#### MINUTES

#### MONTANA SENATE 53rd LEGISLATURE - REGULAR SESSION

#### COMMITTEE ON JUDICIARY

**Call to Order:** By Senator Bill Yellowtail, on January 21, 1993, at 10:00 a.m.

#### ROLL CALL

Members Present:

Sen. Bill Yellowtail, Chair (D)
Sen. Steve Doherty, Vice Chair (D)
Sen. Sue Bartlett (D)
Sen. Bob Brown (R)
Sen. Eve Franklin (D)
Sen. Lorents Grosfield (R)
Sen. Mike Halligan (D)
Sen. John Harp (R)
Sen. David Rye (R)
Sen. Tom Towe (D)

Members Excused: Sen. Crippen, Sen. Blaylock

Members Absent: NONE

**Staff Present:** Valencia Lane, Legislative Council Rebecca Court, Committee Secretary

**Please Note:** These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary: Hearing: SB 146

SB 93

Executive Action: NONE

#### HEARING ON SB 93

#### Opening Statement by Sponsor:

Senator Beck, District 24, said that SB 93 does not eliminate the death penalty, but would eliminate hanging as a form of execution. Senator Beck said that SB 93 does not oppose hanging as a cruel and unusual punishment. Senator Beck said the cost is a factor in eliminating hanging, as appealing costs the state money. Senator Beck referred to a letter from Ted L. Mizner. (Exhibit #1) Senator Beck said SB 93 would become effective on

930121JU.SM1

#### SENATE JUDICIARY COMMITTEE January 21, 1993 Page 2 of 8

the day of passage. Any sentences enacted previous to the passage of SB 93, would not be affected by SB 93. Using one form of execution, death by lethal injection, would give courts direction and minimize the appeals in Montana.

#### Proponents' Testimony:

Mick Gamble, Corrections Administrator for the Department of Corrections and Human services, supported SB 93. Mr. Gamble stated that they feel the management issues associated with hanging are costly and at present we have no facility in which to hang people. We have no clear policy as to how that would be done. As a management issue, he said that the Department preferred lethal injections be used as the only form of execution.

Beth Baker, Department of Justice, told the committee presently there are eight capital cases involved in litigation throughout Montana regarding the death penalty. Making SB 93 applicable to crimes committed after the effective date, will minimize legal issues defendants raise during the appeals process. Ms. Baker urges support of the passage of SB 93 and to maintain section 2 as it presently reads.

#### **Opponents' Testimony:**

Representative Brooke, District 56, stated that with the passage of SB 93, Montana would loose the image of a western state. SB 93 would send a message that Montana is moving forward and away from cruel and unusual punishment. Representative Brooke asked the Committee for a do not pass recommendation.

Scott Crichton, American Civil Liberties Union, read from prepared testimony. (Exhibit #2)

<u>Questions From Committee Members and Responses</u>: Senator Halligan asked Beth Baker about her involvement with appeals concerning the death penalty. Ms. Baker stated that she has not handled a death penalty appeal case.

Senator Halligan asked Ms. Baker about appeals based on cruel and unusual punishment. Ms. Baker said that the Montana Supreme Court has ruled that hanging is not cruel and unusual punishment. If the legislature changes the method of execution, it is not considered a new punishment, but a new form of punishment. The United States Supreme Court ruled that changes in a death penalty law do not violate the ex post facto clause. To minimize any argument about an ex post facto application of the law, it would be to make the act applicable only if the crime is committed after the effective date.

Senator Doherty asked Ms. Baker about litigation after SB 93 is passed. Ms. Baker said that there is litigation presently

SENATE JUDICIARY COMMITTEE January 21, 1993 Page 3 of 8

because of the choices of the death penalty. Presently a death penalty case is on appeal before the Montana Supreme Court concerning hanging as a method of execution. Part of the argument is that forcing the defendant to make a choice between hanging and lethal injection is cruel and unusual punishment. With the passage of SB 93, issues will still be litigated.

Senator Towe asked Ms. Baker about the prisoners on death row in Montana. David Dawson is in state collateral proceedings with the District Court. William Gull and Douglas Turner are on direct appeal to the Montana Supreme Court. Lester Kills On Top and Vern Kills On Top are pending in State District Court on collateral proceedings. Terry Langford is in Federal District Court on a habeas petition. Ronald Allen Smith has a state appeal pending in federal court. Duncan McKenzie is appealing in the Ninth Circuit.

#### <u>Closing by Sponsor:</u>

Senator Beck said SB 93 eliminates hanging as a form of execution to eliminate choice of an inmate. Senator Beck is asking the Committee to take the choice of execution away from the inmates. Senator Beck closed by telling the Committee that Montana finished trials of inmates who were involved in a riot at Deer Lodge State Prison. The inmates were not sentenced to death because if they had a right to choose a form of execution, the inmates would end up in the appeals court for years. The inmates should have been punished by death.

#### HEARING ON SB 146

#### **Opening Statement by Sponsor:**

Senator Waterman, District 22, said that SB 146 creates an exciting and innovating business entity in the state. SB 146 permits Montana business to organize and operate by using the best features of corporation and partnership law. SB 146 will enhance Montanas ability to attract and promote businesses throughout the state. SB 146 provides limited liability that corporations enjoy, while allowing the tax benefits of a partnership. SB 146 is well suited for Montana's small and family businesses.

#### Proponents' Testimony:

Steven Bahls read from prepared testimony. (Exhibit #3) Professor Bahls submitted information on the Limited Liability Company Act. (Exhibit #4, Exhibit #5, Exhibit #6)

Garth Jacobson read from prepared testimony. (Exhibit #7)

Julie McGarry said that limited liability company legislation is being enacted all over the county. If Montana wants to attract investments and new businesses to the state, it has to be aware of what other states are doing in order to remain competitive. (Exhibit #8) Ms. McGarry supports SB 146.

Richard Baskett, attorney, said that SB 146 addresses the competitiveness between the states. There is flexibility in a limited liability company, when compared to other kinds of business organizations. General partnerships are subject to complete liability for the partners. An option that is now available in Montana is the use of a limited partnership. There has to be a general partner in a limited partnership. A limited liability company would not have a general partner. Limited partners are not allowed to have any say in management, only the general partner can be involved with the management of a limited partnership. The limited partner who actively participates would be liable for violating rules, the same as if it were a general partner. SB 146 would avoid those traps. In a limited partnership, it is possible to become liable as a general partner, if the limited partner becomes to involved in management. With limited liability company the potential of becoming liable would be avoided. SB 146 simplifies the organization of businesses in Montana.

David Owen, Montana Chamber of Commerce, stated that SB 146 is a concept that is advantageous for small and family businesses, and professional service organizations. Montana is a small business state, for that reason limited liability would be an advantage for businesses in Montana. Mr. Owen urges support.

Tom Morrison, tax lawyer, stated that Limited Liability Companies will help small businesses in Montana. SB 146 is not a solution or a substitute for large corporations. Large corporations would not use the limited liability company because of the way it was put together. SB 146 would place Montana with the rest of the progressive states that feel Limited Liability Companies are helpful to small businesses.

Bill Stevens read from prepared testimony. (Exhibit #9)

Riley Johnson, National Federation of Business in Montana, urges support of SB 146.

#### **Opponents' Testimony:**

NONE

#### Questions From Committee Members and Responses:

Senator Halligan asked Professor Bahls how the limited liability companies would effect the Uniform Partnership Act. Professor Bahls said that unlike partnerships, the Limited Liability Companies may only be formed by filing with the Secretary of the State. Montana will need a partnership law for those small businesses that are involved in a partnership. Partnerships would not be used as much in Montana if SB 146 passes.

#### SENATE JUDICIARY COMMITTEE January 21, 1993 Page 5 of 8

Chair Yellowtail asked Professor Bahls whether there is incongruity between the partnership acts and SB 146. Professor Bahls stated that SB 146 would work with the existing partnership act and would not be inconsistent with the new uniform partnership act should it pass.

Senator Doherty asked Professor Bahls about the tax revenue. Professor Bahls said that there will be no significant revenue loss to Montana. SB 146 would be used primarily by individuals who are operating as partnerships now, and then would take advantage of limited liability which would not create a change in tax.

Senator Doherty asked Professor Bahls about malpractice under SB 146. Professor Bahls said that section 77 makes it clear that the law firm itself would be liable in a Limited Liability company. The additional people liable would be the attorneys that committed the malpractice or the associates. Section 77 is identical to the sections of the professional corporation act. Montana has the most restricted provisions in the nation with respect to Professional Limited Liability Companies. SB 146 would not give professionals any more protection than they have now under the Professional Corporation Statute.

Senator Doherty asked Professor Bahls if SB 146 would be less protective if that legal entity was a partnership. Professor Bahls said that is correct.

Senator Doherty asked Professor Bahls about debts with a limited liability corporation. Professor Bahls said that with a Limited Liability Company Act, it would be as if dealing with a corporation. If partners decide to incorporate at a point in time, it would be the corporation which is liable and not the individuals.

Senator Doherty asked Professor Bahls about piercing the limited liability corporate veil. Professor Bahls stated that the theory of piercing the corporate veil is not found in the Montana Code Annotated. Professor Bahls feels that piercing the corporate veil ought to apply to limited liability. Professor Bahls gave an example. If a limited liability company commits a fraud on the public, the courts ought to be able to pierce the veil. Professor Bahls gave an example. "If a limited liability company ran a blasting business in a city area and capitalizes the business with one dollar, the courts could pierce the corporate veil. Limited Liability Companies veil should not be pierced merely for failure to observe corporate type formalities. Senator Doherty asked Professor Bahls about proof problems concerning limited liability corporations that attempt to show that an individual should be liable because the corporation was formed to avoid liability. Professor Bahls said that there would be proof problems, the same problems that a plaintiff faces in trying to pierce a corporate veil in Montana. The presumption of piercing the corporate veil can be overcome, but is difficult to

do.

Senator Doherty asked Professor Bahls about forms for SB 146. Professor Bahls said that there are forms that exist for SB 146.

Senator Towe asked Professor Bahls about the liability of a tort that is committed by a member of a limited company. The president of a corporation is liable for negligence committed even though that president was a shareholder.

Senator Towe asked Professor Bahls whether under SB 146 one would obtain the benefits of limited liability for limited partners or shareholders. Professor Bahls said that is correct.

Senator Towe asked Mr. Morrison about the passive loss rules. Mr. Morrison said that the passive loss rules would apply as it would in a partnership.

Senator Towe asked Mr. Morrison whether a partner would be stuck with the passive loss rules if the partner did not take an active role in the operation. Mr. Morrison said that the partner would not.

Senator Towe asked Professor Bahls if SB 146 would allow shares to be divided so the partners could own a certain number of shares. Professor Bahls said that special provisions would need to be included in the articles of organization or the operating agreement to enable SB 146 to do that. SB 146 was drafted for small businesses with the recognition that additional provisions in the articles of organization could accommodate the larger businesses so shares could be issued.

Senator Towe asked Professor Bahls about a dissolution of a partnership. Professor Bahls said that the law provides that there will be a dissolution of the partnership when a partner dies, unless the remaining partners unanimously agree to bind the shares. If the partners bind the shares there will be a disassociation, not a dissolution, similar to the new partnership act.

Senator Towe asked Professor Bahls about page 10. Professor Bahls said that an insurance company or bank cannot organize as a limited liability corporation because they are separately regulated.

Senator Crippen asked Mr. Morrison about selling an interest in a partnership. Mr. Morrison said that at a partnership level, when one partner sells interest, nothing would happen unless the partners elect to take a special basis election.

Senator Crippen asked Mr. Morrison what the partner is selling when the interest is sold under the present law. Mr. Morrison said a partner would be selling an intangible contract right.

SENATE JUDICIARY COMMITTEE January 21, 1993 Page 7 of 8

Senator Crippen asked Professor Bahls about the treatment of income. Professor Bahls said that there are special provisions in the internal revenue code that say accounts receivable of a partnership is treated as ordinary income. Anything left over after the value of the sale is capital gain.

Professor Bahls stated that the present federal tax law controls the treatment of income regarding partnerships. SB 146 was drafted so partners who comply with the general rules will qualify as partnerships for tax purposes. Flexibility has been added to SB 146 to allow enough changes so partnerships could be treated as a corporation for federal tax purposes. The Internal Revenue Service looks at characteristics to determine whether a partnership will be treated as a partnership or a corporation. SB 146 allows a partnership to provide free transfers of ownership or not to, or to provide centralized management or not to. Changing characteristics changes the ultimate tax result of the Limited Liability Company.

Senator Towe asked Professor Bahls whether a partnership would flunk a partnership test in a shared system, if it makes sure that the shares could be easily transferred from one person to another. Professor Bahls said the partnership would flunk the continuity of life, free transferability, limited liability, and centralized management. If the partnership gets involved with centralized management combined with free transferability of interest, as permitted to do under this statute, the partnership would lose the tax benefits.

Senator Halligan asked Professor Bahls about tort liability. Professor Bahls said entity assets would be available for creditors involved in a tort, but personal assets of owners not participating in the tort would not be available.

#### <u>Closing by Sponsor:</u>

Senator Waterman said that it is obvious that the creation of a Limited Liability Company in Montana will have a positive impact on the state, directly and indirectly. SB 146 is a useful alternative to small businesses in Montana. If Montana is to be competitive with other states it needs to be flexible, and SB 146 allows Montana that opportunity.

SENATE JUDICIARY COMMITTEE January 21, 1993 Page 8 of 8

#### ADJOURNMENT

Adjournment: 11:42 a.m.

Chair BILL YELLOWTAIL Decc

REBECCA COURT, Secretary

BY/rc

# ROLL CALL

DATE 1-21-93

NAME	PRESENT	ABSENT	EXCUSED
Senator Yellowtail	X		
Senator Doherty	X	•	
Senator Brown	$\lambda$		
Senator Crippen	in the second seco		X
Senator Grosfield	X		
Senator Halligan	χ		
Senator Harp	X		
Senator Towe	X		
Senator Bartlett	$\times$		
Senator Franklin	X		
Senator Blaylock			Х
Senator Rye	X		<b>X</b>
•			

Attach to each day's minutes

### TED L. MIZNER

JUDGE OF THE DISTRICT COURT 409 Missouri Avenue Deer Lodge, Montana 59722 (406) 846-3680, ext. 38 (406) 563-8421, ext. 222

THIRD JUDICIAL DISTRICT Deer Lodge, Powell and Granite Counties

BEVERLY GIANNONATTI Court Reporter

January 15, 1993

Senator Thomas A. Beck Capitol Station Helena, MT 59620

yng er gladdaff

Dear Senator Beck:

I am writing in support of your proposed legislation amending Section 46-19-103, MCA, which would eliminate hanging as an optional method of execution. As you may know, there are only four states left which still allow hanging as a permissable form of execution. I believe that there is a genuine question as to whether or not hanging would constitute cruel and unusual punishment under the law. As such, the present Montana law merely creates another issue for appeal for defendants that are facing the death penalty. Your legislation would eliminate any issues relative to cruel and unusual punishment and thus eliminate an appellate challenge on this basis.

I have had personal experience with a defendant who has elected hanging, then elected lethal injection and later chose hanging and then appealed on the basis that hanging was cruel and unusual. I believe that the elimination of this kind of "game playing" in the courts is important. I believe there is widespread frustration with the way death penalty cases are handled, particularly as to the way the lengthy appellate process applies. I believe your proposed amendment may well address some of the frustration involved with this judicial process.

The recent hanging in the State of Washington exemplifies this issue. I am convinced that there would no doubt have been stays of execution entered in that case, and further appeals filed on the hanging issue, if the Defendant and his attorney had not insisted on hanging as the method of execution. There were several individuals who attempted to intervene on the defendant's behalf without his permission to stop the execution because they felt hanging was cruel and unusual. I believe your legislation could prevent a similar scenario in Montana.

Please contact me if you have further questions. I apologize that my schedule would not allow me to appear in person.

Sincerely, District Court øydge

TLM:jj



Э

January 20, 1993

SB 93: AN ACT ELIMINATING DEATH BY HANGING AS A METHOD OF EXECUTION OF DEFENDANTS SENTENCED TO DEATH

Mr. Chairman, Members of the Committee:

For the record, I am Scott Crichton, Executive Director of the American Civil Liberties Union of Montana.

In the aftermath of the violence by inmates and then violence by staff at Montana State Prison in 1991, I had occassion to be speaking with staff at the Department of Corrections about the possible state sanctioned execution by hanging of an inmate. The department staff wanted to know if ACLU would oppose such a hanging.

For the record the American Civil Liberties Union holds that the death penalty inherently violates the constitutional ban against cruel and unusual punishment and the guarantee of due process of law and the equal protection of the laws. It is applied randomly at best and discriminatorily at worst. It is imposed disproportionately upon those whose victims are while, on offenders who are peop-le of color, and on those who are themselves poor and uneducated.

But back to the discussion with the Department of Corrections inquiry. Upon further discussion, it became clear to me that the state's major concerns were these: First, where would they build a scaffold? Second, what would that cost the state? And third, how would they find a qualified hangman?

The later is especially important. One article I read preparing this testimony describes the effects of hanging as follows:

"When the drop is too long, decapitation may occur. When the drop is too short, the subject dies a slow, painful death by strangulation... Of all the forms of capital punishement in use in the United States, hanging is probably the most painful."

So I suppose I should be grateful that we are considering eliminating hanging in Montana. I would hope we'd be considering something broader in this committee today, that we'd be examining the whole notion of state sanctioned murder. Because as the 20th century comes to a close, we in Montana could have an opportunity to join the family of humankind who see capital punishment as the anachronism that it is-- like other barbaric practices like slavery, branding and other forms of corporal punishment. There are a few societies besides ours who still think that by killing people we can demonstrate that killing people is wrong. Honestly, I grew up believing that we in the United States were global leaders the field of human rights. I do not want the global community to think we share the values of China, Iraq, Iran and South Africa as nations who sanction the state's takling of a life. I'd rather be alligned with the 28 European countries that have abolished the death penalty either in law or practice.

But instead, today you begin deliberation to consider trying to sterilize the taking of life with this method, this lethal injection, that appears "medical" and purportes to be "humane".

Botched executions continue to happen, not just with electrocution, gas or hanging, but with lethal injection as well. If you think you will be eliminating problems by allowing lethal injection as the sole means of execution, I encourage you to ask a medically trained person about finding suitable veins in the arms or legs of a drug addict.

Some stories from Texas, to make my point: in 1985, in executing Stephen Peter Morin, they had to probe both arms and legs with needles for 45 minutes before they found the vein; in 1986, Randy Woolls, a drug addict had to help the execution technicians find a good vein for his own execution; in 1987, it took 35 minutes to insert the catheter into Elloit Johnson's vein; and in 1989, Stephen McCoy had such a violent physical reaction to the drugs (heaving chest, gasping, choking), that one of the male witnesses fainted.

Make no mistake. Opposition to the death penalty does not arise from misplaced sympathy for convicted murderers. On the contrary, murder demonstrates a lack of respect for human life. For this very reason, murder is abhorrent, and any policy of stateauthorized killing is immoral. A decent and humane society does not deliberately kill human beings.

Lets not fool ourselves that executioners in white coats armed with deadly needles signify any real improvements of a "civilized" state. The guillotine, the chair, the chamber, the needle-- they are all methods of premeditated and ceremonious state-authorized murder.

MEHATE JUDICIARY
LINE 3
1-21-93
SBIYO

Testimony of
 Steven C. Bahls
 in support of
 SB 146
 (Montana Limited Liability Company Act)

My name is Steven C. Bahls. I am the Associate Dean and a Professor at the University of Montana School of Law. I teach Business Organizations I and II, as well as agricultural law. I have had the pleasure of serving as Chair of the Limited Liability Company Subcommittee of the Tax, Probate and Business Section of the State Bar of Montana. It is this subcommittee that drafted SB 146.

Limited liability companies are a relatively new form of business organization in the United States. Limited liability companies originated in Germany in 1892 and are now extensively used in Europe and Latin America. Authorized by legislatures in approximately one third of the states, limited liability companies are a hybrid business entity created by combining the best of both worlds from corporations and partnerships. Limited liability company owners, like corporate shareholders, are not personally responsible for the debts of the business. Section 23. Owners of limited liability companies, however, receive the tax benefits of taxation as partners. Revenue Ruling 88-76. These tax benefits include taxation of the income of a LLC to the owners and not to the LLC. (Corporations, by contrast, are generally subject to double taxation at both the corporate level and at the shareholder level.) Owners of limited liability companies receive the ability to offset any losses incurred in the business against other personal income. Authorizing limited liability companies in Montana will allow Montana business a form of business organization providing the same advantages as Wyoming and several other states in our region provide.

The LLC is an evolutionary entity that provides significant advantages in today's business world. LLCs promise simplicity in formation, flexibility in planning and operation, limited liability, member control of the business and pass through tax advantages without a lot of burdensome restrictions. Given the flexibility and tax advantage of LLCs, LLCs are appropriate for entrepreneurial ventures with a small number of owners. LLCs are especially well suited for family businesses. Finally, LLCs may, in many cases, be appropriate for corporate joint ventures, real estate,

farm and ranch businesses, mining and oil and gas investments, high technology businesses and professional businesses.

#### HISTORY OF LLCs

In 1986, federal tax legislation repealed many of the tax advantages given corporations, thereby reinforcing the double taxation of corporations and shareholders. Likewise, the inversion of the corporation and individual tax rates further compounded problems for businesses taxed as corporations. As a result, business had a greater incentive to organize as partnerships. Many businesses were hesitant to organize as partnerships, however, because owners of partnerships (unlike shareholders) are jointly liable for all partnership debts. The state of Wyoming had enacted legislation creating limited liability companies. Wyoming's legislation was modelled after the German model. Wyoming touted its limited liability company legislation as offering both partnership tax attributes and corporate limited liability. In 1988, the IRS released Revenue Ruling 88-76, which stated properly that structured Wyoming LLCs would be taxed as partnerships, even though its owners had limited liability. This IRS ruling settled many doubts about the future of LLCs and broke the way for further states to begin legislation in this area.

In 1991, driven by changes in tax laws and acting (specifically in reaction to the 1988 Revenue Ruling), the American Bar Association (ABA) released a first draft of the Prototype Limited Liability Company Act. This prototype Act provides the solid foundation for states, such as Montana, to create LLC legislation.

In 1991, the Tax, Probate and Business Section of the Montana State Bar created a Limited Liability Company Subcommittee to study the progress of LLCs on the national level and to propose appropriate LLC legislation for Montana. The objective of the Subcommittee was to provide Montana businesses with the same benefits other states authorizing LLCs provide. The Subcommittee is comprised of a bipartisan, diverse body of attorneys, and includes private practitioners, members of state government and academia, as well as a law student associate member who has reviewed LLC laws of other jurisdictions.

After much research, discussion and several all day meetings, the Subcommittee members unanimously agreed to go forward with proposing LLC legislation for Montana. The members of the Subcommittee unanimously believed that it is in the interest of Montana businesses to adopt legislation as soon as possible. The Subcommittee's proposal was recently endorsed by the State Bar of Montana. Governor Racicot has also stated his support for LLC legislation.

The Montana Subcommittee's proposal is based largely on the version of the Prototype Limited Liability Company Act prepared by the American Bar Association in July of 1992. The ABA Section of Business Law that drafted the LLC Prototype has had a history of drafting successful, comprehensive legislation. This ABA Section is led by many of the nation's foremost legal experts on business organizations. Through the appropriate subcommittee this Section has drafted both the Model Business Corporation Act (adopted by 30 states), the Statutory Close Corporation Act, and the Model Nonprofit Corporation Act, all of which have been adopted in large part by the state of Montana. The ABA Model Acts have dominated state corporate governance statutes. Senate Bill 146 is based on the ABA Prototype, but has been revised by the Montana Bar Committee to better meet the needs of Montana businesses. Revisions include standardized filing provisions with the secretary of state, (sections 12-18) as well as revisions limiting the ability of professionals to escape from liability for malpractice. Section 77.

At this point, I would like the Committee to receive a copy of the ABA Prototype Limited Liability Company Act (with Official Commentary) and the Montana Comments to the Montana Limited Liability Company Act. These materials, if the bill is enacted, will provide valuable guidance in its interpretation.

#### **DESCRIPTION OF LLC**

As I previously indicated, the Montana Limited Liability Company Act borrows provisions from both the corporate and partnership law. It borrows these corporate characteristics.

 Owners of limited liability companies, like corporate shareholders, are generally not liable for the debts of the limited liability company.
 Section 23. Exceptions include when owners guarantee debts of a LLC or when owners personally commit wrongs while acting for an

Event 3 1-21-93

LLC. See Official ABA Commentary and Montana Comments. Section 23. For both of these exceptions, owners will be personally liable for the debts or damages.

- Because limited liability companies are a separate legal entity, limited liability companies must file organizational papers with the secretary of state. Section 9. Limited liability companies must maintain a registered agent and register office in this state. Section 5. Like corporations, limited liability companies must file annual reports with the secretary of state. Section 15. The bill directs the secretary of state to recoup the costs of processing documents by assessing filing fees. Section 18(3).
- When limited liability companies dissolve, like corporations, its owners hold the assets of the limited liability company in trust for creditors. Section 54.

Limited liability companies also possess several important partnership attributes. Many of the partnership attributes of the limited liability company must be included in the legislation in order that limited liability companies are taxed as partnerships.

- Limited liability companies, like partnerships, do not have continuity of life. As such, if an owner of a limited liability company dies, resigns, or files bankruptcy (and the members interest is not purchased by the limited liability company within 90 days), the limited liability company is dissolved. Sections 45 and 46.
- Limited liability companies are generally not managed by managers or by a board of directors, but are instead member managed. Section 24. Unless the organizational documents provide otherwise, each member has one vote. Section 26.
- An interest in limited liability companies, unlike corporate stock, is not freely transferable. As with a partnership interest, an owner of a limited liability company that seeks to transfer his or her interest, transfers only an interest in any distributions from the limited liability company. Section 41. The transferee does not gain the right to manage or vote.
- Limited liability companies are flexible like partnerships. Unlike corporations, there are no rigid requirements for meetings or for a

board of directors. Instead, the operation of a limited liability company is governed by an operating agreement, to be entered into among its owners. Section 2(16).

#### ILLUSTRATION OF WHY LLCs ARE ATTRACTIVE

To illustrate the advantages of a LLC, consider family members who want to operate a small business together. Right now the main choices are operating as a partnership or as a corporation. Both of these familiar business entities offer serious drawbacks along with their benefits. Simplicity is a partnership's main appeal: It's easy to set up and requires no bylaws, board of directors or annual meeting. A partnership is not subject to taxation. All income is divided among the partners, who pay taxes on their share profits at individual rates, which are often lower than corporate rates. Partnership losses can be used to offset a partner's other income.

The downside of partnerships is that each partner is fully liable for the debts of the partnership. If you and your brother-in-law were partners on a farm where a visitor got badly hurt, both of you would be equally responsible for the damages caused by the injury even if the injury was the result of just one partner's negligence.

Fear of such liability has prompted hundreds of small businesses to incorporate. The protection they receive is substantial: Shareholders of a properly structured family corporation are no more responsible for the corporation's debts than General Motors shareholders are for court judgements that may be brought against GM.

But the corporation has to be run properly to maintain that legal shield. The law requires that shareholders elect a board of directors and officers. The corporation also has to hold a business meeting at least once a year and obey the required corporate formalities. Miss a requirement and a court may decide the business is not really a corporation and that the owners should be held personally responsible for its debts.

5

It is true that a small business such as a family farm can declare itself an "S corporation," and avoid the corporate tax. An S corporation is taxed like a partnership. But that choice comes with restrictions - no corporate owners, no foreign owners, no more than 35 shareholders and fewer business related tax advantages than partnerships are allowed.

Most significantly for small business owners, an S corporation cannot have more than one class of owners. This precludes a popular estate planning option in which the family-owned corporation issues preferred stock to the parents and common stock to the children, in hope of providing the children with a greater share of the business' income over time.

The shortcomings of operations and partnerships and corporation explain the appeal of the limited liability company. It offers most of the simplicity, flexibility and tax advantages of a partnership, and the same protection from liability as a corporation.

#### **RESPONSIBLE OPERATION OF BUSINESS**

The Montana Limited Liability Company Act has been drafted to encourage responsible operation of business. Professionals, such as attorneys, accountants and doctors may operate as professionally limited liability companies; but these professionals, by law, would remain liable for their own malpractice and the malpractice of those they supervise. Section 77. The provision governing professional LLC are based on the provision restricting the operation of Montana corporations. Similarly, the legislation does not change the rule that business persons who commit torts are liable for their torts. See Montana Comments.

For example, assume a construction company has become a limited liability company. Assume that the LLC was negligent in its design and erection of a building. The LLC, itself, and those who participated in the design or construction are responsible for the negligence. But just as corporate shareholders or officers who don't participate in the design or construction are not responsible, similarly situated members of a LLC are not responsible. *See, e.g., Little v. Grizzly Manufacturing,* 636 P. 2d 839 (Mont. 1980).

#### CONCLUSION

It is imperative to note that of the approximately one third of the states with LLC legislation in effect, four of the states are in the Rocky Mountain region of the United States: Wyoming (1977), Colorado (1991), Nevada (1991), and Utah (1991). Wyoming advertises that its LLC statute provides a tremendous benefit to those doing business in Wyoming. Montana business deserves the same opportunity and advantage afforded to business in neighboring states. To remain competitive, Montana should provide this opportunity immediately. Not only will LLCs provide an exciting alternative to more conventional forms of business organizations in our state, but legislation will facilitate a welcome improvement in Montana's business image. LLCs are pro-economic development, at virtually no cost. And as Montana strives to be a leader not a follower in providing for small business, it makes great sense that Montana seize this opportunity now.

National statistics show that the most growth in the business arena in the last decade has been in the area of small business. I suspect this is particularly true of business in Montana. Responsible legislation that will help small business in Montana is urgently needed. If Montana wishes to compete for small business with surrounding states, LLC legislation is a practical necessity and a step toward the future.

SP3 146

### **<u>5</u> Law** By STEVEN BAILS and JANE EASTER BAILS

#### A promising solution to the businessstructure riddle

Should you operate the family farm as a partnership or as a corporation? Your best answer may be "neither." At least 16 state legislatures have enacted laws that permit a new type of business structure called the limited liability company. Most other states are considering such legislation.

The LLC, meant to combine the best of the corporation and the partnership, is a needed alternative. Both of the familiar choices offer serious drawbacks along with their benefits. Simplicity is a partnership's main appeal: It's easy to set up and requires no bylaws, board of directors or annual meeting. And a partnership is not subject to taxation. All income is divided among the partners, who pay taxes on their share at individual rates, which are often lower than corporate rates.

The downside is that each partner is fully liable for the debts of the partnership. That's a sobering thought. If you and your brother-in-law were partners on a farm where an employee or visitor got badly hurt, both of you would be equally responsible for the legal bills even if the injury was the result of just one partner's negligence.

Fear of such liability has prompted hundreds of family farmers to incorporate. The protection they receive is substantial: Shareholders of a properly structured farm corporation are no more responsible for the corporation's debts than General Motors shareholders are for court judgments that may be brought against GM.

But the corporation has to be run properly to maintain that legal shield. The law requires that shareholders elect a board of directors and officers. The corporation also has to hold a business meeting at least once a year and file an annual report with the state. Miss a requirement and a court may decide the business is not really a corporation and that the owners should be held personally responsible for its debts. Worse, a corporation's income is subject to double taxation. First the corporation pays taxes on its earnings; then it pays what's left to the shareholders as dividends and the shareholders pay taxes on it as individuals.

True, a small business such as a family farm can declare itself an "S corporation." and avoid the corporate tax: an S corporation is taxed like a partnership. But that choice comes with restrictions — no subsidiaries, no more than 35 shareholders (none of whom may be a partnership, a trust or another corporation) and fewer businessloss write-offs than partnerships are allowed.

Limited liability companies include many of the best features of partnerships and corporations.

Most significantly for farmers. an S corporation cannot have more than one class of owners. That precludes a popular retirement plan in which the corporation issues preferred stock to the parents and common stock to the children, in hope of providing the children with a greater share of the farm's income over time.

The shortcomings of the available forms explain the appeal of the LLC: It offers most of the simplicity, flexibility and tax advantages of a partnership, and the same protection from liability as a corporation.

Limited liability companies as a form of business organization began to attract attention after the Tax Reform Act of 1986 made corporate structures less attractive by increasing the corporate tax rate and eliminating some of



Roger Woodwo

the exceptions to corporate double taxation. LLCs really caught on after the IRS ruled in 1988 that LLCs authorized by an obscure Wyoming statute could provide shareholders with both a corporation's liability shield and a partnership's tax benefits.

Other states decided to follow Wyoming's example. States that currently have rules governing LLCs include Illinois, Minnesota, Kansas and Texas.

lowa allows LLCs but forbids them from owning or leasing farmland. Designed to prevent big LLCs from taking over farmland, the statute fails to provide an exception for family farms.

In general, the rules make creating an LLC quite trouble-free. Two or more persons may set one up merely by filing a simple document with the state and paying a modest fee. The members of the LLC then sign an agreement that governs how the business is managed, how membership interests are transferred and how profits are shared.

LLCs are most appropriate for new farm businesses and existing partnerships that want to convert; corporations that turn into LLCs are likely to be taxed on the conversion. Of course, to make sure an LLC is right for you and to set it up correctly, consult your attorney for guidance.

Steven Bahls is a law professor at the University of Montana in Missoula. Jane Easter Bahls is a FARM FUTURES contributing editor.

-21-93\_\_\_

, ().

#### OFFICE OF THE GOVERNOR

STATE OF MONTANA



-STATE CAPITOL Helenal Montana 34620-0503

3 1-21-93

MARC RACICOT GOVERNOR

January 11, 1993

Steven Bahls Associate Dean and Professor University of Montana School of Law Missoula MT 59812-1071

Dear Steven:

I will support the legislation proposed by the State Bar of Montana authorizing a new type of business entity called Montana Limited Liability Companies.

The Internal Revenue Services' approval of Limited Liability Companies certainly requires that Montana adopt this type of business entity in order to remain competitive with surrounding states.

Since the Department of Revenue does not anticipate a significant loss of revenue and since the public is properly protected, there would not appear to be any major opposition to legislation of this nature.

Best of luck as you shepherd the bill through the legislative process.

Happy holidays.

Sincerely,

Pline KAucak

MARC RACICOT Governor

# SB 14 COMMENTS TO THE MONTANA LIMITED LIABILITY COMPANY ACT

: NRY

EXHIBIT 4 DATE 1-21-93

#### INTRODUCTORY COMMENTS

These Comments are intended to assist with interpreting the Montana Limited Liability Act. These Comments were drafted by Professor Steven C. Bahls and Attorney Julie McGarry and adopted by the Limited Liability Company Subcommittee of the State Bar of Montana's Tax, Probate and Business Section.

All sections of the Montana Limited Liability Company Act, unless otherwise specified, are based on the Prototype Limited Liability Company Act (July 16, 1992) drafted by the American Bar Association's Subcommittee on Limited Liability Companies of the Partnerships and Unincorporated Business Organizations Committee. The Montana Limited Liability Company Subcommittee believes that the Commentary to the ABA Prototype will be of substantial help in interpreting the Montana Limited Liability Company Act.

#### **GENERAL COMMENTS**

As a general rule, a Montana LLC should be considered as a separate entity. The drafters agree with Introductory Comment Eight accompanying the ABA Prototype Act:

"The Committee has concluded that an LLC should be generally considered a separate entity for all purposes rather than merely an aggregate of individual members. Although this decision was made, the term entity was not included in the definition of limited liability company. Thus, for example, the Prototype makes clear that the entity itself owns property and engaged in litigation. This should prevent the confusion resulting in partnerships from the fact that the Uniform Partnership Act does not explicitly characterize the partnership, and contains both aggregate features, such as technical dissolution on dissociation of a member, and entity features, such as the partnership's power to take title to property."

This exhibit is 27 pages long. The original is stored at the Historical Society at 225 North Roberts Street, Helena, MT 59620-1201. The phone number is 444-2694.

### EXECUTIVE SUMMARY

### January 1993

### QUESTIONS AND ANSWERS ABOUT LIMITED LIABILITY COMPANIES

#### QUESTION WHAT IS A LIMITED LIABILITY COMPANY? ONE

ANSWER The limited liability company (LLC) is a hybrid business entity created by combining the best of both worlds from a corporation and a partnership. It uniquely integrates the limited liability attribute of a corporation with the "pass-through" tax advantages enjoyed by a partnership.

> The LLC is an evolutionary entity that provides significant advantages in today's business world. LLCs promise simplicity in formation, flexibility in planning and operation, limited liability, member control of the business, and pass through tax advantages without a lot of burdensome restrictions.

Professor Larry E. Ribstein, of George Mason University School of Law, observes the importance of limited liability companies.

EDTE EDITARY. MULTER MO. 1-21-93 SBILLO

"Many lawyers and legislators have become interested in a new limited liability business form, the LLC, that lets firms adopt limited liability without many of the tax and other costs that once attended limited liability. [Over time] the partnership form of business will greatly diminish in importance. After a transitional period, partnership will survive, if at all, as a residual form for firms that have no customized agreement." Larry E. Ribstein, *The Deregulation of Limited Liability and the Death of Partnership*, 70 WASH. U.L.Q. 417 (1992).

Given the flexibility and tax advantage of LLCs, LLCs are appropriate for entrepreneurial ventures with a small number of owners. LLCs are especially well suited for family businesses. Finally, LLCs may, in many cases, be appropriate for corporate joint ventures, real estate, farms and ranches, mining and oil and gas investments, high technology businesses and professional business.

participation in management.

EXHIBIT 5 UATE 1-21-93 SB 146

(d) Consider Statutory Close Corporations.

While a statutory close corporation may operate with much of the flexibility of a LLC, the Internal Revenue Service has taken the position that statutory close corporations will not be treated as a partnership for tax purposes. The IRS states whenever an organization is incorporated, it cannot be considered a partnership. As such, a statutory close corporation cannot enjoy the tax advantages of a partnership.

(e) Consider Business Trusts.

Though authorized by the Montana Code Annotated, business trusts are rarely used. The tax law governing business trusts is uncertain and the enabling statute is outdated. Further, the limited liability aspects of business trusts are not clear when business trusts from one state seek to do business in other states. See Larry E. Ribstein, supra at 423-24.

(f) Comparison Conclusion.

For savvy business owners who have elected in the recent past to avoid double taxation through the use of an S corporation election, or have pursued limited liability through the limited partnership, the LLC promises to be an enticing alternative: it provides tax advantages without the restrictive S corporation requirements and promises limited liability to all members, even those who control and manage.

#### QUESTION THREE

#### ANSWER

In 1986, federal tax legislation repealed the General Utilities doctrine and Congress reinforced the double taxation of corporations and shareholders. Likewise, the inversion of the corporation and individual tax rates further compounded problems for businesses taxed as corporations. Before 1986, two states (Wyoming and Florida) had limited liability legislation in effect and much doubt existed as to whether LLCs would receive the benefit of taxation as a partnership.

WHY THE LIMITED LIABILITY COMPANY NOW?

In 1988, the IRS released Revenue Ruling 88-76, which stated properly that structured Wyoming LLCs would be taxed as partnerships. This

IRS ruling settled many doubts about the future of LLCs and broke the way for further states to begin legislation in this area.

In 1991, driven by changes in the tax laws and acting specifically in reaction to the 1988 Revenue Ruling, the American Bar Association (ABA) released a draft of the Prototype Limited Liability Company Act. In July of 1992, it released a new version of the Prototype Act. The 1992 prototype Act provides the solid foundation for states, such as Montana, to create LLC legislation.

Given the current status of the tax laws, there is no better time than now for limited liability companies. The time is ripe. Currently sixteen states have enacted LLC legislation. At least twenty other states, including Montana, have formed study groups to investigate the desirability of LLC legislation. Those proposing this Act in Montana believe that Montana needs LLC legislation in 1993.

#### QUESTION WHY CREATE LLC LEGISLATION IN MONTANA? FOUR

#### ANSWER

It is imperative to note that of the seventeen states with LLC legislation in effect as of September 1992, four of the states are in the Rocky Mountain region of the United States: Wyoming (1977), Colorado (1991), Nevada (1991), and Utah (1991).

Wyoming advertises that its LLC statute provides a tremendous benefit to those doing business in Wyoming. Montana business deserves the same opportunity and advantage afforded to business in neighboring states. To remain competitive, Montana should provide this opportunity immediately. Not only will LLCs provide an exciting alternative to more conventional forms of business organizations in our state, but legislation will facilitate a welcome improvement in Montana's business image. LLCs are pro-economic development, at virtually no cost. And as Montana strives to be a leader not a follower in the business world, it makes great sense that we seize this opportunity now.

National statistics show that the most growth in the business arena in the last decade has been in the area of small businesses. This is particularly true of business in Montana. But Montana small businesses need progressive statutes governing business organization. LLCs combine the best attributes of corporations and partnerships. LLCs, as an option, will be especially beneficial to small businesses, because LLCs avoid the complex steps involved in incorporating. The LLC is relatively easy to form. It can be done in one step by filing once with the Secretary of State. There is no need for bylaws and no elections of a board of directors. An oral operating agreement is

possible if that is what the owners want. There is great operational flexibility in a LLC. Anything that will help small business in Montana is urgently needed. If Montana wishes to compete for small business with surrounding states, LLC legislation is a practical necessity and a step toward the future.

#### QUESTION FIVE

ANSWER

# WHAT IS THE HISTORY OF THE MONTANA LIMITED LIABILITY COMPANY ACT?

In 1991, the Tax, Probate and Business Section of the Montana State Bar created a Limited Liability Company Subcommittee to study the progress of LLCs on the national level and to propose appropriate LLC legislation for Montana. The Subcommittee is comprised of a bipartisan, diverse body of attorneys, and includes private practitioners, members of state government and academia, as well as a law student associate member who has reviewed LLC laws of all jurisdictions. Committee members include Professor Steven C. Bahls, Chair and Reporter, Julieann McGarry, Coreporter, Richard M. Baskett, Garth B. Jacobson, Alan L. Joscelyn, and Thomas C. Morrison.

> After much research and discussion, the Subcommittee members unanimously agreed to go forward with proposing LLC legislation for Montana. The members of the Subcommittee unanimously believed that it is in the interest of Montana businesses to adopt legislation as soon as possible. Its recommendations have been endorsed by the State Bar of Montana.

> The Montana Subcommittee's proposal is based largely on the Prototype Limited Liability Company Act prepared by the American Bar Association in July, 1992. The ABA Section of Business Law that drafted the LLC Prototype has had a history of drafting successful, comprehensive legislation. This ABA Section is led by many of the nation's foremost experts on business organizations. Through the appropriate subcommittee this Section has drafted both the Model Business Corporation Act (adopted by 30 states), the Statutory Close Corporation Act, and the Model Nonprofit Corporation Act, all of which have been adopted in large part by the state of Montana. The ABA Model Acts have dominated state corporate governance statutes.

> The ABA supplemented the Prototype LLC Act with a manual that includes in depth comment on each of the issues in the Act. The manual has been disseminated nationally to states interested in the Act. The Prototype Act's provisions are derived primarily from the Revised Uniform Limited Partnership Act (RULPA) and from enacted legislation of the eight states with Limited Liability Company (LLC) Acts in

> > 5 1-21-93 SB 146

5

existence as of 1991. In addition, the Prototype Act relies on provisions from the Model Business Corporation Act (MBCA).

Montana's Proposed Limited Liability Act is based primarily on the ABA Prototype Act, and incorporates its own unique provisions from Title 35 of the Montana Codes Annotated (Corporations, Partnerships, and Associations).

#### QUESTION HOW ARE LIMITED LIABILITY COMPANIES CLASSIFIED SIX FOR TAX PURPOSES?

#### ANSWER

For a LLC to qualify for the tax status of a partnership, a 1988 IRS tax ruling requires that the LLC must lack at least two of the following four corporate characteristics:

- 1. Continuity of life.
- 2. Centralization of management.
- 3. Limited liability.
- 4. Free transferability of interests.

Because the corporate characteristic of limited liability will always exist in the LLC, the entity must relinquish two of the remaining ingredients to become eligible for partnership tax treatment. The Montana Limited Liability Company Act provides for a LLC that generally lacks continuity of life, the centralization of management and free transferability of interests. But the Montana Act is also sufficiently flexible as to allow the owners to tailor the organization to their own needs: a LLC may devise a different scheme from the Montana Act's default plan by providing for such under the operating agreement or articles of organization.

# QUESTIONWILL THE LIMITED LIABILITY COMPANY ACT ALLOWSEVENCOMPANIES TO OPERATE IRRESPONSIBLY?

ANSWER

NO. Although the LLC Act offers the desirable mixture of limited liability with tax advantages, it does not allow LLCs to operate irresponsibly. The owners of an LLC receive no more protection than the protection received by corporate shareholders. Like a corporation's shareholders, each of the LLC's members have no liability to the LLC or its creditors beyond each member's initial contribution. The LLC, as a legal entity, is fully responsible for its debts and other liabilities and obligations it incurs. For example, if a LLC violates the Comprehensive Environment Response, Compensation and Liability Act (CERCLA) of 1980, the LLC will be liable as if it were a corporation. In addition, just as corporate managers may have personal liability under CERCLA, members of the LLC who are managers may have personal liability. Likewise, if a LLC member commits a tort and violates a law, that member receives no protection, just as shareholders and managers in corporations are not protected from torts they commit. *See* Larry E. Ribstein, *supra* at 440-41.

5 1-21-93 SB 146

What the Montana LLC Act does promise is that if you are a member of the LLC and another member or manager violates a law or commits a tort, you are not personally liable for the tort committed by the other member or manager. Unlike a partnership, in which partners are personally liable for the torts and violations committed by another partner, the limited liability company shields members from the debts and liabilities of the organization and other individual members or managers. MCA § 35-10-305, 306 & 307.

For example, assume a construction company has become a limited liability company. Assume that the company was negligent in its design and erection of a building. The LLC, itself, and those who participated in the design or construction are responsible for the negligence. But just as corporate shareholders or officers who don't participate in the design or erection are not responsible, similarly situated members of a LLC are not responsible. See, e.g., Little v. Grizzly Manufacturing, 636 P.2d 839 (Mont. 1980).

# QUESTIONHOW IS A LIMITED LIABILITY COMPANY FORMED ANDEIGHTOPERATED?

ANSWER

The Montana Act involves a simple, relatively easy formation process. To comply with the purpose requirements of the Act, the LLC must be engaged in a lawful business under Montana law. The LLC must consist of one (1) or more persons. The LLC must set forth a name in the articles of organization. The name must not be deceptively similar to the names of other corporations or limited partnerships. The name must contain either the words "limited liability company" or the abbreviation "L.L.C." or the abbreviation "L.C.". The purpose of the name provisions, when read together, is to provide notice to the public and creditors that the members are not personally liable for the liability of the LLC. The LLC must file articles of organization with the Secretary of State and pay a fee. Once filing is complete, the Secretary of State issues a "certificate of organization" and the LLC becomes a recognized legal entity.

Once formed, entities have tremendous operating flexibility. The

majority of the provisions in the Montana Act offer entities the opportunity to select the default provision of the Act or to provide an alternative operating method, by merely indicating the entity's wish to do so in the operating agreement, or the articles of organization. So business organizations really can construct a LLC that suits their individual needs.

# QUESTIONWHAT ARE THE HIGHLIGHTED DRAFTING ISSUES THATTENTHE SUBCOMMITTEE OF THE MONTANA LIMITEDLIABILITY COMPANY ACT CONSIDERED?

ANSWER The following is a list of issues in the Montana LLC Act that compelled a great deal of discussion amongst Subcommittee members. Also included is the Subcommittee's decision on each debate. The Subcommittee welcomes and encourages any comments on the provisions that were ultimately included or excluded.

- (a) Should there be a presumption of member-management or manager-management? The Subcommittee agreed that the Montana Act should be as "bullet proof" as possible for the purpose of obtaining tax treatment as a partnership. The Subcommittee sought to ensure such tax treatment for LLCs by making the default rule provide for member-management. This would ensure that LLCs in Montana lack centralized management, which is one of the four corporate characteristics that an entity may relinquish to receive partnership tax treatment. The Montana Act allows for modification for managermanagement, but the entity may risk losing partnership tax treatment.
- (b) Should interests be freely assignable? The Montana Act permits members to transfer interests in whole or in part; however, free assignability is limited under the Montana Act. The Act requires the unanimous consent of all other members before the assignee may become a member and receive all of the attributes of the transferring member's interest in the LLC. This unanimous consent requirement constitutes sufficient restriction to cause free transferability to be lacking for tax purposes. Entities may provide otherwise.
- (c) Should the LLC have continuity of life? Merely specifying that the life of an organization is for a term of years is not enough to eliminate the characteristic of continuity of life. So the Montana Act does more. It provides that the limited liability company is

5 1-21-93 5B 146

dissolved upon the certain events such as death, resignation, expulsion, bankruptcy etc., but allows the LLC to continue by amendment to the articles of organization or by the unanimous consent of the remaining members. This unanimous agreement permits the members to continue the business, thereby avoiding a dissolution, while ensuring that the LLC in the normal case lacks the corporate tax feature of continuity of life.

- (d) What should be the default provision for voting rights? The Subcommittee agreed that the Montana Act should be as "bullet proof" as possible for the purpose of obtaining treatment as a partnership. To avoid any claim that management was centralized in the hands of the few, the Committee adopted the "one person, one vote" plan, as opposed to members voting "in proportion to their contributions to the capital of the LLC." The Subcommittee believed that the adopted method is more appropriate for service LLCs. Again, the Montana Act provides for flexibility and an organization may provide for a different voting method.
- (e) Should the LLC Act be available to **professionals** in Montana? Yes. In other states, professionals, particularly CPAs, have expressed interest in operating as a LLC.
- (f) Should the allocation of profit and loss be based on a capital interest method, or per capita method? The Committee decided the appropriate default rule of the Montana Act should be to distribute profits and losses equally. This rule is most appropriate for service providing LLCs. Capital intensive LLCs are most likely to be able to hire an attorney to make the appropriate adjustments to capital interest methods.
- (g) Must the operating agreement be in writing? No. Because of the informal nature of many LLCs, operating agreements, like partnership agreements, need not be in writing.
- (h) Should the law permit a one-person LLC? The Subcommittee has debated this issue. The Subcommittee was concerned that an enabling statute authorizing one-person limited liability companies might cause the IRS to question whether LLCs lack the "association" element of partnerships. In the final analysis, however, the Committee believed that the requirement of two members in a LLC would reduce the flexibility of LLCs.

# QUESTIONDOES MONTANA REALLY NEED ANOTHER TYPE OFELEVENBUSINESS ORGANIZATION?

ANSWER YES. The limited liability company is unlike any business entity we have now in this country. The LLC is a legitimate business alternative rooted in traditions of Partnership Association (in the United States) and the limitadus (from other countries such as Mexico and Germany). It is an evolutionary entity that makes sense in today's business world. LLCs promise simplicity in formation, flexibility in planning and operation, limited liability, member control of the business, and pass through tax advantages without a lot of burdensome restrictions. Making the LLC available to Montana business is of practical necessity, if Montana wishes to remain competitive with business in other states. It truly is an exciting business alternative that, given the opportunity, will, at no cost, improve Montana's business image.

# QUESTIONWHAT WILL THE MONTANA LIMITED LIABILITYTWELVECOMPANY SUBCOMMITTEE DO TO HELP BUSINESSES AND<br/>THE BAR LEARN ABOUT LLCs?

ANSWER If LLC legislation is enacted in Montana, the Subcommittee will make the Limited Liability Company Act available in a formbook and on computer disks at an inexpensive price. The Subcommittee has already worked extensively with the Montana Secretary of State's Office to create an acceptable filing form, and upon enactment of the Act, these filing forms will be available to all interested parties. Finally, the Subcommittee members, acting individually and on behalf of the Montana Bar, will provide CLEs to educate the legal and business communities in Montana about the advantages of the LLC.

#### QUESTION IS THE NATIONAL CONFERENCE OF COMMISSIONERS ON THIRTEEN UNIFORM STATE LAWS (NCCUSL) STUDYING LIMITED LIABILITY COMPANIES?

ANSWER Yes, the NCCUSL has formed a study group to develop a possible uniform limited liability company act. The work of the NCCUSL will not be completed for some time.

> The Subcommittee and the Montana Uniform Law Commissioners have agreed that it is appropriate for the Subcommittee to propose to the 1993 legislature the Act based on the ABA Prototype, with an understanding that the legislature should revisit the issues when the NCCUSL completes its work. At that time, after reviewing the NCCUSL proposal, the Subcommittee anticipates returning to the

legislature to recommend adoption of the NCCUSL proposals.

The Subcommittee believes that the need for legislation authorizing LLCs is immediate; as such, the Subcommittee does not recommend waiting for the NCCUSL to finish its work before enacting a "first generation" LLC Act.

# IS THERE ANY INFORMATIVE READING MATERIAL ON LLCs?

#### ANSWER

OUESTION

FOURTEEN

In 1991-92, alone, there was a dramatic increase in the amount of legislation, academic study and comment about the LLC. See Keatinge, et al., The Limited Liability Company: A Study of the Emerging Entity, 47 BUS. LAW. 375 (1992), Geu, Understanding the Limited Liability Company: A Basic Comparative Primer (Part One), 37 S. DAK L. REV. 44 (1992), Gazur and Goff, Assessing the Limited Liability Company, 41 CASE W. RES. L. REV. 387 (1991), and Ribstein, The Deregulation of Limited Liability and the Death of Partnership, 70 WASH. U.L.Q. 417 (1992). Also see Roche, Jr., Limited Liability Companies Offer Pass-Through Benefits Without S Corp. Restrictions, J. TAX'N April 1991, 248-253. See Maxfield, et al., Colorado Enacts Limited Liability Company Legislation, COLO. LAW. June, 1991, 1032-1037. See Limited Liability Company Workshop, American Bar Assn. of Business Law (1991), which includes not only comments to the ABA Prototype Act, but detailed memorandum regarding the Act, as well as sample operating agreements in forms.

11

<u>5-1-21-93</u>

## Comparison of Tax Attributes of S Corporations and Limited Liability Companies

### Compiled by Professor Steve Bahls

At	ribute	S Corporation	LLCs and Partnerships
1.	Maximum number of owners	35	No limit
2.	Do the following qualify as owners?		
	(a) Nonresident aliens	No	Yes
	(b) Corporations	No	Yes
	(c) Partnerships	No	Yes
	(d) Trusts	Generally, no	Yes
	(e) Retirement plans	No	Yes
	(f) Tax exempt entities	No	Yes
3.	Two classes of stock permitted	No	Yes
4.	Pass through taxation	Yes	Yes
5.	IRS election required	Yes	No
6.	Contributions	No recognition, but only if transferors are in control of corporation	No recognition or transfer by members
7.	Distributions	Distribution of appreciated property results in gain	No recognition of gain upon distribution other than money until member sells property
8.	Section 754 special basis adjustment for external sales of interests or certain distributions available	No	Yes
9.	Owners may increase their bases for the amount of the entity debt under § 752	No	Yes

This exhibit is 101 pages long. The original is stored at the Historical Society at 225 North Roberts Street, Helena, MT 59620-1201. The phone number is 444-2694.

EXHIBIT 6 TE 1-21-93 SB 146

### PROTOTYPE LIMITED LIABILITY COMPANY ACT

DRAFT OF July 16, 1992

Drafted by the

#### WORKING GROUP ON LIMITED LIABILITY COMPANIES SUBCOMMITTEE ON LIMITED LIABILITY COMPANIES COMMITTEE ON PARTNERSHIPS AND UNINCORPORATED BUSINESS ORGANIZATIONS SECTION OF BUSINESS LAW AMERICAN BAR ASSOCIATION

#### WORKING GROUP ON LIMITED LIABILITY COMPANIES

Matthew P. Feeney, Phoenix, AZ Stuart Levine, Baltimore, MD Co-Chairs

Professor Larry E. Ribstein, Arlington, VA Reporter

Michael L. Gravelle, Chicago, IL Donald J. Hess, Los Angeles, CA Robert R. Keatinge, Denver, CO Marshall B. Paul, Baltimore, MD James Reynolds, Phoenix, AZ Dale G. Schedler, Overland Park, KS James J. Wheaton, Norfolk, VA

The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association or any of its Sections or Committees and, accordingly, should not be construed as representing the policy of the American Bar Association.

REPRODUCED COURTESY OF



D.C.APV ikt in No. DILL MO.\_

Testimony in Support of SB 146

#### By Garth Jacobson

Representing the Office of the Secretary of State

Before the Senate Judiciary Committee

#### January 21, 1993

Mr. Chairman and members of the Senate Judiciary Committee, for the record I am Garth Jacobson representing the Office of the Secretary of State. I am here today to speak in support of SB 146, the Limited Liability Company Act. I am proud to say that I served on the State Bar of Montana Committee that prepared this legislation that creates Limited Liability Companies (LLC) in Montana. SB 146 will provide Montana one more reason for business to come to this state and promote our economy.

The focus of my testimony will be on the formation, operation and dissolution of LLCs. This area most impacts the Office of the Secretary of State.

A. Formation.

1. Articles of Organization. The Articles of Organization must be filed with the Secretary of State's office and contain the following information:

a. Name. The name of the LLC must be listed.

(1) Name must include "limited liability company", or "LLC".

(2) Distinguishable on the record filing standard. The name must be distinguishable on the record from any other entity or name (corporations, ABNs, Limited Partnerships, etc,) on file with the Secretary of State. The disclaimer "LLC" in itself will not make it distinguishable from other identical business names.

(3) Must identify Professional LLC. If the entity is a professional LLC then that is included in the disclaimer.

b. Latest date of dissolution. The statute makes no limitation on the duration of the LLC but cautious drafters may want to limit the term of the LLC.

c. Address of principal place of business and

registered office and agent. This is about the same as required in corporate articles information.

d. Form of management of LLC. The articles must specify the form of management the LLC will use.

(1) It must distinguish wheather it operates with member/managers or seperate managers.

(2) If the LLC has managers, then the articles must list the names of initial managers.

e. If it is a professional LLC then the articles must identify services being offered.

(1) Must meet professional organization requirements. There may be further restrictions imposed by the licensing entity which would be placed in the articles, such as a provision that requires all members to be licensed attorneys.

2. Filing requirements are the same as corporations.

a. Two copies of Articles of Organization are filed with Sec of State Office.

b. Fax filings are available. The standard fax filing procedures will apply for filing LLC documents.

c. Foreign LLCs must file application plus certificate of existence from jurisdiction of organization.

d. Must pay the filing fee of \$20 and the license fee of \$50. This is the same as the minimum corporate fees.

3. The articles must be executed by the person forming the organization which may or may not be a future member.

B. Operating Agreement. The operating agreement serves as the bylaws and partnership agreement rolled into one.

1. Not filed with Sec. of State.

2. Provides for election of managers, compensation, indemnification, meetings, sharing of profits and losses, sharing of distributions, etc.

5B 146

eta 7 11-21-93

3. If no operating agreement exists, then the statutes control.

C. Managers.

1. Managers can sign amendments and reports.

2. Managers can incur indebtedness and liabilities for LLC.

3. Manager duty of loyalty similar to P-Ship.

4. Managers do not have to be a member if the LLC does not have member/managers.

D. Transfer of membership. The transferability of membership is restricted and required unanimous approval of the remaining membership. If the transferability restrictions are altered then the tax status concerns arise.

E. Disassociation of a member. The disassociation of a member can cause one of three things to happen.

1. The interest of the disassociating member can be transferred to another person upon the consent of the remaining members.

2. The LLC will dissolve if no action is taken within 90 days of the disassociation.

3. The LLC can buy out the members interest and continue to operate. The members must vote to continue the operation following the disassociation.

F. Annual Reports will be required to be filed every year. No other maintenance activities are required to keep the entity operational to preserve the liability protection.

G. Merger. While there are many variations of mergers permitted in some states, Montana permits only mergers between LLCs.

H. Dissolution. Dissolution of an LLC can be triggered by any of the following events.

1. Voluntary dissolution. Following consent of the members, the LLC's articles of dissolution are filed with the Secretary of State.

2. Events Causing Dissolution. LLCs can be dissolved by events specified in either the articles of organization or statutes. a. The articles of organization or organization agreement or the organization agreement may specify an event which triggers dissolution, ie, the term of existence expires.

b. The disassociation of a member and the failure of the LLC members to continue its existence.

3. Involuntary Dissolution. LLCs can be involuntarily dissolved by either judicial or administrative dissolution.

a. Judicial dissolution.

b. Administrative dissolution. An LLC can be involuntarily dissolved due to its failure to file an annual report.

As you can see, LLCs borrow features from both the Corporate and Partnership laws. There is a lot of flexibility in the creation and operation of these entities. This flexibility permits LLCs to meets the demands of the diverse business environment in Montana.

Additionally the Office of the Secretary of State believes that the creation of LLCs will have a slight direct positive fiscal impact on the general fund. Any fiscal impacts on the office will be offset by the revenues generated by filing and license fees. It will also promote business growth which in turn should improve our tax base through economic growth. I would refer any specific fiscal questions to Doug Mitchell.

In conclusion I urge your support of SB 146 and hope you give it a favorable recommendation.

SENATE JUDICIARY COMMITTEE EX : DIT NO. 8 Dave 1: 21.93 BILL NO.

#### STATES WITH A LIMITED LIABILITY COMPANY ACT

1.	Colorado	(1990)	11.	Oklahoma	(1992)
2.	Delaware	(1992)	12.	R.Island	(1992)
з.	Florida	(1982)	13.	Texas	(1991)
4.	Georgia	(1992)	14.	Utah	(1991)
5.	Iowa	(1992)	15.	Virginia	(1991)
6.	Kansas	(1990)	16.	W. Vir.	(1992)
7.	Louisiana	(1992)	17.	Wyoming	(1977)
8.	Maryland	(1992)			
9.	Minnesota	(1992)			
10	Nime and a	(1001)			

10. Nevada (1991)

STATES THAT HAVE INTRODUCED LLCA TO STATE LEGISLATURE -(pending legislation) intro re-intro . Arizona 2/91 1. 2. 3/92 passed Senate Hawaii з. Illinois 4/91 4. Indiana 1/92 awaiting governor's signature 5. Michigan 6/91, 4/92 passed House 6. Mississ. 2/92 7. Missouri 1/93 8. Montana 1/93 Nebraska 2/92 9. post-poned, to be redrafted 10. New Jers. 11/91, 5/92 11. New York 3/92, 1/93 5/92, 10/92 12. Pennsyl. 5/91, 13. S. Carol. 4/92

#### STATES STUDYING LLCA LEGISLATION

1. North Carolina

14.

Tennessee 2/92

2. South Dakota

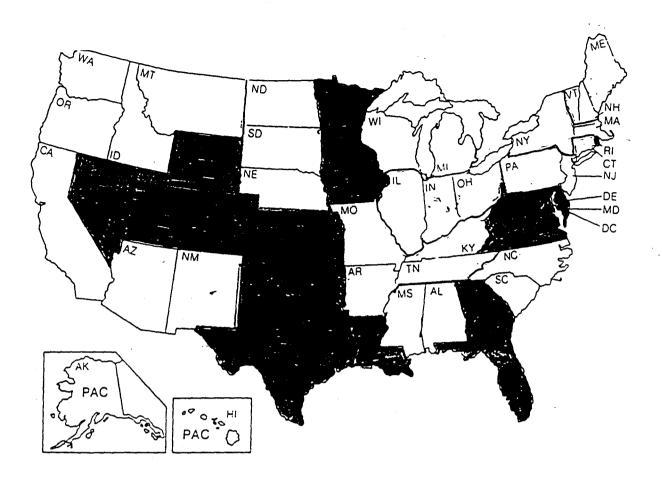
#### STATES THAT HAVE REJECTED LLCA

1. New Hampshire

killed in committee

#### TOTALS: 33 STATES EITHER HAVE LEGISLATION, ARE IN THE PROCESS OF ENACTING LEGISLATION, OR ARE STUDYING LEGISLATION.

Data collected as of 1/93



.

7

Mare .



# MONTANA FOOD DISTRIBUTORS ASSOCIATION

2700 Airport Way • P.O. Box 5775 • Helena, Montana 59604 • (406) 449-6394 • 1-800-735-1082

Testimony of W.E. Stevens in support of SB 146 (Montana Limited Liability Company Act)

For the record my name is Bill Stevens, with the Montana Food Distributors Association and I am the elected President of the Montana Society of Association Executives.

I rise to speak generally for MSAE as it's member associations represent the vast majority of all small businesses in Montana.

I can speak specifically for MFDA as over the years we have sponsored many seminars and work shop sessions, using the best legal and accounting minds we could find, to assist our membership in determining how best to structure their business.

For many, the pit falls of both the partnership and the corporation options caused the owner of the family business to remain as a sole proprietorship, thus discouraging the son or daughter from becoming very involved and/or interested in the business.

The authorization of the limited liability company incorporating the best features of both corporations and partnerships will go a long way toward perpetuating the independent small businesses of Montana.

SENATE JUDICIARY COMMITTEE	
EXHIBIT NO 9	:
DATE 1-21-93	
BILL NO SBILLY	

DATE 1-21-93	
SENATE COMMITTEE ON Andreian	
BILLS BEING HEARD TODAY: SB144, SB93	

Name	Representing	Bill No.	Check One Support Oppose
Garth Jacobson	Sec at State	146	$\checkmark$
Ruk Baskett	Atts Solt	146.	~
Julie Mc Garry	self	14 k	
Tom MORRISON	Self	144	
David Owen	mt chamber	1462	~
Mich Gambile	DCHS	93	
Bill Jtevens	MJAE & MADA	146	r
Steven Bahls	Self	146	~
RILEY JOHNSON CHARLOSK. BRODIES	NFFB	146	
Charles K. Brooks	MT. Rotail Resoc	146	2

# VISITOR REGISTER

## PLEASE LEAVE PREPARED STATEMENT WITH COMMITTEE SECRETARY