. For example, the statute explains that there is no violation of a member's duty of loyalty simply because an action also

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41. *Id.*

42. *See* 373 Ark. 14, 280 S.W.3d 1 (2008).

43. Frances S. Fendler, *Losing Faith: Limited Liability Companies in Arkansas and the Fiduciary Duties of Loyalty and Good Faith*, 31 U. ARK. LITTLE ROCK L. REV. 245, 249 (2009).

44. ARK. CODE ANN. § 4-38-409(b) (2021).

45. ARK. CODE ANN. § 4-38-409(c) (2021).

46. ARK. CODE ANN. § 4-38-409(d) (2021).

further the member's own interests.<sup>47</sup> The statute also establishes rules for ratification of contracts that might be a conflict of interest<sup>48</sup> and instructions on accepting proof of fairness as a defense to a duty of loyalty claim.<sup>49</sup> In addition, under the language of the statute, the base fiduciary duties and obligations may be restricted in an operating agreement "[i]f not manifestly unreasonable."<sup>50</sup> Finally, it is also possible for an LLC to limit or even eliminate liability of a manager to the LLC or other members for monetary damages except for breaches of the duty of loyalty, liability for improper distributions, or conduct involving bad faith, willful or intentional conduct, or knowing violations of law.<sup>51</sup>

Closely related to the issue of fiduciary duties in an LLC, unlike the old LLC Act,<sup>52</sup> the Arkansas ULLCA includes judicial dissolution as a potential remedy for oppressive conduct by those in control of the business. The new provision authorizes any member to seek a court order dissolving the LLC on the grounds that "the managers or those members in control of the company . . . have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant."<sup>53</sup>

While the Arkansas ULLCA does not have the expansive fiduciary obligations that some may have hoped for, at least default obligations are spelled out along with rules as to how those duties may and may not be further limited or defined.

## Charging Orders

The old LLC Act contained relatively sparse provisions dealing with the rights of creditors of LLC members. It allowed judgment creditors of members to obtain an order charging the members' LLC interest "with payment of the unsatisfied amount

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47. ARK. CODE ANN. § 4-38-409(e) (2021).

48. ARK. CODE ANN. § 4-38-409(f) (2021).

49. ARK. CODE ANN. § 4-38-409(g) (2021).

50. ARK. CODE ANN. § 4-38-105(f)(3) (2021).

51. ARK. CODE ANN. §§ 4-38-105(e)(7), (f)(3)(C) (2021).

52. The only grounds for judicial dissolution under the old LLC Act was if it was "not reasonably practicable to carry on the business of the limited liability company in conformity with the operating agreement." ARK. CODE ANN. § 4-32-902 (repealed 2021).

53. ARK. CODE ANN. § 4-38-701(4)(C) (2021). This provision covers actions that are illegal, fraudulent, or oppressive to the plaintiff.

of judgment with interest” and gave the creditor the rights of an assignee.<sup>54</sup> The only other relevant provision required unanimous consent of other members for an assignee to become a member of the LLC.<sup>55</sup>

Contrast that very bare bones language with the extensive explanation of the process and creditors’ rights under the Arkansas ULLCA provision on charging orders.<sup>56</sup> The new section not only provides for the possibility of charging orders against the transferable interest of members, but also covers others (such as transferees who have not become members) who own such an interest.<sup>57</sup> The provision explains the effect of the charging order as a lien on the transferable interest, explaining the obligation of the LLC to pay distributions otherwise owed to the holder of the interest to the holder of the charging order.<sup>58</sup> The statute also gives the court explicit authority to appoint receivers and make other orders to effectuate the charging order.<sup>59</sup> In addition, the possibility of foreclosure of the charging order is explicitly contemplated, after which the right of the member or transferee to satisfy the judgment and extinguish the charging order terminates.<sup>60</sup> Upon foreclosure, the purchaser at the foreclosure sale becomes a holder of the transferable interest, unless admitted as a member on the unanimous vote of other members.<sup>61</sup> There are special rules if the foreclosure of a charging order is against the sole member of an LLC, in which case the purchaser does become a member and the debtor is dissociated as a member.<sup>62</sup> The new statute also clarifies that this is the exclusive remedy for a creditor to enforce a judgment against a member or transferee’s interest in an LLC.<sup>63</sup>

The new statute therefore offers substantially more detail and clarifies issues that could have arisen under the old LLC Act.

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54. ARK. CODE ANN. § 4-32-705(a)(1) (repealed 2021).

55. ARK. CODE ANN. § 4-32-706 (repealed 2021).

56. ARK. CODE ANN. § 4-38-503 (2021).

57. ARK. CODE ANN. § 4-38-503(a) (2021).

58. ARK. CODE ANN. § 4-38-503(a).

59. ARK. CODE ANN. § 4-38-503(b) (2021).

60. ARK. CODE ANN. § 4-38-503(c), (d) (2021).

61. ARK. CODE ANN. § 4-38-503(c) (2021).

62. ARK. CODE ANN. § 4-38-503(f) (2021).

63. ARK. CODE ANN. § 4-38-503(h) (2021).

### Derivative actions

The old LLC act did not include any provisions about whether members in an Arkansas LLC have the right to bring derivative claims, although the Arkansas Rules of Civil Procedure specifically reference the possibility that members “of an unincorporated association” might maintain derivative actions.<sup>64</sup> This omission created confusion as to if and when members in an Arkansas LLC could bring derivative claims, as demonstrated in the 2014 decision in *Muccio v. Hunt*.<sup>65</sup> In this case, members of a bankrupt LLC brought claims against other members, managers, and the lawyers of the business.<sup>66</sup> The appellants sought review of the circuit court’s decision that the claims were derivative in nature, and that the individual plaintiffs therefore lacked standing to pursue them in their own names.<sup>67</sup> While improperly referencing corporate law and corporate terms in the context of the Arkansas LLC, the case has been “widely noted for establishing the precedent that members of an Arkansas LLC could assert direct claims against their fellow members, and the LLC’s managers, for fraud, breach of duty to disclose, and conversion.”<sup>68</sup>

This Arkansas ULLCA should resolve some of this confusion. First, the new statute explicitly authorizes members of an LLC to bring both direct and derivative claims. Direct claims are defined as those designed “to enforce the member’s rights and protect the member’s interests, including rights and interests under the operating agreement or this chapter or arising independently of the membership relationship,” and the member bringing the claim must both plead and prove an alleged injury “that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company.”<sup>69</sup> Derivative claims

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64. ARK. R. CIV. P. 23.1.

65. 2014 Ark. 35, 2014 WL 346929.

66. The opinion incorrectly calls the LLC a “corporation,” although it was not. *See Muccio*, 2014 Ark. at 1, 2014 WL 346929 at \*1 (referring to the entity as a “limited liability corporation”). The inaccurate assumption that the business was a corporation appears to continue throughout the opinion.

67. 2014 Ark. at 2, 2014 WL 346929 at \*1. The plaintiffs raised other errors as well.

68. Allison R. Gladden, *Beyond Direct vs. Derivative: What Muccio v. Hunt Tells Us About Arkansas LLCs*, ARK. LAW 34, 35 (Winter 2016).

69. ARK. CODE ANN. § 4-38-801 (2021).

are brought “to enforce a right of” the LLC,<sup>70</sup> and the statute requires the member to make a demand on those with management authority to explain why such demand would be futile.<sup>71</sup>

There are additional procedural requirements spelled out by the Arkansas ULLCA, meaning that there should be no need to refer to corporate law to determine how to proceed with derivative claims. For example, the new law includes the requirement that the plaintiff in a derivative action must either have been a member when the conduct complained of occurred or be one “whose status as a member devolved on the person by operation of law or pursuant to the terms of the operating agreement from a person that was a member at the time of the conduct.”<sup>72</sup>

If a derivative action is filed, the statute also authorizes the LLC to form a special litigation committee to investigate the asserted claims.<sup>73</sup> This stays the litigation while the committee does its investigation, although it does not prevent a person from enforcing their rights to information or preclude the granting of an appropriate temporary restraining order or preliminary injunction.<sup>74</sup> The requirements for composition of the committee and how it is to be appointed are included in the statute,<sup>75</sup> and the objective of the committee’s investigation is to determine if “it is in the best interests” of the LLC to continue, settle, or dismiss the action.<sup>76</sup> The statute also sets out the standards pursuant to which the court is to evaluate the committee’s recommendation and whether to enforce it.<sup>77</sup>

With provisions that are this complete, future direct and derivative actions by LLC members should be able to avoid some of the confusion and uncertainty caused by the lack of specificity in the old LLC Act.

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70. ARK. CODE ANN. § 4-38-802 (2021).

71. ARK. CODE ANN. § 4-38-802(1)-(2) (2021). This information must be alleged with particularity in the complaint. ARK. CODE ANN. § 4-38-804 (2021).

72. ARK. CODE ANN. § 4-38-803 (2021).

73. ARK. CODE ANN. § 4-38-805(a) (2021).

74. ARK. CODE ANN. § 4-38-805(a).

75. ARK. CODE ANN. § 4-38-805(b)-(c) (2021).

76. ARK. CODE ANN. § 4-38-805(d) (2021).

77. ARK. CODE ANN. § 4-38-805(e) (2021).

## Events and Consequences of Dissociation

Another area where the Arkansas ULLCA deviates from the old LLC Act is in the events that cause a member's dissociation from the LLC. Under the old LLC Act a member had no right to dissociate by voluntary withdrawal, absent a provision in the operating agreement giving them that right.<sup>78</sup> The Arkansas ULLCA works differently, giving a member the right to withdraw, absent a restriction in an operating agreement.<sup>79</sup> However, the effect of this dissociation is that the transferable interest owned immediately prior to dissociation as a member becomes owned as a transferee.<sup>80</sup> There is no right to be bought out, as there would have been under the old LLC Act.<sup>81</sup>

The rights of other members to remove a problematic member have also been changed. Under the old LLC Act, the default rules provided that a member who transferred all of his or her interest in the LLC could be removed by agreement of a majority of other members.<sup>82</sup> If a member was bankrupt, the default rules allowed for their removal by unanimous vote of

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78. The wording of the old LLC Act was circuitous and confusing. ARK. CODE ANN. § 4-32-802(a)(1) (repealed 2021) indicated that “[a] person ceases to be a member of a limited liability company” when “[t]he member withdraws by voluntary act . . . as provided in subsection (c) of this section.” However, subsection (c) clarified that

[a] member may withdraw from a limited liability company only at the time or upon the happening of an event specified in the articles of organization or an operating agreement. Unless the articles of organization or an operating agreement provides otherwise, a member may not withdraw from a limited liability company prior to the dissolution and winding up of the limited liability company.

ARK. CODE ANN. § 4-32-802(c) (repealed 2021).

79. ARK. CODE ANN. § 4-38-602(1) (2021) (“A person is dissociated as a member when . . . [the LLC] knows or has notice of the person’s express will to withdraw as a member, but, if the person has specified a withdrawal date later than the date the company knew or had notice, on that later date”). *Accord* ARK. CODE ANN. § 4-38-601(a) (2021) (“A person has the power to dissociate as a member at any time, rightfully or wrongfully, by withdrawing as a member by express will”).

80. ARK. CODE ANN. § 4-38-603(a)(3) (2021).

81. ARK. CODE ANN. § 4-32-602 (repealed 2021) (providing that on dissociation that did not cause dissolution of the LLC, “a dissociating member is entitled to receive any distribution to which the member was entitled,” and if the operating agreement did not otherwise provide “the member shall receive within a reasonable time after dissociation the fair value of the member’s interest in the limited liability company as of the date of dissociation based upon the member’s right to share in distributions from the limited liability company”).

82. ARK. CODE ANN. § 4-32-802(a)(3)(B) (repealed 2021).

other members.<sup>83</sup> Otherwise, the right to remove a member was determined by the operating agreement.<sup>84</sup> Under the Arkansas ULLCA, the default rules add the right to expel a member by unanimous vote of other members if “it is unlawful to carry on the limited liability company’s activities and affairs with the person as a member.”<sup>85</sup>

This is one of the situations that had the potential to create real problems under the prior law. Consider this situation that could have arisen under the old LLC Act. Three lawyers organize their law firm as an LLC. Later, one of them is disbarred but refuses to voluntarily leave the firm. If they had lacked the foresight to include a provision covering this situation in a written and signed operating agreement, the old LLC Act offered no recourse other than to seek a judicial order of dissolution.<sup>86</sup> This potential trap for the unwary is avoided in the new Arkansas ULLCA.

Another difference in the dissociation provisions is the addition of the default right to expel an organizational member. Such expulsion can occur when that member has filed a statement of dissolution, has been administratively dissolved, has had its right to conduct business suspended, has been given notice of pending expulsions, or has not corrected the situation within the time limits set out in the statute.<sup>87</sup>

Finally, the new statute adds a number of grounds for a member to seek a judicial order expelling a member.<sup>88</sup> Potential grounds for such an order include where such person has: (1) engaged in wrongful conduct adversely and materially affecting the LLC; (2) willfully or persistently materially breached his or her statutory duties or contractual obligations; or (3) engaged in

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83. ARK. CODE ANN. § 4-32-802(a)(4) (repealed 2021). This section contained a number of different triggers such as making an assignment for the benefit of creditors, filing a voluntary petition in bankruptcy, being adjudicated a bankrupt, etc.

84. ARK. CODE ANN. § 4-32-802(a)(3)(A) (repealed 2021).

85. ARK. CODE ANN. § 4-38-602(5)(A) (2021).

86. ARK. CODE ANN. § 4-32-902 (repealed 2021) (giving circuit courts authority to decree dissolution “whenever it is not reasonably practicable to carry on the business of the limited liability company”). Even the court was given no authority to simply expel the offending member.

87. ARK. CODE ANN. § 4-38-602(5)(C)-(D) (2021).

88. ARK. CODE ANN. § 4-38-602(6) (2021).

conduct that makes it not reasonably practicable to carry on the LLC's business with such person as a member.<sup>89</sup>

### Conclusion

As noted at the outset, this short article does not purport to be (and most definitely is not) a complete examination of the myriad of changes that will be facing Arkansas LLCs. Most of such changes, however, will be ministerial and should not affect the organization or day-to-day operation of most of these businesses.<sup>90</sup>

The point of this note is to make Arkansas practitioners aware that the law governing LLCs is changing. As of September 1, 2021, new laws will govern all LLCs in the state, imposing new obligations and new rights, creating new procedures, and hopefully adding clarification where the old law was ambiguous or silent. Hopefully, most of the more significant changes are noted here, as an introduction to the newest Arkansas business entity statute.

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89. ARK. CODE ANN. § 4-38-602(6)

90. As an example of this kind of change, the Arkansas ULLCA added a series of sections dealing with registered agents that the old LLC Act relegated to model registered agents act. *See* ARK. CODE ANN. §§ 4-38-115 to -119 (2021). Another change that is likely to have little practical impact is ARK. CODE ANN. § 4-38-403 (2021), which imposes potential liability for unpaid or unfulfilled obligations to make contributions even if the commitment was not reduced to writing. *Cf.* ARK. CODE ANN. § 4-32-502(a) (repealed 2021).