



**KANSAS BAR
ASSOCIATION**

TO: The Honorable Rick Wilborn
And Members of the Senate Judiciary Committee

FROM: William Matthews, Edwin Hecker, Virginia Harper Ho, William Quick, and Garrett Roe
On Behalf of the Kansas Bar Association

RE: House Bill No. 2105 – Amending the Kansas Revised Limited Liability Company Act and Business Entity Standard Treatment Act

DATE: March 20, 2019

Chairman Wilborn and Members of the Senate Judiciary Committee:

We appreciate the opportunity to appear today to brief the Committee and answer questions related to HB 2105, a bill requested by the Kansas Bar Association (KBA).

We are members of a special committee created by the KBA's Section on Corporation, Banking & Business Law, composed of Kansas practitioners, academics, and a staff attorney from the Secretary of State's Office. Over the past year, we have worked to draft amendments to the Kansas Revised Limited Liability Company Act (KRLCA) and related business entity statutes, including the Business Entity Standard Treatment (BEST) Act. Our proposed bill seeks to bring the KRLCA, and corresponding applicable provisions of the BEST Act, up to date with appropriate innovations adopted by Delaware since 2012, the year from which we last updated the KRLCA. We have also sought to implement other legislative fixes and technical changes.

Our testimony today has three goals. First, we wish to provide a brief background on the relationship between Kansas's and Delaware's business entity laws and the benefits Kansas has derived from that relationship. Second, we have briefly highlighted those provisions of the proposed bill that we feel are most significant or innovative. Lastly, we note several features of Delaware law that are not appropriate for Kansas to adopt, at least at this time.

The Importance of Delaware Business Law to Kansas

The State of Delaware is the acknowledged gold standard on business entity law, as evidenced by the number and size of corporations and limited liability companies (LLCs) formed there. Delaware has a special court, the Court of Chancery, that only hears business cases. As a result, its judges have specialized expertise in interpreting its statutes and in deciding business cases not controlled by statute. The Court of Chancery produces a high volume of excellent quality decisions each year on a great variety of issues, which has resulted in a robust and comprehensive body of precedent. Furthermore, the Delaware legislature is constantly evaluating the case law results, reviewing new business developments, monitoring changes in federal law (e.g., the federal securities laws), and taking input on business entity issues. Nearly every

session, the Delaware legislature makes modifications to its corporation and LLC acts with the goal of making certain they are on the cutting edge of learning in this area.

By modeling its corporation and LLC statutes on those in effect in Delaware, Kansas and its business and legal communities have been able to benefit greatly. Not only is our statutory law consistent with that of the world's leader, but our courts have come to recognize the tremendous value of a rich body of judicial precedent based on those statutes. In HB 2105, our committee seeks to continue a trend that has been an integral part of Kansas law for over 45 years.

Significant Provisions in HB 2105

Section 39 (K.S.A. 17-76,143) and Various Sections Throughout. In 1996, Delaware enacted a groundbreaking provision that permitted an LLC to have designated “series” of members, managers and interests with separate purposes, powers, rights and duties with respect to specified assets and liabilities. Although a series is not technically a separate entity, in many respects it is treated as if it is.

In 2012, the Kansas Legislature first adopted series of limited liability companies. Kansas chose to not adopt the series provision as then in effect in Delaware. Instead Kansas adopted the series model as enacted in Illinois. The reason for this choice was due to Illinois’ requirement that a filing be made with the Secretary of State for the establishment of each series. *See* 805 Ill. Comp. Stat. 180/37-40. This choice has resulted in several issues under Kansas law, including that the series provision does not match well to the general structure of the KRLLLCA and the series concept is not integrated throughout the KRLLLCA. The present bill aims to address these issues.

Since 2012, several other states have enacted series LLC provisions, and last year the Uniform Law Commission proposed the Uniform Protected Series Act. In 2017 Delaware amended the Delaware Limited Liability Company Act (DLLCA) to create two different types of LLC series—the “protected series,” which is the same as its existing series concept, and the “registered series,” which seeks to satisfy the desire of many to more clearly accommodate the perfection of security interests in the assets of series. Effective August 1, 2019, the Delaware amendments require a filing with the Secretary of State to create a registered series and make registered series a “registered organization” under Article 9 of the Uniform Commercial Code, which means that financing statements may be filed against registered series in their state of organization. One may obtain a certificate of good standing for a registered series, and registered series must make annual franchise tax filings.

We propose to substitute the current version of K.S.A. 17-76,143 with a provision that matches Delaware’s registered series provision and make changes throughout the KRLLLCA and BEST Act that conform to Delaware law for registered series. As proposed, series could only be formed by a filing with the Kansas Secretary of State, the same as currently required. The proposed amendments more tightly integrate series throughout the KRLLLCA and BEST Act. As Kansas currently has no franchise tax, we propose that series file annual reports. Like Delaware, we have proposed a future effective date of July 1, 2020 for implementation of the series changes to provide the Secretary of State’s Office appropriate time to make programming changes to its systems.

New Section 3. Series of the same LLC may merge or consolidate into or with each other in a manner similar to the merger or consolidation of LLCs. Series may not otherwise merge or consolidate with series of different LLCs or with other types of entities.

New Section 4. A series whose certificate of designation has been cancelled for failing to file an annual report may be reinstated by filing a certificate of reinstatement and paying past-due annual report fees, similar to the reinstatement of an LLC whose articles of organization have been cancelled.

New Sections 5-12. These provisions enact statutory public benefit limited liability companies (SPBLLCs). Like public benefit corporations (enacted in Kansas in 2017), SPBLLCs are for-profit LLCs (and taxed as such) that must adopt a “public benefit” (a positive effect or reduction of a negative effect on one or more categories of persons other than the members in their capacity as members), and the members or managers of a SPBLLC must manage and direct the affairs of the SPBLLC in a manner that balances the pecuniary interests of the members, those materially affected by the SPBLLC’s conduct, and the chosen public interest. The SPBLLC must prepare an annual statement, based on third-party standards, of the SPBLLC’s promotion of its public benefit(s). As a default, super-majority votes are required to become a SPBLLC, cease to be a SPBLLC, or merge with or divide into LLCs with articles of organization with a materially different public benefit statement. Because the KRLLLCA is an enabling statute that upholds the freedom of contract, the SPBLLC provisions are merely a safe harbor and do not prevent LLCs from seeking the same goals in any other legal way.

New Section 2. This provision enacts a new ability of an LLC to divide its assets and liabilities into two or more LLCs (whether the existing and new LLCs or all new LLCs). An LLC may divide unless prohibited by its operating agreement or agreement with a third party. For LLCs formed before the effective date of the legislation, an agreement that prohibits merger or consolidation also will be treated as prohibiting a division. If an operating agreement does not specify, the vote required to approve a division is the same vote required to approve a merger or consolidation. A division would not be effective against the claims of a creditor if the division would constitute a fraudulent transfer.

New Section 1 and Section 45 (K.S.A. 17-7916). These changes modify K.S.A. 17-7916 by retaining power-of-attorney provisions applicable to filings with the Kansas Secretary of State and separating into a new section of the KRLLLCA a power of attorney provision applicable to operating agreements and other non-filing matters.

Sections 22 (K.S.A. 17-7681), 32 (K.S.A. 17-76,116), and 33 (K.S.A. 17-76,118). These changes eliminate the default class or group voting requirements in connection with the merger or consolidation, dissolution and winding up of an LLC and the termination and winding up of a series of an LLC. This means that unless the operating agreement specifies that voting on these matters is by class or group, all members vote on the matter. The previous default class or group voting requirements are maintained for LLCs formed prior to the effective date of the legislation.

Sections 23 (K.S.A. 17-7687) and 26 (K.S.A. 17-7695). Changes in these provisions state that a consent or approval given by a person as a member or manager to be effective at a future time will be effective if that person is a member or manager at such time. This overrules a Delaware case that held such consents were ineffective in a corporate dispute.

Section 30 (K.S.A. 17-76,113). This change clarifies that a charging order is the only remedy sanctioned by the KRLLLCA, and attachment, garnishment, and other legal and equitable remedies are not available to a judgment creditor of a member that seeks to satisfy its judgment out of the member’s LLC interest.

Section 31 (K.S.A. 17-76,114). This change specifies that the assignee of a voluntary assignment by the sole member of an LLC of all of the member’s LLC interests becomes a member. A voluntary assignment excludes an assignment effected by foreclosure or similar legal process.

Section 34 (K.S.A. 17-76,135). This change clarifies that default fiduciary duties may apply to LLCs. This is a statutory fix in response to a Delaware Supreme Court case that questioned whether default fiduciary duties applied. Prior changes to the KRLLLCA clarified that fiduciary duties may be reduced or eliminated under the operating agreement.

Various Sections Throughout. Throughout the KRLCA changes are made to provide express statutory authority to use networks of electronic databases, including blockchain and distributed ledgers, for certain electronic transmissions and records.

Various Sections Throughout. The default requirement that a consent or approval be in writing has been eliminated. This provides greater flexibility for different types of consents or approvals. An operating agreement can override this default by requiring written consent or approval.

DLLCA Provisions Not Included

Because we suggest only the adoption of the equivalent of the DLLCA's registered series and not protected series, we have not adopted the DLLCA provisions on the conversion of a protected series to a registered series and vice versa.

In the past several years, Delaware adopted comprehensive reform of the regulation of resident agents (called "registered agents" in Delaware), including special provisions applicable to "commercial registered agents" who serve as registered agent for more than 50 entities. Unlike the volume of entities handled by Delaware, the Secretary of State's Office determined that the current system is adequate to manage resident agents in Kansas. We have not proposed further refinements under the DLLCA related to resident agents.

We have not proposed changes to the fee sections, including technical corrections under the DLLCA for the fee applicable to filing a corrected certificate and the fee applicable to filing a certificate of correction. We have proposed changes to K.S.A. 17-76,136 to include the new certificate of division.

Because the KRLCA already provides a mechanism for cancellation of the articles of organization of a limited liability company upon application of the Attorney General, *see* K.S.A. 17-76,117(a), we did not propose changes adopted in Delaware of similar effect.

Conclusions

We believe that HB 2105 advances Kansas's reputation as being business friendly and at the forefront of innovations in business law. Adopting this legislation continues Kansas's policy of leveraging cutting edge developments and the body of case law advanced by Delaware to the benefit of Kansas and its business community.

We thank you for the opportunity to appear today and your patience. We would be happy to answer your questions.

Respectfully Submitted,

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