

Beware of Ohio LLCs: New law changes the game for LLC members

Article By:

Jason B. Sims

If you are thinking about forming an LLC in Ohio for your new business, you may want to think again. And if you are a member of an existing Ohio LLC, the Ohio legislature just signed you up for a non-compete agreement with that LLC. **On May 4th, the provisions of [House Bill 48](#) related to Ohio LLCs went into effect.** House Bill 48 was a legislative initiative that made several changes to the Ohio corporate statute and LLC statute. While the Bill made many positive changes, the Ohio legislature made some changes to the LLC statute that seriously bring into question if an Ohio LLC is a viable option any more for selecting what type of entity that a new business will operate under. Here is a brief summary of the important changes that House Bill 48 made to Ohio's LLC statute:

Members have fiduciary duties of loyalty and care to other members. Members also have an obligation of good faith and fair dealing when discharging the member's duties to the LLC or the other members. The statute already set out the [fiduciary duties of managers](#) that were similar to the standard for directors of a corporation. However, if a member is a manager these manager specific fiduciary duties only apply if the member was appointed in writing and the member has agreed in writing to serve as a manager; otherwise the member's fiduciary duties are the same as those of the members (duty of loyalty, care and the obligation of good faith and fair dealing).

- The duty of loyalty for a member is defined as: (1) accounting to the LLC and hold in trust for the LLC any profit or benefit the member derives in the conduct of the LLC's business or the member's use of the LLC's property (which includes appropriating a company opportunity of the LLC); (2) refraining from dealing with the LLC on behalf of a party having an interest adverse to the LLC; and (3) refraining from competing with the LLC. This last obligation is troubling.
- The duty of care for a member is defined as refraining from gross negligence, intentional misconduct or knowingly violating the law, all when acting on behalf of the LLC.
- An operating agreement cannot eliminate the members' duties of loyalty, care and good faith and fair dealing. However, the operating agreement may identify specific categories of activities that do not violate the duty of loyalty so long as they are not manifestly unreasonable.
- Members can authorize or ratify an action that would otherwise be a breach of a duty of loyalty after full disclosure of all material facts related to the action.

While Ohio courts have adopted many of these duties for members, they have never included an express obligation to refrain from competing with the LLC. With these changes, Ohio now goes in the opposite direction of Delaware, which expressly permits the [elimination of fiduciary duties](#) for managers and members.

These additional duties would not provide any significant problems if the members of an LLC could opt out or alter them to meet the particular needs of the members and the LLC. However, the new provisions of the statute prohibit members of an Ohio LLC from eliminating the duties of care, loyalty and good faith and fair dealing in the LLC's operating agreement. Also, these express duties apply to all members regardless of the size of their equity interest or involvement in the operation of the LLC. In many instances, an operating agreement for an LLC will expressly permit competition as there is a recognition that members may come together to invest in a specific opportunity but otherwise want to be free to pursue their other interests without any restrictions.

As to the idea that you can carve out some items from the duty of loyalty that are not "manifestly unreasonable", in my nearly 20 years of practice I have never figured out exactly what manifestly unreasonable means. It is one of those legal terms that sounds important and fair, but in practice makes it nearly impossible for lawyers to provide concrete guidance to their clients. So, while businesses look for certainty, they are left with a "I know it when I see it" standard. Members of LLC's will be able to carve out certain items from the duty of loyalty, but as to exactly what items, who knows?

The concept of an LLC was founded on the basic principal of freedom of contract. As a result, LLC's provide great flexibility to its members on how to conduct their affairs in operating the business of the LLC. While I am sure the Ohio legislature did not intend to do this, one result of these changes is to restrict this flexibility. So, if you are in Ohio and want to form an LLC with multiple members for your new business, you should consider forming a Delaware LLC or an LLC in some other state and qualify to do business in Ohio as a foreign company.

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