

March 18, 2013

The Honorable Lance Kinzer, Chairperson
House Committee on Judiciary
Statehouse, Room 165-W
Topeka, Kansas 66612

Dear Representative Kinzer:

SUBJECT: Fiscal Note for HB 2398 by House Committee on Federal and State Affairs

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2389 is respectfully submitted to your committee.

HB 2398 would amend the Kansas Revised Limited Liability Company Act. The bill would amend the definitions of “member,” “operating agreement,” and “person;” and remove the definition of “majority in interest.” The bill would clarify that limited liability companies (LLCs) include foreign business trusts, foreign partnerships, and domestic or foreign corporations. The bill would also clarify that a person qualified for membership of a limited liability company could include a person licensed to practice with a professional association or professional corporation. The bill would no longer require a limited liability company organized to exercise powers of a professional association or professional corporation to be certified under the licensing body of that profession.

A limited liability company would have the power and authority to make contracts of guaranty and suretyship and enter into interest rate, basis, currency, hedge or other swap agreements or cap, floor, put, call, option, exchange or collar agreements, derivative agreements, or other similar agreements. In addition, a limited liability company would have the power and authority to grant, hold or exercise a power of attorney, including an irrevocable power of attorney. The bill would require a limited liability company to indemnify any present or former member, manager, officer, employee or agent that has been successful on the merits or otherwise in defense of any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, against expenses actually and reasonably incurred, including attorney fees. A manager of a limited liability corporation would include anyone who participates materially in management, unless solely for participating in the election or selection of a manager.

The bill would allow a certificate of correction to be filed to correct an erroneously executed certificate of cancellation if the certificate of correction is filed with the Office of the

Secretary of State prior to the dissolution or the completion of winding up of an LLC. The Secretary of State could not issue a certificate of good standing with respect to a limited liability company if its articles of organization are canceled. The bill would clarify that the articles of organization could be canceled upon a future effective date of filing a certificate of cancellation or certificate of merger or consolidation with the Secretary of State. The bill would require an agreement of merger or consolidation of one or more domestic limited liability companies to be approved by members who own more than 50.0 percent of the current percentage of other interest in the profits of the domestic limited liability company owned by all of the members or by the members in each class or group. The bill would provide that an operating agreement may prohibit a domestic limited liability company from merging or consolidating. A person would acquire a limited liability company interest and be admitted as a member of a limited liability company as a result of a merger or consolidation in which the limited liability company is not the surviving or resulting limited liability company. A member would have no preemptive right to subscribe to any additional issue of limited liability company interests or another interest in a limited liability company.

The bill would allow meetings of members to be held by telephone conference or other communications equipment by means of which all persons participating in the meeting can hear each other and the meeting would be considered in person. Votes could also be consented to by electronic transmission. The bill would allow the operating agreement of a limited liability company whose original articles of organization were filed with the Secretary of State on or after July 1, 2013, to be amended by a supermajority amendment provision or by approval of all members. The rights of a member or manager to obtain information may be restricted in an original operating agreement or in any subsequent amendment approved or adopted by all of the members or in compliance with any applicable requirements of the operating agreement.

The bill would remove provisions in statute related to requirements under an operating agreement which (1) gives each member in a member managed LLC the authority to bind the limited liability company, and each manager, in a manager managed LLC the authority to bind the LLC; (2) prohibits a member from acting solely in the member's capacity as an agent of the LLC and requires every manager to act as an agent of the LLC for business and affairs if the articles of organization provide that management of the LLC is vested in one or more managers; and (3) provides that an act of a member or manager which is not for carrying on the usual way of business or affairs of the LLC does not bind the LLC.

The bill would remove a provision which considers a waiver in writing signed by a person entitled to be notified of a meeting as the equivalent to having given notice of the meeting. The bill would also provide that a member, manager or liquidating trustee of a limited liability company would be fully protected in relying in good faith on the records of the LLC, including, but not limited to, the value and amount of assets or reserves or contracts, agreements or other undertakings that would be sufficient to pay claims and obligations of the limited liability company or to make reasonable provision to pay such claims and obligations. Members who resign from a limited liability company whose original articles of organization were filed with the Secretary of State after June 30, 2013, would no longer be afforded the rights of an assignee or entitled to receive any distribution under the operating agreement. In addition, the

term distribution would not include amounts constituting reasonable compensation for present or past services or reasonable payments made in the ordinary course of business under a bona fide retirement plan or other benefits program. The assignee of a member's limited liability company interest would have no right to participate in the management of the business and affairs of a limited liability company unless approved through the affirmative vote or written consent of all of the members of the limited liability company.

The bill provides that an operating agreement may prohibit a limited liability company interest from being assigned prior to the dissolution and winding up of the limited liability company. The bill also provides that an operating agreement may authorize the assignment or transfer of any limited liability company interest represented by a certificate of limited liability company interest issued by the limited liability company. A limited liability company would not have the power to issue a certificate of limited liability company interest in bearer form. The bill would allow a court having jurisdiction which receives application from a judgment creditor of a member or of a member's assignee, to charge the limited liability company interest of the debt to satisfy the judgment. To the extent so charged, the judgment creditor would have the right to receive only any distribution or distributions to which the judgment debtor would otherwise have been entitled in respect of such limited liability company interest. A charging order would constitute a lien on the judgment debtor's limited liability company interest. A member or member's assignee could not be deprived of rights under exemption laws with respect to the judgment debtor's limited liability company interest. The entry of a charging order would be the only remedy by which a judgment creditor of a member or of a member's assignee could satisfy a judgment out of the judgment debtor's limited liability company interest. No creditor of a member or of a member's assignee would have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited liability company. The district court would have jurisdiction to hear and determine any matter relating to any such charging order.

Under the bill, an assignee of a limited liability company interest could become a member if approved by an affirmative vote or written consent of all of the members of the limited liability company. If a member dies or a court of competent jurisdiction adjudges the member to be incompetent to manage the member's person or property, the member's personal representative may exercise all of the member's rights for the purpose of settling the member's estate or administering the member's property, including any power under an operating agreement of an assignee to become a member. If a member is a corporation, trust or other entity and is dissolved or terminated, the powers of that member may be exercised by its personal representative.

Current law requires that an LLC be dissolved and its affairs be wound up when the first of a number of actions were to occur, including the written consent of the members or by the members in each class or group who own more than 50.0 percent of the then-current percentage or other interest in the profits of the LLC. HB 2398 would change the statute to require the LLC dissolved upon the affirmative vote or written consent of the members or by the members in each class or group who own more than two-thirds of the then-current percentage or other interest in the profits of the LLC. The bill would allow an operating agreement to provide that the personal

representative of the last remaining member could be obligated to agree in writing to continue the limited liability company and to the admission of the personal representative of such member or its nominee or designee to the limited liability company as a member. In addition, the LLC would not be dissolved and wound up if a member is admitted to the limited liability company under the operating agreement, effective with or within 90 days of the occurrence of the event that terminated the continued membership of the last remaining member. The resignation of a member could not cause the LLC to be dissolved. The bill would allow a LLC to be dissolved involuntarily by the district court when members owning at least 25.0 percent of the outstanding interest in the capital or profits and losses in the LLC file a petition stating a proposed plan of dissolution unless members who own more than two-thirds of the then-current percentage or other interest in profits of the LLC owned by all members or each class or group file with the district court an answer and a certificate stating that they have agreed on either the petitioner's plan, or a modification or alternative.

An LLC which has been dissolved would be required to make provisions to sufficiently provide compensation for any claim against the limited liability company which is the subject of a pending action, suit or proceeding to which the limited liability company is a party; and those that have not arisen or been made known to the limited liability company but are based on facts known to the limited liability company or are likely to arise or to become known to the limited liability company within 10 years after the date of dissolution. Upon the winding up of an LLC, a member would be liable to the LLC for any assets the member received in violation of this act if the member and knew that the distribution was in violation. The term distribution would not include amounts constituting reasonable compensation for present or past services or reasonable payments made in the ordinary course of business under a bona fide retirement plan or other benefits program. The member would not be liable if he or she did not know the distribution was in violation. Unless otherwise agreed, a member who receives a distribution from a limited liability company would have no liability under this act or other applicable law unless an action to recover the distribution from the member is commenced and an adjudication of liability is made in the action within three years from the date of the distribution.

In order to register with the Secretary of State to do business in Kansas, a foreign LLC would be required to submit an irrevocable written consent that actions may be commenced against it where there is proper venue by the service of process on the Secretary of State, and stipulating and agreeing that this service be taken and held, in all courts, to be valid and binding as if due service had been made upon a member of the foreign LLC, if it is member-managed, or upon its managers if it is manager-managed. The activities of a foreign LLC which do not constitute doing business in Kansas would include selling, by contract consummated outside the State of Kansas, and agreeing, by the contract, to deliver into the State of Kansas machinery, plants or equipment, the construction, erection or installation of which within the state requires the supervision of technical engineers or skilled employees performing services not generally available, and as part of the contract of sale agreeing to furnish these services, and only these services, to the vendee at the time of construction, erection or installation. A person would not be deemed to be doing business in the Kansas solely by reason of being a member or manager of a domestic limited liability company or a foreign limited liability company. The district court would have jurisdiction to require any foreign limited liability company or its agent, from doing

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any business in Kansas if the foreign limited liability company has secured a certificate from the Secretary of State on the basis of false or misleading representations.

The bill would allow an assignee of a limited liability company interest to bring an action in the district court in the right of a limited liability company to recover a judgment. The bill would allow the duties of any member, manager or other person that is a party to or is otherwise bound by an operating agreement, to be expanded or restricted or eliminated by provisions in the operating agreement, except that the operating agreement may not eliminate the implied contractual covenant of good faith and fair dealing. An operating agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties, including fiduciary duties, of a member, manager or other person to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by an operating agreement, except that an operating agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.

The bill would require that a certificate of reinstatement include the date of filing of the articles of organization or application for registration of the LLC. The bill would provide that the annual report required to be filed by an LLC with the Secretary of State constitutes an oath or affirmation, under penalties of perjury that, to the best of the person's knowledge and belief, who filed the report, are factual and true. The bill outlines additional provisions related to the cancellation of an LLC's articles of organization; exceptions for the dissolution and winding up of an LLC; and the cancellation of any domestic or foreign LLC doing business in Kansas. The majority of the provisions in this bill are supported by a clause which indicates they would apply unless otherwise provided in an operating agreement or other agreement. The bill includes various technical corrections and clarifications.

The Office of the Secretary of State indicates that the provision that would require that a certificate of reinstatement include the date of filing of the articles of organization or application for registration of an LLC would increase its expenditures by \$40,000 in FY 2013 to modify its online filing system. Any fiscal effect associated with HB 2398 is not reflected in *The FY 2014 Governor's Budget Report*.

Sincerely,



Steven J. Anderson, CPA, MBA
Director of the Budget

cc: Rachel Sciolaro, Secretary of State's Office