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2022 BSA/AML Event of the Year 30

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Arkansas's New LLC Act: Practical Steps for Lenders

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The review of organizational documents of entities is a critical element of risk management in underwriting any loan. With many LLCs applying for and receiving loans, lenders should review and update their underwriting guidelines in response to the Revised Uniform Limited Liability Company Act enacted last year as Act 1041 of 2021 (the "Revised Act"). The Revised Act applies to all Arkansas LLCs, whether formed before or after the effective date of September 1, 2021. The Revised Act repealed Arkansas's old LLC act, the Arkansas Small Business Entity Tax Pass Through Act (the "Former Act"), which no longer governs LLCs. The Revised Act now impacts every loan transaction involving an Arkansas LLC. This article addresses significant legal changes between the Revised Act and the Former Act and provides practical recommendations lenders should consider during their review.

Management. One of the Revised Act's most important changes relates to an LLC's management. The Former Act required all LLCs to designate in their Articles of Organization whether the LLC was manager-managed. Under the Revised Act, the operating agreement determines the management structure. If the operating agreement is silent on management, the LLC is presumed to be member-managed. For LLCs filed under the Former Act, the designation in the Articles of Organization will control.

Lenders must be keenly aware of this process to determine the management structure of LLC clients and may consider implementing different review policies based on the date of the LLC's formation. If the LLC was formed before September 1, 2021, the lender should refer to the LLC's Articles of Organization in conjunction with the operating agreement to determine the management structure. If the LLC was formed on or after September 1, 2021, the lender should consult the operating agreement alone.

Authority. The Revised Act has also altered the principles relating to member authority. Under the Former Act, members of an LLC presumptively had authority to sign instruments binding the LLC in the ordinary course of business. The Revised Act, on the other hand, grants no presumptive authority to members; instead, authority is determined by agency law.

Thankfully, the Revised Act provides an alternative. An LLC may file a Statement of Authority, which includes basic information about the LLC and a specific statement of the authority granted to positions and persons within the LLC to enter into other transactions and act for the LLC. The Statement of Authority, effective when accepted by the Secretary of State, provides conclusive proof of a party's authority on behalf of the LLC. For real estate transactions, the Statement of Authority should also be filed in the real estate records of the appropriate county in order for lenders to rely on it. The Statement of

Authority is only effective for five years; provided, the LLC can file a cancellation or limitation prior to expiration. To avoid complex questions of agency law, lenders should require and carefully review Statements of Authority for loans involving LLCs.

Formation. Under the Former Act, an LLC was formed when Articles of Organization were delivered to the Secretary of State. Because the Secretary of State occasionally declined filing due to a legality or error, parties could not always rely on the delivery date. The Revised Act amended this process, attempting to provide a more concrete timeline.

First, the organizing document is now called a "Certificate of Organization." Lenders will therefore need to replace "Articles of Organization" with the new title in loan documents. Second, the LLC is now formed only after (i) the Certificate of Organization is accepted by the Secretary of State (or a delayed effective date selected by the filing party) and (ii) at least one person becomes a member. Generally, persons become members of an LLC by signing the operating agreement. To ensure an LLC has been legally formed, lenders should confirm (i) the operating agreement does not have a delayed effective date and (ii) at least one member has signed the operating agreement. **Operating Agreements.** The Former Act required members to record their operating agreements in writing. In contrast, the Revised Act authorizes written, oral, and implied operating agreements. Lenders must be particularly cognizant of oral modifications to written operating agreements and should consider requiring LLCs to warrant the provided operating agreement has not been modified.

Charging Orders. Finally, the Former Act lacked clarity regarding remedies available to judgment creditors. The Revised Act expands on judgment creditors' rights, allowing charging orders against a member's interest and providing opportunities to appoint a receiver and foreclose on the member's interest. The charging order is the sole remedy available to judgment creditors; however, secured creditors may still utilize UCC Article 9 remedies.

Of the numerous changes in the Revised Act, the foregoing are some of the most significant to lenders. Lenders should carefully review the Revised Act with their legal counsel in order to implement best practices during their document review. The Revised Act has caught many Arkansas LLCs by surprise, and members and managers will need time to adjust. By implementing these suggestions, lenders can help smooth the transition.



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