



**KANSAS BAR  
ASSOCIATION**

**TO:           The Honorable Lance Kinzer**  
                  And Members of the House Judiciary Committee

**FROM:       William Quick, William Matthews, Joseph Jarvis, and Edwin Hecker**  
                  On Behalf of the Kansas Bar Association

**RE:           House Bill No. 2398 – Amending the Kansas Revised Limited Liability**  
                  Company Act

**DATE:        March 18, 2013**

Chairman Kinzer and Members of the House Judiciary Committee:

We appreciate the opportunity to appear today to brief the Committee and answer questions relating to H B 2398, a bill requested by the Kansas Bar Association (KBA).

We are members of the KBA's Section on Corporation, Banking & Business Law. Over the course of the last year we have worked as a subcommittee to draft amendments to the Kansas Revised Limited Liability Company Act (KRLCA). KRLCA was enacted effective January 1, 2000, and like our corporation statute, was patterned on Delaware's statute. It had not been comprehensively reviewed in the thirteen years since its enactment. Our work centered on two major themes. Principally, we strove to bring KRLCA up to date with the innovations adopted in Delaware since 2000 to the extent those innovations were not inconsistent with Kansas policy. In addition, we sought to identify and correct deficiencies in the present law.

Our purpose today is threefold. First, we wish to explain briefly the benefit Kansas derives from patterning its business statutes on those of Delaware. Second, we will attempt to highlight for the Committee those features of our legislative proposal that we deem most significant or innovative. Finally, we will note the two major areas of the Delaware statute that we determined were inappropriate for adoption in Kansas.

### **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 H B 2398, our subcommittee sought to continue a trend that has been an integral part of Kansas law for over four decades.

### **H B 2398: Significant Provisions**

*Sections 5 and 12 (K.S.A. 17-7668(i) and 17-7676(c)).* Irrevocable powers of attorney are authorized with respect to the organization, internal affairs, and termination of an LLC. These provisions make it possible to avoid unnecessary turmoil in the LLC's affairs that untimely death, disability, bankruptcy or other similar event might otherwise cause.

*Section 20 (K.S.A. 17-7686(d)).* Existing members do not have preemptive rights to purchase additional interests in the LLC in preference to others unless the operating agreement provides otherwise. This provision is consistent with existing corporate law.

*Sections 21 and 27(K.S.A. 17-7687(d) and 17-7695(d)).* Meetings of members and managers may be held by conference telephone or video conference. Members and managers may also be represented and vote at meetings by proxy, including electronically transmitted proxies.

*Section 21 (K.S.A. 17-7687(g)).* KRLUCA presently provides no statutory default rule for amendment of the operating agreement. This defect is remedied consistent with contract law by requiring a unanimous vote of the members unless the operating agreement provides otherwise. Section 17-7687(g) is not retroactive to pre-existing LLCs.

*Section 26 (K.S.A. 17-7693).* Currently, this section requires that managers of an LLC be chosen by the members in the manner provided in the operating agreement. In practice, this requirement is often honored in the breach, with many operating agreements directly appointing a manager. In keeping with actual practice and the policy of freedom of contract codified in section 17-76,134(b), the amended version simply states that managers shall be chosen as provided in the operating agreement.

The bill also repeals the provisions currently in this section concerning the ability of members and managers to enter into contracts on behalf of an LLC. Regulation of these matters involves a delicate balance of the competing interests of the LLC and third parties that is better left to resolution by the courts on a case by case basis.

*Section 28 (K.S.A. 17-7697).* The defense of good faith reliance on records, information, and reports is extended from members and managers to liquidating trustees.

*Sections 34 and 35 (K.S.A. 17-76,106 and 17-76,107).* Under current law, unless the operating agreement provides otherwise, a member may freely resign from an LLC but is not entitled to be paid the fair value of his or her interest until dissolution of the LLC. The apparent purpose is to help ensure stability of the LLC's capital. Delaware law achieves the same purpose with converse provisions. That is, unless the operating agreement provides otherwise, members may not resign prior to dissolution of the LLC, but if the agreement does permit resignation, the member is entitled to be paid the fair value of his or her interest. The proposal reverses current law and follows Delaware's lead. It is not retroactive to pre-existing LLCs.

*Sections 37 and 38 (K.S.A. 17-76,112 and 17-76,113).* The proposal repeals section 17-76,112(f), which, in conjunction with section 17-76,113, has been interpreted to permit the separate creditor of the member of a single member LLC to assume control of the LLC. Section 17-76,113 has been reworded to reinforce this change and to make it clear that the separate creditor of a member of an LLC has no rights with respect to the LLC's property. Neither of these sections affects the rights of creditors of the LLC itself.

*Section 41 (K.S.A. 17-76,116).* Because of the overriding importance of the question, unless otherwise provided in the operating agreement, the vote necessary for dissolution of an LLC specified in subsection (a)(3) is increased from members who own a simple majority to members who own two-thirds of the interest in profits. In addition, that portion of subsection (b) that permits the members to vote for dissolution upon the occurrence of an event that terminates the membership of any other member is repealed because it is redundant in light of the broader inclusive language of subsection (a)(3).

*Section 44 (K.S.A. 17-76,119(b)-(d)).* The amendments to this section, which governs distribution of the assets of an LLC after dissolution and winding up, increase protection for creditors in two ways: by requiring that provision be made for the adverse outcome of pending litigation and claims that are unknown or that have not arisen but that are likely to arise or become known within ten years after dissolution; and by imposing liability on members who knowingly receive a distribution in violation of section 17-76,119, subject to a three year statute of limitations. The latter mirrors existing provisions in section 17-76,110 which applies to distributions by an ongoing LLC.

*Section 57 (K.S.A. 17-76,134(c), (e)).* The proposed amendments to this section conform KRLLLCA to the current law in Delaware and further the policy of freedom of contract codified in subsection (b). They permit complete contractual waiver of fiduciary duties and elimination of liability for the breach thereof. They do not, however, permit elimination of the implied contractual covenant that each party will act in good faith and deal fairly with the other party; nor do they permit limitation or elimination of liability for a bad faith breach of that covenant.

*New Section 63.* This new section confirms the power of the district court, upon a showing of good cause, to appoint trustees or receivers to wind up the affairs of an LLC after dissolution.

*New Section 64.* This new section permits the members of an LLC that has been dissolved other than by judicial decree, to revoke the dissolution and continue the business by unanimous vote.

*New Section 65.* KRLLLCA currently lacks a comprehensive provision permitting retroactive reinstatement of LLCs, both domestic and foreign, that have had their articles of organization or authority to do business cancelled or forfeited for failure to file annual reports or failure to be current in their appointment of resident agents. New section 65 fills this void.

### **Portions of the Delaware Limited Liability Company Act Not Included**

The Delaware Act contains comprehensive provisions for mixed entity mergers (such as a merger of an LLC with a corporation); conversion of one type of business entity into another type (such as conversion of an LLC into a corporation or conversely), and domestication (change of domicile of an LLC from one state or country to another). These provisions are unnecessary in Kansas because our Business Entity Transactions Act (K.S.A. 17-78-101 et seq.) already adequately covers these kinds of transactions and more.

In addition, we omitted all Delaware sections that were devoted solely to filing documents with the Secretary of State. We have been informed that the Kansas Secretary of State's Office has undertaken a

major project that, when completed, will unify filing requirements for all business entities. Because of this project, no significant changes in current Kansas LLC filing are called for at this time.

### **Conclusion**

We believe H B 2398 will further solidify the state's reputation as being business friendly and in the forefront of 21<sup>st</sup> century business law innovation. By enacting this legislation, Kansas will continue to leverage Delaware's huge investment in staying at the cutting edge of new developments, maintain continuity with our other business statutes which also follow Delaware and its integrated approach across entity types, and provide consistency with the basics of current law and practice.

Thank you for the opportunity to appear today and for your patience. We would be happy to try to answer any questions you may have.

Respectfully,

William Quick  
William Matthews  
Joseph Jarvis  
Edwin Hecker

#### *About the Kansas Bar Association:*

The Kansas Bar Association (KBA) was founded in 1882 as a voluntary association for dedicated legal professionals and has more than 7,200 members, including lawyers, judges, law students, and paralegals. [www.ksbar.org](http://www.ksbar.org)