

The Implications of Alabama's New Limited Liability Act (LLC)

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During its 2014 legislative session, the Alabama Legislature passed a significant revision of the state's Limited Liability Act. The new Act applies to any Limited Liability Company (LLC) that is created on or after January 1, 2015, and all existing LLCs, including those that were formed prior to January 1, 2015, will be bound by the new act on January 1, 2017.

The new LLC Act is the result of a multi-year process that began in 2007 when a committee was formed to determine what revisions could be made to the existing Act in order to make Alabama more business-friendly. The overarching policy behind the changes involves giving business owners more flexibility to fashion the obligations and structures of their limited liability companies. It's also aimed at empowering managers and owners with the ability to craft and mold the governance of LLCs through the power of contract. In many ways, the changes in the Act bring Alabama law more in line with Delaware's Limited Liability Act, a state that is known for being a very business-friendly place.

The state will see a number of significant changes under its new LLC Act, beginning with the fact that it provides further protections to an LLC's members, officers and managers in terms of limiting the fiduciary responsibilities of those who are in charge of operating the business. The owners of an LLC now have broader ability to limit those liabilities; through the LLC's Operating Agreement, which under the new Act is called a "Company Agreement," the parties can effectively restrict or eliminate the fiduciary responsibilities of those who are leading the LLC. However, the new act does provide that owners may not fully eliminate the implied contractual covenant of good faith and fair dealing.

The new Act also allows LLC owners to create subsidiary companies ("series LLC") that have their own assets and liabilities under the general structure of the LLC without having to create a new separate entity. This will help simplify and reduce the costs to keep certain risks separate from the general operating assets and normal liabilities of the company.

Perhaps the most profound change provided by the new LLC Act is that it allows companies to establish their Company Agreements not only through a written document, but also verbally or implied. Under previous law, the Operating Agreements could only be written. While this change was inserted into the new Act to further extend the owner's flexibility, it will almost certainly lead to increased litigation among LLC owners.

Now that owners can create and amend the operating requirements and obligations in a non-documented manner, litigation will move from the four corners of a company's written agreement to the uncertain, and often contradictory, realm of verbal testimony. LLC disputes among owners will become far less certain and substantially more costly. This is something our firm has seen time and time again, and it is a true axiom of litigation that a "he said, she said" dispute is very expensive to litigate.

Because of this, it is now far more important for companies to have their arrangements, especially their initial Company Agreement, in writing to help limit the opportunity for disagreement and confusion. Having a written Company Agreement will help provide clarity, not only as to obligations and contractual rights, but also to help define the expectations of the parties involved in the ownership of the business.

While Company Agreements should have written clauses that require written amendments, it will be interesting to see if Alabama courts will determine, even in the presence of those clauses, whether verbal amendments can still be enforced. Under existing Alabama law, the provisions requiring that amendments be written have not been universally enforced. *See Ex Parte Cullman*, 861 So. 2d 1080 (Ala. 2003). While the Act specifically provides that owners can limit the methods in which the Company Agreement can be changed, courts in the future will be called to interpret this statutory language in determining whether to create a rule of evidence where subsequent verbal agreements are or are not enforced.

Overall, the new LLC Act's flexibility provides LLC members with the ability to have more contractual freedom in establishing the operational contours of their LLC. But whenever there's a change in the law, there is some anxiety in the business community. We have had business owners contact us to evaluate their operating agreements to see if they are in compliance with the new LLC law – as anyone with questions should. It's crucial for business owners to be prepared, which means having a strategy in place to minimize any negative consequences of the new Act.

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