

Summary of Updates to LLC Act

Background

The first LLC was created in 1977 in Wyoming. Delaware started offering LLCs in 1993. LLCs were in all states by 1995. Now, over 2/3rds of all entities being formed are LLCs. As example, in Delaware 73.4% of businesses formed were LLCs in 2021. In South Dakota, the Secretary of State reported over 66.2% of the new business entities formed were LLCs in 2019. With LLCs popularity for entity choice, it is important that South Dakota's LLC Act not only stay current but ideally top-notch.

The South Dakota Uniform Limited Liability Act became effective in March of 1998 and has been revised over time. As people are becoming more educated on jurisdiction selection, we are seeing even South Dakotans decide to organize LLCs in other jurisdictions. Our LLC Act should be updated to be more competitive with the "top" jurisdictions to attract and retain current LLCs, but also make sure our laws are the best in the country for our own South Dakota citizens.

Process

In 2021, a subcommittee of the Business Law Committee was formed to review, analyze and make improvements to the LLC Act. The "excluded manager" was a precipitous of the proposed changes and largely derived from mirroring the directed trustee language in South Dakota's trust laws. This language would allow the excluded manager a limited role in management and thereby limiting liability only to the role that it performed, which is similar to the directed trustee. In today's world, this is important because duties are typically divided between managers to either take advantage of each person's expertise or to recognize the preference of the LLC members wanting only certain individuals to hold certain responsibilities in management. By adding the excluded manager(fiduciary) concept, which is similar to the directed trust laws, managers are more willing to agree to a divided duties concept knowing that if they do not have a certain responsibility or duty, they do not have the liability for that excluded duty. Thus this concept is not about *no one* having the responsibility, but rather recognizing that the person that has the duty has the responsibility and liability for its exercise or non-exercise.

Numerous states, including the four states that are considered the "top" jurisdictions to organize an LLC (Delaware, Alaska, Wyoming and Nevada) were examined and compared by the subcommittee. In 2022, the proposed changes to the LLC Act passed out of the subcommittee and then passed out of the larger Business Law Committee. The Governor's Trust Task Force then asked for time to allow their task force to review said proposals. Accordingly, the subcommittee asked the Business Law Committee to drawback the proposals. In the fall of 2022, the subcommittee of the Business Law Committee, with the addition of several members from the Governor's Trust Task Force who were asked to be part of the subcommittee, again reviewed and compared LLC Acts but only focused on the "top" four, namely, Delaware, Alaska, Wyoming and Nevada, to see if any further updates or changes should be made.

When comparing South Dakota to the top four states, noticeable differences existed that are considered an advantage for people setting up LLCs. In January of 2023, this committee along with three members from the Governor's Trust Task Force, and along with the Director of the Division of Banking, held a virtual meeting and discussed these proposed changes, made minor amendments and the result is the revised proposals.

Comparisons/Findings

1. Privacy Concerns. Although South Dakota doesn't require the members of member-managed LLCs to be reported, the managers of a manager-managed LLC must be reported with those names and information being public on the SOS website. In comparison, Delaware, Alaska and Wyoming do not require the members or the managers to be reported. In Nevada, both the members and the managers must be reported. In today's world, privacy concerns are real. That said, the committee does not support secrecy. It is believed that the incoming Corporate Transparency Act that goes into effect in 2024 will address and alleviate the secrecy aspect with its required disclosures to the government. This committee also anticipates that the SD Division of Banking may require additional disclosures by LLCs that are involved in the trust business, either via Special Purpose Entities or otherwise. In terms of disclosure, it makes little sense to treat member-managed and manager-managed LLCs differently with reporting requirements. SD attorneys indicated that they have lost LLC work to Delaware and Wyoming specifically because of the required manager disclosure so these changes will support keeping SD businesses organized in SD.
2. Clarity in law. SDCL has a freedom to contract clause. However, if it isn't clear in the statute what is or isn't allowed, people will be drawn to the clarity of other state laws where the statutes specify the operating agreement will control. For example, in Delaware an LLC itself has the power to grant or execute a power of attorney. South Dakota's freedom to contract clause is quiet on this topic and therefore if it is important to a potential business owner, he or she may choose Delaware. Similarly, we discovered states allowing for the creation of a similar Excluded Manager role wherein the Excluded Manager has specific authority compared to a typical Manager and the question was raised whether South Dakota already allows for this under our freedom to contract provision. When deciding on if they want to use South Dakota for their LLC business, owners want to "know" what their options are to compare and telling them what "might" be ok because we have a broad power is not typically something an attorney is willing to opine. Thus, business owners may choose another state that has clear policy.
3. Modernizing roles. The world is increasingly specialized. Managers taking on a limited role should be liable for only those things they are performing. Allowing for Excluded Managers lets companies assign specific and specialized tasks to the right person who is not expected to understand or make decisions in an area covered by another Manager. By allowing for a division and specialization, a company can clarify roles and responsibilities to be responsive and clear both internally and externally regarding who is the authority on specific matters. These Excluded Managers are also protected from feeling responsible or distracted by other responsibilities. This addition also allows for an overarching tier of non-excluded Managers to keep abreast of the entirety of the company while establishing a more efficient reporting structure.

Proposed Legislation

The proposed changes involve updating three areas of the South Dakota Uniform Limited Liability Company Act; namely the powers of the LLC under 47-34A-112, the administrative reporting requirements, and adding a new section regarding excluded managers.

Regarding the powers of the LLC itself, 47-34-A-112 lists the powers the LLC holds to carry out its business, but please understand these powers may be limited or modified by the company itself.

Therefore, these changes are not requirements, but clarifications of the authority that may be held by the LLC should the company desire them. The revisions add two powers: the first indemnifying and holding harmless members or managers against any claims, and the second allowing the LLC to grant, hold or exercise a power of attorney. The power of attorney language being proposed is near identical to that of Delaware. The indemnification language is also similar to Delaware, but the other states also have indemnification provisions similar to this but even more elaborate.

These powers are express in other states and will provide clarity in responsibility and authority to the South Dakota code as currently drafted. The intent is to provide LLCs themselves with the authority to protect the members and managers and also to assign authority to others to improve efficiency and clarity of authority.

Regarding the administrative reporting requirements, the proposed revisions remove the need to report the initial managers in the Articles of Organization and in ongoing Annual Reports. This is in alignment with Delaware, Alaska and Wyoming laws. Further, this change would now treat member-managed and manager-managed LLCs uniformly. Additionally, the revision allows for documents filed with the Secretary of State to be executed by a “person authorized by the company.” Currently, a Power of Attorney may be allowed to sign off on documents with the Secretary of State, but as described herein, the authority to execute a Power of Attorney is not expressly granted as the code currently stands.

By adopting this change, South Dakota will allow LLCs clarity and flexibility in assigning the ability to sign documents with the Secretary of State. These powers are some of the more common reasons others choose states outside of South Dakota, and by making these revisions, our business owners can be confident that South Dakota is aiming to keep competitive with neighboring states and those across the nation.

Regarding the new section with excluded managers, the revisions allow for the Operating Agreement to separate and limit powers amongst certain managers or certain members to the exclusion of other managers or members. The proposed language establishes the reporting and liability responsibilities of managers and excluded managers. Additionally, the revisions update section 47-34A-404.1 regarding management of LLCs by clarifying that the excluded managers may be excluded from voting, adding that they may have duties that are expanded or restricted as long as they do not remove duties required by law, and providing protection to members and managers for liability for decisions and actions based on a good faith reliance on the provisions of the operating agreement.

These revisions allow companies a defined ability to control and assign responsibilities within their manager pool. As businesses grow, diversify, adopt remote workers, or become more specialized in their market, a manager faces challenges in being all things to all parts of the business. By separating responsibilities, and creating rules on where these separations are to be found, everyone in the company gains an understanding of who is responsible for which areas of the business and the important tasks regarding reporting, oversight, compliance, and management can be assigned to separate both the work and responsibility to manage beyond a managers scope. The freedom to contract may already provide for some of these appointments, but revising the code will provide clarity and make the appointments consistent in language and scope for existing and prospective LLC owners.

Conclusion

Updating the LLC Act to keep current with what the top jurisdictions in the country are doing is important. These will improve our national competitiveness as an LLC option for businesses wanting to expand, and arguably more importantly, it will provide our citizens with the tools offered elsewhere along with tools necessary to compete nationally.