

2009 HOUSE JUDICIARY

HCR 3005

2009 HOUSE STANDING COMMITTEE MINUTES

Bill/Resolution No. HCR 3005

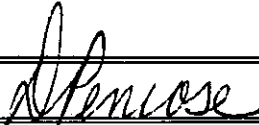
House Judiciary Committee

☐ Check here for Conference Committee

Hearing Date: 1/7/09

Recorder Job Number: 6631 & 6632

Committee Clerk Signature



Minutes:

Chairman DeKrey: We will open the hearing on HCR 3005.

Rep. Klemin: Sponsor (two attachments). This HCR proposes that LC study the feasibility and desirability of adopting the Revised Uniform Limited Liability Company Act, including consideration of issues other states have addressed in considering the act. In 2006, the National Conference of Commissioners on Uniform State Laws approved and recommended for enactment in all states the Revised Uniform Limited Liability Company Act, which revises the Uniform Limited Liability Company act. North Dakota enacted, in 1993, the Limited Liability Company act which was based on Minnesota's Limited Liability Company. Historically, ND's business entity laws have been drafted with the cooperation and input of interested persons, including the Secretary of State, and have taken into account the business entity laws of Minnesota. Although no other state has yet enacted the revised Uniform Limited Liability company act, during the 2009 legislative session several states, including Minnesota, will likely introduce legislation to adopt the revised uniform limited liability company act or to amend the states' existing limited liability laws.

Chairman DeKrey: Thank you. Further testimony in support of HCR 3005.

Al Jaeger, Secretary of State: (see attached)

Chairman DeKrey: Thank you. Further testimony. We will close the hearing.

Rep. Delmore: I move a Do Pass on HCR 3005.

Rep. Griffin: Second.

Chairman DeKrey: We have a Do Pass motion and second. Any further discussion. The clerk will call the vote.

13 YES

0 NO 0 ABSENT

DO PASS

Rep. Klemin

Date: 1/7/09
Roll Call Vote #: 1

2009 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HCR 3005

HOUSE JUDICIARY COMMITTEE

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken ☒ DP ☐ DNP ☐ DP AS AMEND ☐ DNP AS AMEND

Motion Made By Rep. Delmore Seconded By Rep. Griffin

Representatives	Yes	No	Representatives	Yes	No
Ch. DeKrey	✓		Rep. Delmore	✓	
Rep. Klemin	✓		Rep. Griffin	✓	
Rep. Boehning	✓		Rep. Vig	✓	
Rep. Dahl	✓		Rep. Wolf	✓	
Rep. Hatlestad	✓		Rep. Zaiser	✓	
Rep. Kingsbury	✓				
Rep. Koppelman	✓				
Rep. Kretschmar	✓				

Total (Yes) 13 No 0

Absent 0

Floor Carrier: Rep. Klemin

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE (410)
January 7, 2009 11:23 a.m.

Module No: HR-02-0079
Carrier: Klemin
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HCR 3005: Judiciary Committee (Rep. DeKrey, Chairman) recommends DO PASS and BE PLACED ON THE CONSENT CALENDAR (13 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). HCR 3005 was placed on the Tenth order on the calendar.

2009 SENATE INDUSTRY, BUSINESS AND LABOR

HCR 3005

2009 SENATE STANDING COMMITTEE MINUTES

Bill/Resolution No. 3005

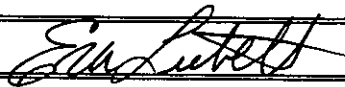
Senate Industry, Business and Labor Committee

☐ Check here for Conference Committee

Hearing Date: March 23, 2009

Recorder Job Number: 11409

Committee Clerk Signature



Minutes:

Representative Larry Klemin: Handed out Revised Uniform Limited Liability Company Act and the summary of the Act. Pointed out a few of the items in the Act.

Senator Nodland: What was the purpose for creating limited liability company acts?

Representative Klemin: CPA's liked them a lot.

Senator Potter: Does North Dakota have limited liability companies or limited liability partnerships?

Representative Klemin: We have both plus limited liability company partnerships. A lot of the things we do are not just for North Dakota people have companies here that work across state borders, people coming in from out of state like to have a law their familiar with so we try to make them uniform across the country.

Senator Potter: Your goal is to do some code revisions that will lead to more uniformity?

Representative Klemin: Yes, we don't have the uniform law in North Dakota now. If we approve this in the next session we will have it.

Chairman Klein: There is a uniform act out there that people are trying to attach themselves to?

Representative Klemin: A number of states are considering it and two states have adopted it. We're talking about the revised 2006 one. Hopefully this will be the standard in a couple of years.

Senator Horne: You serve on the uniform law commission and you all think this is what we need?

Representative Klemin: Yes, you have to be an attorney to serve on this commission.

Senator Wanzek: We have a limited liability law how is it different from the uniform law?

Representative Klemin: Doing the study would show us what we want to keep. Your question is the focus of this study.

Senator Nodland: Since the inception of all these limited liability company how has the finance industry handled this?

Representative Klemin: I don't think that it affects them. Sub chapter eight is very close to that. There are more LLC being adopted. I know often time financial institutions don't want to make loans to small companies without the backing of its members.

Al Jaeger, Secretary of State: Written testimony.

Senator Horne: Family LLC's are not very popular?

Al: I think they should all be organized in the state. The option is there. I don't think it is a reflection of the structure but of the business being organized.

Senator Wanzek: The farm program limits farmers from entering into the LLC. Not all farmers but farms that are run by families.

Chairman Klein: Closed the hearing;

Senator Andrist: Moved a do pass.

Senator Nodland: Seconded.

Passed 7-0

Senator Horne to carry the bill.

Date: 3/23/09
Roll Call Vote #: 1

Senate

Industry, Business and Labor

Legislative Council Amendment Number

☒ **Pass**

☐ **Do Not Pass**

☐ Amended

Motion Made By Senator Andrist Seconded By Senator Nodland

[illegible]

Total (Yes) 7 No 0

Absent 0

Floor Assignment *Senator Horne*

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE (410)
March 23, 2009 2:22 p.m.

Module No: SR-52-5625
Carrier: Horne
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HCR 3005: Industry, Business and Labor Committee (Sen. Klein, Chairman)
recommends **DO PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING).
HCR 3005 was placed on the Fourteenth order on the calendar.

2009 TESTIMONY

HCR 3005

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SECRETARY OF STATE
STATE OF NORTH DAKOTA
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BISMARCK ND 58505-0500

January 7, 2009

*Same given
to Senak*

TO: Representative DeKrey and Members of the House Judiciary Committee

FR: Al Jaeger, Secretary of State

RE: HCR 3005 – Study of Revised Uniform Limited Liability Corporation Act

First, I want to thank Rep. Klemin and the members of the North Dakota Commission on Uniform State Laws for sponsoring this resolution in lieu of introducing the national uniform bill that was presented to the Interim Judiciary Committee on August 12, 2008.

This study is particularly important because of the complexity of the national bill and to make sure it is modified to include the provisions applicable to North Dakota practices and procedures. This office has supported uniform laws in the past and very much want to be a part of this study.

The Limited Liability Company business entity structure in North Dakota was first adopted during the 1993 session. As of today, here are the statistics for the number of registered with the Secretary of State's office:

General	6,561
Professional	88
Farm	116
Foreign	3,805
Total	10,570



SUMMARY

Revised Uniform Limited Liability Company Act (2006)

The Uniform Limited Liability Company Act gestated from 1994 to 1996 when it was finally promulgated by the Uniform Law Commission. By that time the majority of the states had legislation that provided for limited liability companies. Therefore, the 1996 Uniform Act has been enacted in only nine states by 2006. The limited liability company as a distinct form of business organization has a very recent history. The first legislation in Wyoming in 1977 introduced the concept. A limited liability company is generally characterized as a business organization which looks like a partnership or limited partnership in terms of internal structure and relationships between members, or members and managers, but with the additional characteristic of a liability shield from vicarious liability for members and managers.

A limited liability company has members who primarily contribute capital to the company and who share in the profits or losses. It may have managers who do the business of the company. A member may be a manager, but non-member managers are also allowed. If there are no designated managers, members run the company as general partners in a general partnership would. A limited liability company statute has certain key features: a means of creating the company, usually by filing a certificate; a liability shield provision; rules governing the relations between members, and between members and any managers; rules governing distributions of profits or losses to members and a member's creditor's rights; rules governing a member's exit rights from the company; rules on dissolution of the company, and rules governing mergers and conversions. A limited liability company is usually governed by an operating agreement that almost always supercedes and overcomes the statutory rules.

The limited liability company originated in the desire to have a full liability shield while retaining the so-called "pass-through" qualities of a partnership. This means that the company itself pays no federal income tax, leaving any tax liability to members receiving taxable distributions from the company. Before limited liability companies, full limitation of liability was available only for corporation shareholders. Corporations, however, are taxed as individuals on their income, but shareholders are also taxed on corporate distributions made to them. The ability to obtain pass-through status, then, provided very substantial incentive for states to enact limited liability company statutes. They did this, but did not do so with anything like coherent uniformity. The great wave of statutes preceded the promulgation of the 1996 Uniform Act.

Limited liability companies have other qualities than pass-through status that make them desirable as a business organization. A limited liability company may be tailored specifically to the business or objective of the members because its structure mainly depends upon the agreement between members and managers (if there are managers). This means a kind of flexibility coupled with the liability shield that makes the limited liability company a more efficient kind of organization than the corporation (specifically) or any of the other unincorporated business organizations for many purposes. The limited liability company kind of structure lends itself to nonprofit organizations, and many states (and the successive Uniform Acts) do not require a for-profit reason for organization. The limited liability company form has been adapted to allow a single member company to be formed. A single person may not form a partnership or limited partnership. Forming a corporation raises the tax issue and the complexities of maintaining a corporation for a single shareholder. A single-member limited liability company resolves these problems, and makes it an efficient way for a single individual to have a vicarious liability shield.

Because of its utility, the law of limited liability companies is very dynamic. New ideas and features seem to appear yearly with the objective of enhancing this form of business organization. The many developments since 1996 have led the Uniform Law Commission to reconsider the Uniform Act. The result is the 2006 Uniform Limited Liability Company Act.

The issues addressed in the 2006 Uniform Act are issues of formation, relationships between members and managers (if applicable), distributions, disassociation, dissolution and winding up, foreign limited liability companies, merger and conversion and actions against a company by members. It is not possible in a short summary to do more than highlight some significant changes. Here are some of the changes made in 2006 over 1996:

1. In the 2006 Act, the operating agreement determines whether a company is manager-managed or member-managed. In the 1996 Act the kind of management is determined in the certificate of organization. If the agreement is silent, the company is a member-managed company by default. Leaving this decision to the agreement allows the company to determine and re-determine its management structure more flexibly. A third-party creditor may seek affirmation of a manager's or a member's authority before doing business with the company and practice indicates does so without checking the official record for the certificate. In addition, certificates of authority may be filed to provide notice that only certain members or managers in a company are entitled to do business on behalf of the company.
2. There is no requirement that a company's operating agreement be in writing in either the 1996 or 2006 Act. However, the definitions "record" and "signature" establish that any statute of frauds requirement within the 2006 Act may be satisfied with electronic records and signatures. The 1996 Act does not recognize electronic records or signatures.
3. A member may not transfer his or her membership in a company, unless the operating agreement makes it possible. The only interest that may be transferred is called the "distributional interest" in the 1996 Act and the "transferable interest" in the 2006 Act. In the 2006 Act, a "transferable interest" is generally any right to distributions that a member has under the operating agreement. The

operating agreement may impose restrictions on a right to transfer. However, the certificate of organization may provide that a "transferable interest" is freely transferable under the 2006 Act. If it does, the transferable interest may be certificated in the same manner any investment security is, and is likely to be a security under Article 8 of the Uniform Commercial Code.

4. In both the 1996 and the 2006 Acts, members owe a duty of care to each other. The duty in the 1996 Act is to refrain from conduct that is grossly negligent or reckless conduct, intentional misconduct or knowing violation of law. In the 2006 Act, the standard is ordinary care (care that a person in a like position would reasonably exercise) subject to the business judgment rule.

5. Under both the 1996 and 2006 Acts, the operating agreement governs the relationships between members and members and managers (if any). The 1996 Act, however, provides that the duty of loyalty and the duty of care may not be eliminated in the operating agreement. But the operating agreement may specify those acts and transactions that do not violate the duty of loyalty, so long as not manifestly unreasonable. In the 2006 Act, the operating agreement may eliminate the duty of loyalty or duty of care, provided that eliminating them is not "manifestly unreasonable." The agreement may not authorize intentional misconduct or knowing violations of law, as well.

6. The 1996 Act does not expressly address the issue of indemnification of members or managers, but the 2006 Act does. It provides for indemnification as a statutory matter. But the operating agreement may alter the right to indemnification, and may limit damages to the company and members for any breach except for breach of the duty of loyalty or for a financial benefit received to which the member or manager is not entitled.

7. The 1996 Act makes no provision for companies that are initially organized without members. There must be at least one member upon filing the certificate of organization. In the 2006 Act, a member does not necessarily need to be named at least 90 days from the day the certificate is filed. There is a limited ability, therefore, to create what are called "shelf" companies.

8. One issue that especially vexes limited liability company law is the rights creditors of members have in the assets of the company. The 1996 Act restricts creditors' interests to a member's distributional interest and provides a judgment creditor with a "charging order" as the only method of executing against that interest. The resultant lien may be foreclosed and sold in a judicial foreclosure sale. The 2006 Act further requires a finding: that payment may not be made within a reasonable time, before a court orders foreclosure of the lien. This finding is not required in the 1996 Act. In addition, the 2006 Act makes it absolutely clear that a purchase in a foreclosure sale does not make the purchaser a member.

9. In the 1996 Act dissociation (resigning from membership) of a member by express will triggers an obligation to buy the interest of that member in an at-will or term company. Failure to buy may subject the company to a judicial dissolution and winding up of the business. The 2006 Act provides no obligation to buy out a dissociating member, nor a ground based upon failure of a buyout for judicial dissolution. The company has greater stability under the 2006 Act, notwithstanding any dissociation of a member.

10. The 1996 Act provides members with the right to file a derivative action on behalf of a company alleging certain kinds of misfeasance on the part of the company by its management. Under the 2006 Act, the company may form a "litigation committee" to investigate claims asserted in a derivative action. This stays the litigation while the committee does its investigation. The objective of the investigation is to determine if the litigation is for the good of the company. The litigation committee ultimately reports to the court with a recommendation to continue with the plaintiff or the committee as plaintiff, or to settle, or to dismiss.

11. The 1996 Act allows no right of direct action against the company on behalf of a member as a plaintiff. The 2006 Act provides for direct action.

These are some of the changes in the 2006 Uniform Limited Liability Company Act. It is not possible to do more than highlight some of the more prominent changes. Hopefully, this summary will alert readers to the improvements sufficiently to interest them to support the 2006 Act in the state legislatures.

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Why States Should Adopt the...

Revised Uniform Limited Liability Company Act (2006)

Limited liability companies (LLCs) are a relatively new form of unincorporated business organization providing corporate-style limited liability to its owners; LLCs began to be widely used after Revenue Ruling 88-76 upheld their taxation as partnerships. Every state has enacted some sort of LLC legislation and LLC filings approach and in many states outnumber the number of new corporate filings on an annual basis. The existing state LLC statutes, however, are far from uniform and many have been amended on a patchwork basis and have not kept up with the LLC cases and other legal developments.

The Uniform Law Commission (ULC) promulgated the original Uniform Limited Liability Company Act (ULLCA) in 1995 and amended it in 1996 to take into account the then newly adopted federal tax "check-the-box" regulations. It, like most existing state LLC statutes, can be classified as a "first generation" statute. The **2006 Revised Uniform Limited Liability Company Act (Re-ULLCA)** is a comprehensive, fully integrated "second generation" LLC statute that takes into account the best elements of the "first generation" LLC statutes and two decades of legal developments in the field. Here are some of the more significant changes and innovations in **Re-ULLCA**:

- **The operating agreement.** In Re-ULLCA, the operating agreement, rather than the certificate of organization, determines whether an LLC is member-managed or manager-managed. Re-ULLCA also makes it clear that the operating agreement is binding on the LLC even in the case of a single member LLC and even if the LLC has taken no formal action to adopt the operating agreement.
- **LLCs may engage in any lawful purpose.** Under Re-ULLCA, an LLC is not restricted to for-profit business activities. It can have "any lawful purpose, regardless of whether for profit." This expands the availability of LLCs to family vacation homes and organizations whose activities might be classified as non-profit.
- **Internal affairs default rules.** Re-ULLCA contains a basic set of internal affairs default rules governing the relationship members and managers of an LLC between themselves and each other, most of which can be varied by the operating agreement. For example, if the operating agreement is silent on the type of management structure, an LLC is member-managed by default. There are also default rules for decisions by members and managers and for other matters.
- **Flexible management structure.** Under Re-ULLCA, it is possible to have any type of management structure the LLC members want, including a corporate-style board of directors and officers. The type of management structure is set forth in the operating agreement.
- **Dates and liabilities of managers.** Re-ULLCA incorporates the fiduciary duties of loyalty and due care for managers and clarifies the contractual status of the duty of good faith and fair dealing. These duties may be restricted or eliminated "if not manifestly unreasonable." The business judgment rule is applicable to a case involving a breach of due care claim. The operating agreement may limit or eliminate liability of a manager to the LLC or other members for monetary damages except for breaches of the duty of loyalty, improper distributions, intentional infliction of harm to the LLC or a member or an intentional violation of criminal law. These rules are similar to those found in state corporation statutes.
- **Shelf LLC.** It is possible under Re-ULLCA to file a certificate of organization before an LLC actually has a member. A second filing made once a member is appointed completes the formation of the LLC, assuming the second filing is made within 90 days of the first filing.
- **Agency authority.** The authority of members and managers to bind an LLC is determined by agency law and not by status, as is the case under most existing LLC statutes. Certificates of authority may 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) to provide notice that only certain members or managers have authority to conduct business on behalf of the LLC.
- **Charging orders.** Re-ULLCA clarifies and simplifies the rules governing charging orders, the exclusive remedy for a creditor of a member to obtain a member's financial rights to distributions from the LLC. Re-ULLCA also provides the rules for foreclosing on a charging order and makes it absolutely clear that a purchaser of a foreclosed interest only obtains financial rights and does not become a member of the LLC by virtue of the foreclosure.
- **Distributions.** Re-ULLCA specifies the circumstances under which distributions from an LLC can and cannot be made and contains provisions for recovery of improper distributions. Re-ULLCA also makes it clear that payment for reasonable compensation and for retirement plans or other benefits programs are not distributions.
- **A remedy for oppressive conduct.** Reflecting case law developments around the country, Re-ULLCA permits a member to seek a court order "dissolving the company 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 member."
- **Direct and derivative claims, special litigation committees.** Under Re-ULLCA, a member can bring a direct action for injuries to that member and can bring a derivative action to enforce a claim of an LLC. If a derivative action is filed, the LLC may form a special litigation committee to investigate the asserted claims. This stays the litigation while the committee does its investigation. The objective of the investigation is to determine if the litigation is for the good of the company.

- **Reorganization transactions.** Re-ULLCA has comprehensive provisions authorizing LLCs to merge or convert into another type of entity and also authorizes other types of entities to merge and convert into an LLC. Re-ULLCA authorizes an LLC to domesticate in another state and also authorizes a foreign LLC to domesticate in the enacting state.

Re-ULLCA represents a significant advancement in this area of law. Some of the benefits of uniformity include reduced compliance costs, streamlined administration (which reduces costs to states) and decisive consistency across jurisdictions.

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