MINUTES

MONTANA HOUSE OF REPRESENTATIVES
53rd LEGISLATURE - REGULAR SESSION

COMMITTEE ON JUDICIARY

Call to Order: By **CHAIRMAN RUSSELL FAGG**, on February 4, 1993, at 8:00 a.m.

ROLL CALL

Members Present:

Rep. Russ Fagg, Chairman (R)
Rep. Randy Vogel, Vice Chairman (R)
Rep. Dave Brown, Vice Chairman (D)
Rep. Ellen Bergman (R)
Rep. Jody Bird (D)
Rep. Vivian Brooke (D)
Rep. Bob Clark (R)
Rep. Duane Grimes (R)
Rep. Scott McCulloch (D)
Rep. Jim Rice (R)
Rep. Angela Russell (D)
Rep. Tim Sayles (R)
Rep. Liz Smith (R)
Rep. Bill Tash (R)
Rep. Howard Toole (D)
Rep. Tim Whalen (D)
Rep. Karyl Winslow (R)

Members Excused: Rep. Karyl Winslow

Members Absent: None.

Staff Present: John MacMaster, Legislative Council
Beth Miksche, Committee Secretary

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

Committee Business Summary:

Hearing: SB 78, SB 129, SB 146, HB 396
Executive Action: SB 129, SB 146, HB 340, HB 255, HB 396

HEARING ON SB 78

Opening Statement by Sponsor:

SEN. DELWYN GAGE, Senate District 5, Cut Bank, said this bill will allow a city attorney to represent the state in the higher court on appeal if a driver's license has been suspended or revoked following a DUI charge if the incident leading to the suspension or revocation resulted in a city or municipal charge. Currently, the case goes to the county attorney which requires the county attorney to collect all the information/evidence on that case.

Proponents' Testimony:

John Conner, Asst. Attorney General appearing on behalf of Montana County Attorney's Association (MCAA), stated that this bill was requested on behalf of the MCAA because the county attorneys think there is a disparity in the law with respect to the relative responsibilities of the county attorney opposed to the city attorney.

Mr. Conner said he had consulted with the county attorneys in his jurisdiction who said that this bill is fine; he will work with the city attorney on it.

Opponents' Testimony:

David Hull, City Attorney, City of Helena, indicated he may not oppose this bill if the language that **SEN. GAGE** discussed is, in fact, the intent of the bill. **Mr. Hull** discussed several problems he has with the bill, one being how it is currently written. He insisted that a state license is a civil matter, and it is the state's obligation to revoke a license if a person chooses to do so. This has nothing to do with the criminal prosecution of the DUI. If the state wants to put the burden on the city to handle these cases, then the state should pay the city attorney to do that.

Questions From Committee Members and Responses:

REP. RANDY VOGEL asked **Mr. Conner** how the city or county is going to handle this situation. **Mr. Conner** answered that DUIs are being prosecuted by the city; if the case arises from the city, the city attorney's office ought to handle any appeals that arise. **Mr. Conner** believes that if a DUI is a city case, it should be a city charge; if it is a county case, it should be a county charge. If the city doesn't have the resources, then the structure of this bill, as it's designed as a mandate, then the county should handle it. It does pose a problem when there are

two different entities handling the same defendant in different forms.

REP. VOGEL asked **Mr. Conner's** opinion as to whether it may be necessary to put language in the bill whereby if it is a city case, the city attorney does handle some county cases, unless certain circumstances would not permit that. **Mr. Conner** said the bill was patterned that way when originally drafted. One of the main problems with this bill is that the smaller communities are not equipped to handle the cases, and the county attorneys didn't contemplate that when they drafted the bill. The bill needs to be drafted so that smaller communities will handle it if they are equipped to do so. The problem exists in some of the larger communities where there are more of those cases being handled.

CHAIRMAN FAGG said he believes **Mr. Conner** is correct; that if the city is going to prosecute the DUI, it makes sense that the city takes this civil proceeding onto its shoulders. **CHAIRMAN FAGG** asked **Mr. Hull** if the person who prosecutes DUIs in his office take on this case in district court. **Mr. Hull** concurred, but said it would be more of a burden to the city attorney or the deputy city attorney to handle a state, civil license mandate. **CHAIRMAN FAGG** believes it makes sense to have the city attorney's office, who is going to prosecute the DUI and will have to become familiar with the case, to do this as opposed to the county attorney's office which won't have to prosecute the DUI. This, basically, makes two people become familiar with the case. **Mr. Hull** doesn't believe this bill guarantees that's not going to be a problem.

REP. BOB CLARK referred to the cost of a DUI, and asked **Mr. Hull** if the city gets any of the fees from a DUI. **Mr. Hull** said that when the case is prosecuted by the city, the city gets 13 percent at the time for the criminal act.

Closing by Sponsor:

SEN. GAGE said he understands that city attorneys do handle criminal cases that arise in the city, and it can't cost the city that much more money. He said this is a common sense bill.

HEARING ON SB 129

Opening Statement by Sponsor:

SEN. STEVE DOHERTY, Senate District 20, Great Falls, explained that he is bringing this bill forward because there have been problems in Great Falls with cars zooming around school buses; the school bus drivers report this, but the county attorney's office has not been able to prosecute that individual for violating school bus regulations. On page 3, subsection (6) SB 129 simply requires the identity of the driver in order to have a

case. **Office of Public Instruction (OPI)** offered some amendments on page 2 which are basically cleanup language. The amendment requires all cars to stop until the school bus drivers turn off the red flashing signal.

Proponents' Testimony:

Donna Hall, Hall Transit, Montana School Bus Contractors Association, said in 1992, seven children, nationwide, were hit and killed by cars not waiting for children to cross the street after getting off school buses. It is very difficult for bus drivers to identify the drivers driving past the buses, as the bus driver's first priority is taking care of the children.

Cheryl Thares, Great Falls Public Schools Transportation, presented written testimony. **EXHIBIT 1**

Jan Thompson, Office of Public Instruction, said she solicits support for SB 129.

Opponents' Testimony: None.

Questions From Committee Members and Responses:

REP. ELLEN BERGMAN asked **SEN. DOHERTY** to clarify why people who drive past the buses aren't being caught. **SEN. DOHERTY** said bus drivers have been able to get some kind of identification of the car, the license plate, and some vague description of the driver; however, given the requirement to positively identify the driver, they haven't been able to prosecute.

REP. VOGEL said it is his and the court's understanding that, presently, under this statute, a police officer can write a citation to the owner of the vehicle when the school bus driver was unable to identify the driver. The owner of the vehicle is in violation. He asked **SEN. DOHERTY** the reasoning behind this bill. **SEN. DOHERTY** said that what **REP. VOGEL**, who is a police officer, can do in Billings is different from Great Falls. The reason for this bill, especially in the Great Falls area, is so that police officers can go after these offenders.

Closing by Sponsor: None.

HEARING ON SB 146

Opening Statement by Sponsor:

SEN. MIGNON WATERMAN, Senate District 22, Helena, presented

written testimony on this bill creating the Montana Limited Liability Company Act. **EXHIBIT 2**

Proponents' Testimony:

Steven Bahls, Professor of Law, University of Montana, Missoula, presented written testimony. **EXHIBITS 3 and 4.**

Garth Jacobson, Chief Counsel, Secretary of State, presented written testimony. **EXHIBITS 5, 6, 7 and 8.**

Richard M. Baskett, Attorney, Missoula, said his practice specializes in general partnerships and small businesses. He asked the committee to be aware of the way the legislation is drafted. It is possible, in one of these corporations, that the Internal Revenue Service looks for certain attributes to determine whether an organization is a partnership or a corporation. The statute provides only one form of organization, and the LLC must have the attributes that are set forward.

Tom Morrison, Attorney, Helena, said the LLCs which were inspired due to the 1986 Tax Reform Act have accomplished two things: 1) They have reversed tax rates when individuals are generally taxed at lower rates now compared to corporations. There was a time when individuals would be taxed as high as 99 percent, and corporations were only taxed 50 percent. Now it's totally reversed, and there's a real incentive for people who want to do business with an individual tax agreement rather than corporate tax. 2) "S" corporations are the "cure-all." They allow the limited liability that small businesses need for the privilege of being passed as individual proprietors or partners.

Opponents' Testimony: None.

Closing by Sponsor: None.

HEARING ON HB 396

Opening Statement by Sponsor:

REP. TIMOTHY WHALEN, HD 93, Billings, said he presented HB 396 at the request of his insurance agent. Several of the agent's clients were trying to purchase insurance but were on suspicion of driving under the influence of alcohol. Police officers asked these people to take a blood test so they could determine the amount of alcohol in their blood. Current Montana law contains an implied consent statute that, in essence, says if a person has a criminal record on his drivers license, consent is implied when the person is pulled over by law enforcement in order to take a breath test.

REP. WHALEN'S said his concern is whether or not the breath test is accurate or effective compared to the blood test. In the event that a person does not provide a test, the drivers license will be suspended for a period of 90 days. What HB 396 means is that it will be difficult to acquire automobile insurance if a person is stopped and asked to take a breath test or blood test for alcohol.

Proponents' Testimony: None.

Opponents' Testimony:

Greg Van Horssen, State Farm Insurance Company of Montana, presented written testimony. **EXHIBIT 9**

Roger McGlenn, Independent Insurance Agents Association of Montana (IIAAM), stated that statistics show that one of the major contributing factors of auto accidents is driving under the influence. This bill would not help to discourage this activity; in fact, probably the opposite would occur. From the IIAAM's standpoint, companies have a right to underwriting information in regard to driving records, particularly when there is a conviction, for the purpose of assessing premiums on automobile policies. Yet, companies feel they can't obtain any brief record of the operator's tests.

Questions From Committee Members and Responses:

REP. DAVE BROWN stated it is his understanding, from the testimony, that if a person is stopped for an alleged DUI offense and refuses to take the test, and if he is not convicted, then it is not the insurance company's business to know that. He asked **Mr. Van Horssen** to respond. **Mr. Horssen** said there's probably not too many reasons to refuse to submit to an alcohol or drug test. His guess is that, even though a person may not have been convicted of a DUI and his license has not been suspended, the suspension alone indicates the possibility of that individual being suspended in the future. **REP. BROWN** objected to the last statement. A conviction, he understands, but the issue here is alleged activity affecting insurance premiums.

REP. BROWN said he doesn't understand why this is the insurance company's business and asked **Mr. Van Horssen** what this would do to an individual's record. From **Mr. Van Horssen's** perspective, he said there are few reasons to refuse the alcohol test; however, it is recognized that it is a suspension, and in this case, a suspension for refusal of examination does indicate that this individual poses negligent risk for automobile insurance and to the general public.

REP. JODY BIRD inquired whether the court system could protect

certain classes of people from this legislation, or whether it could be abused. **REP. WHALEN** said the classes of people that would be protected would be all people of Montana. There is a narrow set of circumstances when a person refuses to give a blood test. Based upon the blood test, the insurance company will discover that the person may have had a medical problem, i.e. diabetes. Although a person has been stopped by a police officer due to a medical problem such as this, he still suffers the consequences of losing his license. Once the courts find out this is not a DUI issue, it becomes an insurance issue.

REP. BIRD asked whether, if a person is arrested for reckless driving due to a medical problem, he or she would have access to this information from health providers. **REP. WHALEN** said this bill has nothing to do with personal medical records, as those kept in doctors/health provider's offices. It does have to do with public record, and a person's insurance records are not public record. Therefore, this bill protects the abuse of this personal information.

REP. DUANE GRIMES asked whether if a person had been stopped for drunk driving but was not drunk and was convicted anyway, this situation would raise the insurance premium. **Mr. McGlenn** said if an acquittal's been charged, and if the company continued to charge a higher rate to that person's policy, the insurance company would be in violation of discrimination laws of the Montana insurance code. Upon a charge, the Montana Department of State Motor Vehicles is not responsible for notifying the insurance company if this person has a charge against him, unless the insurance company ordered that particular motor vehicle report.

As a parole office, **REP. BOB CLARK** said that blood alcohol tests are done prior to the arrest, but it is not required to take the test until after the arrest. He also said that many people refuse the blood alcohol test which means that a vast amount of people are stopped for a DUI conviction. He asked **Mr. Van Horssen** to respond. **Mr. Van Horssen** stated he simply understands that the refusal is subject to suspension, and, once again, is recognized as increasing the insurer's risk of future violations, even though it may not be a DUI violation.

Mr. Van Horssen told the Judiciary Committee to keep in mind that if it serves to keep ten people insured as opposed to losing insurance altogether, HB 396 should not pass.

REP. VOGEL asked **Mr. Van Horssen** if it would be acceptable to slightly alter the bill. For instance, if a person was found innocent of all charges, at that point, those documents would be sealed and not be used in any way for information about that person. **Mr. Van Horssen** was not entirely certain, but did say that they are talking about two victims' concerns here; the first is guilty or innocent, and the second is increased risks, and how those increased risks should impact insurability. It is **Mr. Van**

Horssen's understanding that an individual who had a license suspended one or more times with failure to submit to this required test does, in fact, represent an insurance risk, and logically following, is a risk to other drivers. In that respect, **Mr. Van Horssen** asked **REP. VOGEL** to make that distinction between guilty versus innocent and risk versus no risk.

Closing by Sponsor:

REP. WHALEN believes that one of the ways to draft this bill is in the context of liability insurance laws in Montana. A number of years ago, insurance companies were going to require everybody who drove a car in Montana to purchase liability insurance. When that law was challenged in the Supreme Court, it was appraised to be constitutional, and people were forced to go out and buy liability insurance. **REP. WHALEN** mentioned that this law actually contributes towards that policy in protection of the general travelling public by making sure that insurance is available.

EXECUTIVE ACTION ON SB 129

Motion: **REP. BROWN** moved the amendments.

Discussion:

Mr. MacMaster read and explained the amendments. See attached House Standing Committee Report. He specifically discussed amendment number 3: Page 2, lines 2 and 3. Strike: "resumes motion or the driver has signaled traffic to proceed" and insert: "ceases operation of its visual flashing red signal." This amendment says that, if a driver comes from behind or in front of a stopped school bus and if children are leaving the bus, a driver in another vehicle cannot start the engine and proceed until the children have crossed the street into safety and the bus driver has turned off the flashing red signal.

Subsection (a), page 1, lines 20 and 21, refers to the school bus having an operation of a residual flashing red signal as specified in section 19-402.

Vote: The question was called on the amendments. The motion carried unanimously 18-0.

Discussion:

Motion: **CHAIRMAN FAGG** moved an amendment to strike section 2 which is the effective date upon passage and approval. He would prefer the legislation to come into effect October 1, 1993.

REP. GRIMES asked **CHAIRMAN FAGG** why he doesn't want the effective date to be the fiscal year and whether everybody has to be notified. **CHAIRMAN FAGG** said the reason for his amendment that, the MCA books are not published and printed until October 1. If a date isn't documented specifically, the effective date is October 1, 1993; supposedly, people do get some kind of notice because the new codes are printed. If it's effective upon passage and approval and the MCA books aren't printed within four or five months, then during that four- or five-month period, nobody will be aware of the law changes.

Vote: The question was called on the amendment to give the bill an effective date of October 1, 1993. Motion carried 12-6. Those in favor of the amendment were **CHAIRMAN FAGG, REPS. VOGEL, BERGMAN, BIRD, GRIMES, RICE, SAYLES, SMITH, TASH, TOOLE, WHALEN,** and **WINSLOW.** Those voting against the amendment were **REPS. BROWN, MCCULLOCH, CLARK, WYATT, BROOKE** and **RUSSELL.**

Motion/Vote: **REP. VOGEL MOVED SB 129 BE CONCURRED IN AS AMENDED.** Motion carried 17-0. **REP. WINSLOW** did not vote, and **REP. VOGEL** will carry the bill on the House floor.

EXECUTIVE ACTION ON SB 146

Motion/Vote: **REP. TOOLE MOVED SB 146 BE CONCURRED IN.** Motion carried 17-0. No proxy for **REP. WINSLOW. REP. RICE** will carry the bill in the House.

EXECUTIVE ACTION ON HB 340

Motion: **REP. BROWN MOVED HB 340 DO PASS.**

Discussion:

REP. BROWN commented about an article in the Independent Record, December 1992, regarding the **Tavern Association's** discussion to take some of the onus off establishments that sell liquor and put some of the responsibility on the youth attempting to make a purchase of alcoholic beverages. **REP. BROWN** said he doesn't believe section 2 does what it's supposed to do, according to the question and answer portion of the hearing. There are parts in the bill that are not to the committee's liking, subsection (1), page 4, for example. He said the argument is too weak to strike because then the bill will only have two things to work against instead of all three. The intent of the bill is not to put too onerous an application on youth attempting to purchase. Possession statutes, he reminded the committee, are still very stiff, especially after the first time. Those statutes will not be changed.

REP. BROWN said he had called other states and asked if there is a standard state policy dealing with legal liabilities for bar

owners selling to under-age youths or to convenience stores. He found out that there is no standard policy; it varies from state to state. **REP. BROWN'S** counsel also called the neighboring states to get the language from their statutes, and he settled on North Dakota because it was the most fair in terms of treatment of the youth attempting to purchase and to the bars to give them reasonable relief. The point is there has to be some reasonable application in the law so that the person selling the alcoholic beverages doesn't get unfairly convicted. **REP. BROWN** said if the committee preferred to strike section 2 from the bill, and there aren't enough votes to pass the bill, then he preferred the committee to table the bill.

REP. CLARK asked if there was any objection to striking the word "person" on page 2, line 19-24 and on page 3, line 15 and replacing it with "juvenile," and also including that language at the end of line 16, page 30. **REP. CLARK's** reasoning for this change is that 19- and 20-year-olds have graduated from high school, many are working, earning wages, and are considered a different class from persons 18 years old and under. **REP. BROWN** that this is the kind of onerous burden that he was trying to steer this legislation away from. He recognizes the argument that 19- and 20-year-olds are taking in a wage, and that they are in a different class than 18 and under; however, he is inclined not to agree with **REP. CLARK**, and he didn't think it will terminate the bill if it were included. **REP. BROWN** said his main concern is if a person is caught in the 19- and 20-year-old category, he will be charged for possession far more than attempt to purchase.

REP. TOOLE said his opinion is that these cases are very hard to prove, and **REP. BROWN's** bill will make it all the more difficult to prove. Although **REP. TOOLE** believes that what **REP. BROWN** is trying to do with this bill isn't unfair, he objects to having three subsections under section 2, because each one of the subsections would make an extensive jury instruction. It's difficult to try these cases because of lack of evidence.

REP. TOOLE offered to strike section 2, page 4, subsections 1 and 3 and use only subsection 2, because section 2 out-balances in favor of defendants.

REP. VOGEL insisted that **REP. TOOLE's** amendment overwhelmingly broadens the defense. If section 2 is stricken, the bill is way too broad.

CHAIRMAN FAGG does not like section 2 of the bill but approves of **REP. TOOLE's** amendment. **CHAIRMAN FAGG** prosecuted three of these types of cases, two of which were jury trials, and he agrees with **REP. TOOLE** that these cases are very, very difficult to prosecute. If section 2 is put into the law, it's going to give the jury that much surer of a hook to find somebody not guilty.

Motion: **CHAIRMAN FAGG** moved a substitute motion that all of

section 2 be stricken from the bill.

REP. LIZ SMITH spoke in objection to striking section 2 from the bill. She asserted that it is difficult for young clerks to screen those people purchasing alcoholic beverages. Secondly, speaking for the youth of today, they think this is a good law; it's a law that remains equal in responsibility.

REP. BROWN indicated the reason this bill is being introduced in this fashion is to keep that balance equal on both sides. He disclosed that if someone were to visit the small businesses and convenience stores in this area, a person would find that owners would have testified in support for this bill. When young people take a job in convenience stores, it's incumbent on them to try to enforce the law that's related to the job they take, just as it is in any profession. Peer pressure on young people isn't any greater than it is on adults; therefore **REP. BROWN** has difficulty accepting that argument. He hopes that the committee defeats **CHAIRMAN FAGG's** motion, and accepts his offer of an amendment to insert "reasonable status" into subsection 1, 2, or 3 so that it can be dealt with in a reasonable fashion.

REP. VOGEL believes that **Mr. Fleiner, Montana Sheriffs' and Police Officers Association (MSPOA)**, misunderstood section 2, subsection 2. However, **Mr. Fleiner** decided to keep the bill as is. Due to the MSPOA's views on the bill, **REP. VOGEL** spoke against the motion.

REP. SCOTT MCCULLOCH affirmed that the $50 fine will become a deterrent to under-age drinkers, but they must be taught, from the schools and their homes, that this is a law.

REP. JIM RICE said he reads section 2 differently from the rest of the committee. In order to set up a defense, an attorney would need three factors: 1) documentation, 2) appearance, and 3) sale in good faith and reliance of evidence. There must be a balance of these three factors in order to have a fair defense. If this statute is put into the law, it makes cases easier to prosecute, because, generally, it establishes defenses to pinpoint all three factors. **REP. RICE** asked **CHAIRMAN FAGG** if he agreed with him.

CHAIRMAN FAGG disagreed with **REP. RICE**, and explained that although there are three subsections in section 2, there are basically two things that must be done: 1) representation that a person is and looks 21; and 2) representation of a valid ID. Once these two things have been demonstrated, the burden has been shifted in prima facie evidence.

CHAIRMAN FAGG explained to the committee that this bill does two things: 1) The first section of the bill creates the offense of attempting to purchase an intoxicating substance; and 2) Section 2 gives a presumption to the bar owner that if certain things occur, then the bar owner is presumed to have not broken the law

in selling to a minor.

CHAIRMAN FAGG withdrew his amendment.

Motion: **REP. BROWN** moved a substitute amendment to **REP. TOOLE's** amendment. The amendment is as follows:
In the title, page 1, line 6: strike "624"; insert "623"
Page 4, line 10: strike "624"; insert "623"
Page 4, line 17, after "evidence" insert "an ordinary and prudent person would accept"
Page 4, line 22, before "reliance" insert "reasonable."

REP. BROWN reemphasized that this bill does not attempt to give an establishment that sells liquor an ironclad shield to protect them from what is a crime. He urged the committee to add reasonableness throughout this bill.

REP. VOGEL asked **REP. TOOLE** if he still wants to eliminate subsection 1, section 2 from the bill. **REP. TOOLE** agrees with **REP. BROWN** that "reasonableness" must be added to the content of the bill. He is not concerned about striking subsection 1 from the section 2; and asked **REP. BROWN** if he agrees to, in subsection 2, line 21, after beverages, inserting "; and " which will incorporate all three subsections.

REP. BROWN affirmed with **REP. TOOLE** that he did not have a problem with his request. **REP. BROWN** and **REP. RICE** pointed out that in section 2, line 11, the bill already says, "the following facts ...to a person under the legal age:" He said the colon indicates a person selling liquor must consider all three subsections. **REP. BROWN** said that a ";" must also be added after beverages on line 18 and 21, and an "and" must be added to the amendment.

REP. WHALEN asked **REP. BROWN** if this language would eliminate the language previously offered by **REP. BROWN**. For clarification, the "reasonableness" language would also be included in the amendment. **REP. WHALEN** wondered whether the language was reasonable in view of the events of the ";" and the "and". He explained that adding ";" and the "and" means that a person selling alcoholic beverages must prove all three subsections.

REP. RICE said the reason he likes the reasonable language to subsection 1, disclosing the evidence, is that it makes sure credible evidence must be demonstrated.

REP. KARYL WINSLOW mentioned to **CHAIRMAN FAGG** and **REP. BROWN** that earlier **REP. BROWN** said he would table the bill in the event of certain circumstances and that he would only vote to pass the bill in the event of certain circumstances. She said so many things have been discussed in the last half hour, that she wanted **REP. BROWN** to explain what his criteria is to the committee. **REP. BROWN** said that if section 2 is eliminated from the bill, it would destroy the balance of the bill. He is trying to keep a

balance in the bill and, within that concept, trying to do what the majority of the committee finds is reasonable.

Vote: The question was called on **REP. BROWN's** amendments. The motion carried unanimously 18-0.

Motion: **REP. RICE MOVED HB 340 DO PASS.**

Discussion:

REP. VOGEL addressed his concern to **REP. BROWN** and referred to page 3, line 16 regarding the $50 fine. He expressed his concern, again, that $50 is reasonable for a first offense, but for subsequent offenses, specifically second and third offenses, the fine should be raised from $50 to a maximum of $250. **REP. BROWN** stated he would prefer to leave the fine at $50.

Motion: **REP. VOGEL** moved an amendment that for a subsequent offense the fine be raised to a maximum to $250.

REP. MCCULLOCH explained he disapproved of **REP. VOGEL's** amendment for the simple fact that a felony was just raised in another bill to $500, and it will deter the passage of this bill on the floor. **REP. MCCULLOCH** also feels that a $250 subsequent fine is inappropriate for this bill.

CHAIRMAN FAGG reminded the committee that this bill is discretionary with the judge. If the judge feels it's a terrible case, then the fine may be raised to $250.

REP. BERGMAN said if the committee is discussing subsequent fines, then perhaps the fines should be kept reasonable, i.e. $50, $75, and $100.

REP. RICE mentioned that there is already in the law a very similar offense to this. He said the committee is trying to add attempt to purchase intoxicating substances as an offense, and there already is in the law an offense for violation. There is a violation for someone under 21 to misrepresent his qualifications for purpose of obtaining an alcoholic beverage. A very similar offense is already in the law, and the penalty for that offense is tied into page 2 of the bill, which is the offense the county set forth of second, third and forth offense described on lines 19-24 on page 3.

REP. BROWN believes this bill provides a visible weapon that youth can be warned about, and its deterrent effect is almost better than its financial return to whomever is collecting the fine. **REP. BROWN** believes that $250 is too much for under-age drinkers because there are other penalties available.

REP. VOGEL withdrew his motion.

Rep. Bird asked where the fine money is allocated. **CHAIRMAN FAGG**

said to the city or county court where the fine is being charged.

Vote: **HB 340 DO PASS.** Motion carried 16-2 with **CHAIRMAN FAGG** and **REP. RUSSELL** voting no.

EXECUTIVE ACTION ON HB 255

Motion: **REP. BROWN MOVED HB 255 DO PASS.**

Motion: **REP. SMITH** moved to adopt a concept amendment and asked **Dan Anderson, Administrator, Department of Corrections and Human Services, Mental Health Division,** for his assistance and opinion.

Mr. Anderson said he has no objection to amending the bill back to its original language, wherein the original court had changed its extension.

REP. RICE asked **Mr. Anderson** what the official procedure is. **Mr. Anderson** responded that, following the initial hearing, the same judges make a determination of jurisdiction, where a patient should be. That means the Department of Corrections would transport that person back to his own district court.

CHAIRMAN FAGG asked **Mr. Anderson** if the Department of Corrections would have to transport patients once a year after this law. **Mr. Anderson** said that current law allows for an optional annual review. **CHAIRMAN FAGG** thought that is what this law is changing. He thought, currently, it was an optional review once a year, and this law was requiring that review under a Supreme Court decision. **Mr. Anderson** said the bill requires an annual clinical review of the patient's status and a report of clinical status to the director. The Department of Corrections has the option, using clinical information, to determine whether the patient is discharged or not. The patient, himself, also has an option to be reviewed each year.

Vote: The question was called on the concept amendment of **REP. SMITH.** Motion carried unanimously 18-0.

Motion/Vote: **REP. BROWN MOVED HB 255 DO PASS AS AMENDED.** Motion carried unanimously 18-0.

EXECUTIVE ACTION ON HB 396

Motion: **REP. WHALEN MOVED HB 396 DO PASS.**

Discussion:

REP. BROWN asked **Ron Ashabraner, State Farm Insurance,** whether

the information would show on a person's record, even though he is subsequently acquitted of that allegation, and whether it enters into decision whether the insurance policy increases should take place in terms of risk. **Mr. Ashabraner** said yes, and added that it does not cover a person if he is convicted. If a person has a DUI, it goes on the record, as it should.

REP. VOGEL said one valid reason why he raised that question is because police officers are obligated to arrest someone on suspicion of drunk driving. Therefore, innocent people may be charged and, even though they are acquitted later, they would still be guilty as far as State Farm or any other insurance companies are concerned.

REP. GRIMES asked **REP. WHALEN** if there is any way to discourage people from taking the breath test. **REP. WHALEN** explained that a person's license is suspended for 90 days should he decide not to take the test.

CHAIRMAN FAGG asked **REP. WHALEN** if he would consider a friendly amendment, based on **REP. TOOLE'S** amendment. He wondered whether the committee could somehow structure the bill so that it would only apply to the arrest if it didn't result in a conviction. If there isn't a conviction that ensues, then this information shouldn't be used; however, if a conviction does ensue, then the information should be used. **REP. WHALEN** doesn't have any problems in writing it such that it's automatically considered confidential criminal justice information until such time as there is a conviction. He doesn't know if anyone gains anything as far as the insurance industry is concerned. He believes this is an insurance industry question; if it doesn't take anything away from law enforcement personnel and their ability to prosecute felons, all it has to do is report it to the insurance industry. If there is a conviction, the insurance industry is going to have access to the fact that there is a conviction for a DUI. A person is going to have access to the fact that, on a first offense, a drivers license is suspended for a year. **REP. WHALEN** doesn't think the amendment is going to change anything as far as underwriting purposes are concerned. The one problem he does see with this amendment is it is a technical problem, and that is, at what point is it considered a conviction - after the trial when the verdict has been handed down or after the appeal to the district court? These kinds of issues must be dealt with in the amendment offered.

<u>Motion</u>: **CHAIRMAN FAGG** moved to adopt the following amendment: Page 4, line 5, strike: "whether or not" and insert: "if" After "the driver is" insert: "not". It would read: "If the driver is not convicted of an underlying offense under 61-8-401 or 61-8-406." The second part of the amendment would be as follows: after "test" insert: ", which case does not result in a conviction," **REP. WHALEN** recommended language indicating "in the event," conviction does not result. He does understand what **CHAIRMAN FAGG** is trying to do and asked **Mr. MacMaster** to draft

the amendments for them both. Standing Committee Report attached.

Vote: The question was called on the conceptual amendment. The motion carried unanimously 18-0.

Motion/Vote: REP. BROWN MOVED THAT HB 396 DO PASS AS AMENDED. Motion carried 18-2 with **REPS. BERGMAN** and **GRIMES** voting no.

ADJOURNMENT

Adjournment: 11:30 a.m.

Russell Fagg

REP. RUSSELL FAGG, Chairman

Beth Miksche

BETH MIKSCHE, Secretary

RF/bcm

HOUSE OF REPRESENTATIVES

Judiciary COMMITTEE

ROLL CALL DATE February 4, '93

NAME	PRESENT	ABSENT	EXCUSED
Rep. Russ Fagg, Chairman	✓		
Rep. Randy Vogel, Vice-Chair	✓		
Rep. Dave Brown, Vice-Chair	✓		
Rep. Jodi Bird	✓		
Rep. Ellen Bergman	✓		
Rep. Vivian Brooke	✓		
Rep. Bob Clark	✓		
Rep. Duane Grimes	✓		
Rep. Scott McCulloch	✓		
Rep. Jim Rice	✓		
Rep. Angela Russell	✓		
Rep. Tim Sayles	✓		
Rep. Liz Smith	✓		
Rep. Bill Tash	✓		
Rep. Howard Toole	✓		
Rep. Tim Whalen	✓		
Rep. Karyl Winslow			✓
Rep. Diana Wyatt	✓		

HR:1993
wp.rollcall.man
CS-09

HOUSE STANDING COMMITTEE REPORT

February 5, 1993

Mr. Speaker: We, the committee on Judiciary report that House Bill 255 (first reading copy -- white) do pass as amended .

Signed: Russ Fagg
Russ Fagg, Chair

And, that such amendments read:

1. Page 4, line 21.
Following: "~~judicial~~"
Insert: "court that ordered the commitment unless that court transfers jurisdiction to the"

-END-

2-6-93
11:25

Committee Vote:
Yes 18, No 0.

290842SC.Hpf

HOUSE STANDING COMMITTEE REPORT

February 6, 1993

Mr. Speaker: We, the committee on Judiciary report that House Bill 396 (first reading copy -- white) do pass as amended .

Signed: _____
Russ Fagg, Chair

And, that such amendments read:

1. Page 3, line 20.
Strike: "Department"
Insert: "Unless and until there is a conviction on the charge in relation to which the test was requested that has become final, department"

2. Page 4, lines 5 and 6.
Strike: ", whether" on line 5 through "convicted" on line 6
Insert: "if there is no final conviction"

Committee Vote:
Yes ___, No ___.

300737SC.Hss

HOUSE STANDING COMMITTEE REPORT

February 5, 1993

Mr. Speaker: We, the committee on Judiciary report that Senate Bill 146 (third reading copy -- blue) be concurred in .

Signed: _____
Russ Fagg, Chair

Carried by: Rep. Jim Rice

Committee Vote:
Yes 17, No 5. 1 excused

290923SC.Hpf

HOUSE STANDING COMMITTEE REPORT

February 5, 1993

Mr. Speaker: We, the committee on Judiciary report that House Bill 340 (first reading copy -- white) do pass as amended .

Signed: _____
Russ Fagg, Chair

And, that such amendments read:

1. Page 4, line 10.
Strike: "45-5-624"
Insert: "45-5-623"

2. Page 4, lines 16, 19, and 22.
Strike: "The"
Insert: "the"

3. Page 4, line 17.
Following: "evidence"
Insert: "that an ordinary and prudent person would accept"

4. Page 4, line 18.
Strike: "."
Insert: ";"

5. Page 4, line 21.
Strike: "."
Insert: "; and"

6. Page 4, line 22.
Following: "and in"
Insert: "reasonable"

-END-

Committee Vote:
Yes 16, No 2.

290814SC.Hpf

HOUSE STANDING COMMITTEE REPORT

February 5, 1993

Mr. Speaker: We, the committee on Judiciary report that Senate Bill 129 (third reading copy -- blue) be concurred in as amended .

Signed: _____
Russ Fagg, Chair

And, that such amendments read: Carried by: Rep. Vogel

1. Title, line 6.
Following: "REGULATIONS;"
Insert: "AND"

2. Title, lines 7 and 8.
Strike: "; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE"

3. Page 2, lines 2 and 3.
Strike: "resumes motion or the driver has signaled traffic to proceed"
Insert: "ceases operation of its visual flashing red signal"

4. Page 3, line 11.
Following: "school"
Insert: "or for school functions"

5. Page 4, lines 3 and 4.
Strike: section 2 of the bill in its entirety

-END-

Committee Vote:
Yes 17, No 0. 1 Rep. Excused

290845SC.Hpf

HOUSE OF REPRESENTATIVES

Judiciary **COMMITTEE**

ROLL CALL VOTE

DATE 2-4-93 **BILL NO.** HB396 **NUMBER** 18

MOTION: Motion to pass HB396 carried unanimously 18-0

NAME	AYE	NO
Rep. Russ Fagg, Chairman	✓	
Rep. Randy Vogel, Vice-Chair	✓	
Rep. Dave Brown, Vice-Chair	✓	
Rep. Jodi Bird	✓	
Rep. Ellen Bergman	✓	
Rep. Vivian Brooke	✓	
Rep. Bob Clark	✓	
Rep. Duane Grimes	✓	
Rep. Scott McCulloch	✓	
Rep. Jim Rice	✓	
Rep. Angela Russell	✓	
Rep. Tim Sayles	✓	
Rep. Liz Smith	✓	
Rep. Bill Tash	✓	
Rep. Howard Toole	✓	
Rep. Tim Whalen	✓	
Rep. Karyl Winslow	✓	
Rep. Diana Wyatt	✓	

HOUSE OF REPRESENTATIVES

Judiciary **COMMITTEE**

ROLL CALL VOTE

DATE 2-4-93 **BILL NO.** HB 255 **NUMBER** 15

MOTION: Motion to pass carried 18-0 unanimously

NAME	AYE	NO
Rep. Russ Fagg, Chairman	✓	
Rep. Randy Vogel, Vice-Chair	✓	
Rep. Dave Brown, Vice-Chair	✓	
Rep. Jodi Bird	✓	
Rep. Ellen Bergman	✓	
Rep. Vivian Brooke	✓	
Rep. Bob Clark	✓	
Rep. Duane Grimes	✓	
Rep. Scott McCulloch	✓	
Rep. Jim Rice	✓	
Rep. Angela Russell	✓	
Rep. Tim Sayles	✓	
Rep. Liz Smith	✓	
Rep. Bill Tash	✓	
Rep. Howard Toole	✓	
Rep. Tim Whalen	✓	
Rep. Karyl Winslow	✓	
Rep. Diana Wyatt	✓	

HOUSE OF REPRESENTATIVES

Judiciary **COMMITTEE**

ROLL CALL VOTE

DATE 2-4-93 **BILL NO.** HB 340 **NUMBER** 18

MOTION: Motion to pass HB 340 carried 18-2

NAME	AYE	NO
Rep. Russ Fagg, Chairman	✓	
Rep. Randy Vogel, Vice-Chair	✓	
Rep. Dave Brown, Vice-Chair	✓	
Rep. Jodi Bird	✓	
Rep. Ellen Bergman	✓	
Rep. Vivian Brooke	✓	
Rep. Bob Clark	✓	
Rep. Duane Grimes	✓	
Rep. Scott McCulloch	✓	
Rep. Jim Rice	✓	
Rep. Angela Russell	✓	
Rep. Tim Sayles	✓	
Rep. Liz Smith	✓	
Rep. Bill Tash	✓	
Rep. Howard Toole	✓	
Rep. Tim Whalen	✓	
Rep. Karyl Winslow	✓	
Rep. Diana Wyatt	✓	

HOUSE OF REPRESENTATIVES

Judiciary **COMMITTEE**

ROLL CALL VOTE

DATE 2-21-93 **BILL NO.** HB 146 **NUMBER** 17

MOTION: Motion to Pass HB 146 carries 17-2

NAME	AYE	NO
Rep. Russ Fagg, Chairman	✓	
Rep. Randy Vogel, Vice-Chair	✓	
Rep. Dave Brown, Vice-Chair	✓	
Rep. Jodi Bird	✓	
Rep. Ellen Bergman	✓	
Rep. Vivian Brooke	✓	
Rep. Bob Clark	✓	
Rep. Duane Grimes	✓	
Rep. Scott McCulloch	✓	
Rep. Jim Rice	✓	
Rep. Angela Russell	✓	
Rep. Tim Sayles	✓	
Rep. Liz Smith	✓	
Rep. Bill Tash	✓	
Rep. Howard Toole	✓	
Rep. Tim Whalen	NO	VOTE
Rep. Karyl Winslow	✓	
Rep. Diana Wyatt	✓	

HOUSE OF REPRESENTATIVES

Judiciary **COMMITTEE**

ROLL CALL VOTE

DATE 2-4-93 **BILL NO.** SB 129 **NUMBER** 17

MOTION: Motion to Pass SB 129 carried 17-8

NAME	AYE	NO
Rep. Russ Fagg, Chairman	✓	
Rep. Randy Vogel, Vice-Chair	✓	
Rep. Dave Brown, Vice-Chair	✓	
Rep. Jodi Bird	✓	
Rep. Ellen Bergman	✓	
Rep. Vivian Brooke	✓	
Rep. Bob Clark	✓	
Rep. Duane Grimes	✓	
Rep. Scott McCulloch	✓	
Rep. Jim Rice	✓	
Rep. Angela Russell	✓	
Rep. Tim Sayles	✓	
Rep. Liz Smith	✓	
Rep. Bill Tash	✓	
Rep. Howard Toole	✓	
Rep. Tim Whalen	NO VOTE	
Rep. Karyl Winslow	✓	
Rep. Diana Wyatt	✓	

EXHIBIT 2
DATE 2-4-93
SB 129

gfps GREAT FALLS PUBLIC SCHOOLS
1100 4th Street South
P.O. Box 2429
Great Falls, Montana 59403
(406) 791-2300

February 4, 1993

The House Judiciary Committee
State Capitol
Helena, MT 59602

Dear Representatives:

This letter is in reference to Senate Bill #129, to eliminate the requirement to identify the driver in a school bus violation. The Great Falls Public Schools supports the passage of this bill.

Great Falls Public Schools transports approximately 3,000 students in the morning and approximately 3,000 students in the afternoon. They contract 32 school buses from Big Sky Bus Lines and 47 school buses from Hall Transit.

My position with Great Falls Public Schools is in the Transportation Office. I schedule the special education school buses and work with the regular school buses also.

The reason for the change is that it is almost impossible for a school bus driver to see the driver of a vehicle. The buses are higher than passenger vehicles so the only thing a driver can see is the top of the vehicle. It would be much easier if the only thing the driver had to identify is the license number and a brief description of the vehicle.

There are too many people driving through the red stop lights and stop signs on the school buses and nothing is being done because the school bus driver cannot identify the driver of the vehicle. I would like to see this law changed before any student is either injured or killed because a vehicle neglected to observe the red lights.

Thank you very much.

Sincerely,

Cheryl Thares

Cheryl Thares
Great Falls Public Schools Transportation

EXHIBIT
DATE 2-4-93
SB 146

Limited Liability Company Act

Executive Summary

The Montana Legislature has an opportunity to promote business development and improve its business climate through legislation prepared by a State Bar of Montana committee and to be introduced by Senator Waterman and cosponsored by Representative Rice and others. The Limited Liability Company Act creates a new business organization called a "limited liability company" (LLC).

Highlights

- An LLC is designed to combine the advantages of corporate - type limited liability protection for owners (called members), with pass-through tax treatment of partnerships. While LLC tax treatment is similar to S. Corporations it does not have all the pitfalls and limitations S. Corporations have.

- The liability of a member of a LLC is limited to the member's capital contribution.

- Through the articles of organization (filed with the secretary of state) and an operating agreement, members of an LLC have maximum flexibility to establish and manage the operating and financial structure of the entity. If the members fail to prepare an operating agreement then the legislation states how the entity will function.

- LLCs can operate like partnerships and have all members participate in the management functions or they can operate like a corporation and have designated managers handle their affairs.

- Membership interests may be transferred but only upon consent of the other members.

- The bill would permit professional LLCs. Professionals would still be liable for their own malpractice but they would not be personally liable for the mistakes of other members of their LLC.

- This bill would permit Montana to recognize out of state LLC and permit them to register and do business in the state.

Reasons For Passage

- This bill creates a useful alternative business organization designed for small businesses, joint ventures, real estate developments, businesses seeking foreign capital, family businesses and others.

- If Montana is to be competitive with other states seeking business development it needs this modern and flexible business alternative. Over one third of the other states now have LLCs.

EXHIBIT # 2
DATE 2/4/93
SB 146

EXECUTIVE SUMMARY

January 1993

QUESTIONS AND ANSWERS ABOUT LIMITED LIABILITY COMPANIES

QUESTION ONE — **WHAT IS A LIMITED LIABILITY COMPANY?**

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.

> "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.

QUESTION TWO — WHAT ARE THE ADVANTAGES OF LIMITED LIABILITY COMPANIES OVER OTHER BUSINESS ENTITIES?

ANSWER

(a) Consider Corporations and Partnerships.

Corporations have limited liability but do not receive any of the tax advantages that partnerships do. Partnerships on the other hand have significant tax benefits but no limited liability. LLCs possess the desirable attributes of both.

(b) Consider S Corporations.

Although S corporations, like LLCs, promise limited liability with pass through tax advantages, S corporations are burdened with restrictive requirements that LLCs avoid.

S corporations are limited to 35 shareholders or less. They cannot have multiple classes of stock and may not own a subsidiary. Shareholders in qualifying S corporations may not be other corporations, nonresident aliens, partnerships or most types of trusts. Further, S corporations do not receive all of the tax benefits that partnerships and LLCs enjoy. *See* Gazur & Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 454-457 (1991).

By contrast, the LLC, treated as a partnership, provides tremendous flexibility in planning distributions and special allocations. And LLCs enjoy the benefits of favorable adjustments in the LLC's basis in its assets when membership interests are sold. Overall, LLCs are easier to operate than S corporations because they involve less formality. In S corporations, the governing board must be elected. In LLCs, the members may manage without complying with corporate formalities. Exhibit A includes a fuller comparison between S Corporations and LLCs.

(c) Consider Limited Partnerships.

Whereas limited partnerships, like LLCs, provide for limited liability, only the limited partners, and not the general partners, of the limited partnership have limited liability. And limited partners lose this protection if they participate in the control of the partnership. By contrast, all members of the LLC are provided limited liability protection, regardless of the level of

participation in management.

(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 **WHY THE LIMITED LIABILITY COMPANY NOW?**

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.

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 FOUR **WHY CREATE LLC LEGISLATION IN MONTANA?**

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

ANSWER

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

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 SIX **HOW ARE LIMITED LIABILITY COMPANIES CLASSIFIED 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.

QUESTION SEVEN **WILL THE LIMITED LIABILITY COMPANY ACT ALLOW COMPANIES 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.

EXHIBIT 3
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SB 146

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.

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).

QUESTION EIGHT **HOW IS A LIMITED LIABILITY COMPANY FORMED AND OPERATED?**

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.

QUESTION TEN **WHAT ARE THE HIGHLIGHTED DRAFTING ISSUES THAT THE SUBCOMMITTEE OF THE MONTANA LIMITED LIABILITY 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 manager-management, 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

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.

QUESTION ELEVEN — **DOES MONTANA REALLY NEED ANOTHER TYPE OF BUSINESS 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.

QUESTION TWELVE — **WHAT WILL THE MONTANA LIMITED LIABILITY COMPANY SUBCOMMITTEE DO TO HELP BUSINESSES AND 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 THIRTEEN — **IS THE NATIONAL CONFERENCE OF COMMISSIONERS ON 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.

QUESTION FOURTEEN **IS THERE ANY INFORMATIVE READING MATERIAL ON LLCs?**

ANSWER

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.

EXHIBIT 3
DATE 2-4-93
SB-146

Exhibit A

Comparison of Tax Attributes of S Corporations and Limited Liability Companies

Compiled by Professor Steve Bahls

Attribute	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

EXHIBIT # 4
DATE 2/4/93
SB 146

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

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.

Worse yet, 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.

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).

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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.

Ag Law

By STEVEN BAILS and JANE EASTER BAILS

A promising solution to the business-structure 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 business-loss 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 Woodworth

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.

Iowa 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.

EXHIBIT 4
DATE 2-4-93
SB-146

OFFICE OF THE GOVERNOR

STATE OF MONTANA

MARC RACICOT
GOVERNOR

STATE CAPITOL
HELENA, MONTANA 59620-0801

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,

Marc Racicot

MARC RACICOT
Governor

TELEPHONE: (406) 444-3111 FAX: (406) 444-5529

EXHIBIT 5
DATE 2-4-93
SB 146

Testimony in Support of SB 146

By Garth Jacobson

Representing the Office of the Secretary of State

Before the House Judiciary Committee

February 4, 1993

Mr. Chairman and members of the House 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.

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.

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

EXHIBIT 6
DATE 2-4-93
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STATES WITH A LIMITED LIABILITY COMPANY ACT

1.	Colorado	(1990)	11.	Oklahoma	(1992)
2.	Delaware	(1992)	12.	R.Island	(1992)
3.	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.	Nevada	(1991)			

STATES THAT HAVE INTRODUCED LLCA TO STATE LEGISLATURE - (pending legislation)

		intro	re-intro	
1.	Arizona	2/91		
2.	Hawaii	3/92		passed Senate
3.	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		
9.	Nebraska	2/92		post-poned, to be redrafted
10.	New Jers.	11/91,	5/92	
11.	New York	3/92,	1/93	
12.	Pennsyl.	5/91,	5/92, 10/92	
13.	S. Carol.	4/92		
14.	Tennessee	2/92		

STATES STUDYING LLCA LEGISLATION

1. North Carolina
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

STATES WITH LLC LEGISLATION

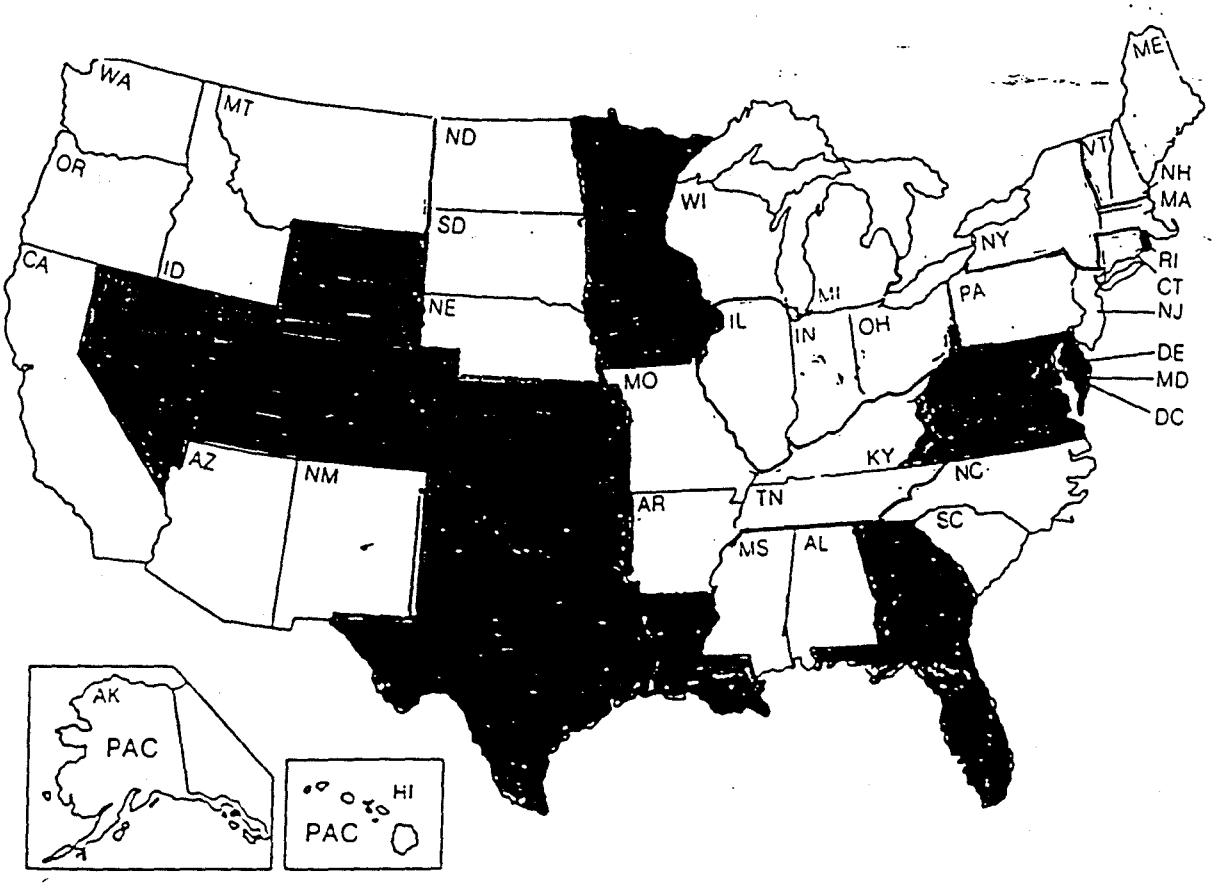

EXHIBIT # 7
DATE 2-4-93
SB 146

COMMENTS TO THE MONTANA LIMITED LIABILITY COMPANY ACT

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."

The failure of a limited liability company to observe the formalities customarily followed by business corporations or requirements relating to the exercise of its powers or management of its business and affairs is not a ground for courts disregarding the separate entity status of an LLC or for imposing personal liability on the members for liabilities of the limited liability company. Courts should not pierce the limited liability company "veil" merely as a result of failure to follow normal formalities required of a corporation. See Keatinge et al., The Limited Liability Company: A Study of the Emerging Entity, 47 BUS. LAW. 375, 446 (1992). See also Gazur and Goff, Assessing the Limited Liability Company, 41 CASE WESTERN RES. L. REV. 401-403 (1991). Of course, the court may still pierce the limited liability company veil if piercing the veil otherwise is necessary to prevent fraud or necessary to achieve equity.

See, e.g., Jody J. Brewster (comment), Piercing the Corporate Veil in Montana, MONT. L. REV. (1983).

The Montana Limited Liability Company Act has been drafted so that limited liability companies not modifying the statutory default rules qualify for the tax status of a partnership. Internal Revenue Service Revenue Ruling 88-76 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: an 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. It is expected and intended that the Montana Department of Revenue apply the same analysis as that applied in Revenue Ruling 88-76 to determine that LLCs are taxed as partnerships in Montana.

§ 1. Short title.

Montana Comment: This section is modeled after § 101 of the ABA Prototype Act.

§ 2. Definitions.

Montana Comment: All definitions are based on § 101 of the ABA Prototype, with the exceptions of subsections (4), (9), (10), (18), (19), and (20) that are borrowed from MCA § 35-4-104 of the Montana Professional Corporation Act. These terms appear throughout the Montana Limited Liability Company Act.

Subsection 19 defining "professional service" is adapted from MCA § 35-4-104(5), which is based on § 3(7) of the American Bar Association's Model Professional Corporation Supplement. The Official Comment to § 3(7) of the Model Professional Corporation Supplement is helpful:

> "The definition of 'professional service' in section 3(7) limits and describes the purpose for which corporations may be organized under section 11. As a

general proposition, corporations may not be formed under business corporation acts for the purpose of practicing a 'profession' or rendering 'professional services.' In the absence of a statutory definition, however, the courts have held that not all licensed services are 'professional services.'

"As a result, the determination of whether particular licensed services may be rendered by corporations has been made on a case-by-case basis under the state business corporation act and the applicable licensing law.

"The definition of 'professional service' in section 3(7) adopts the conclusions reached by courts in this litigation and defines a "professional service" as a licensed service that 'may not be lawfully rendered by a corporation under the [Model] Business Corporation Act.' All professions that meet this standard may incorporate as professional corporations under this supplement."

§ 3. Name.

Montana Comment: Though based on § 103 of the ABA Prototype, this section has been modified to:

- change the "deceptively similar" standard to "distinguishable" in subsection (2). This change conforms the LLC law to the Montana Business Corporation Act.
- prohibit LLC names not distinguishable from reserved names.
- prohibit LLC names not distinguishable from other names registered (or reserved) with the secretary of state.

This section lists the requirements regarding a company name that a limited liability company must abide by to make a name effective.

This section incorporates by reference MCA § 35-1-310, which provides an administrative procedure for resolving name contests.

§ 4. Reservation of name.

Montana Comment: This section is modeled after § 104 of the ABA Prototype Act, which is derived from the provisions of the Revised Uniform Limited Partnership Act (RULPA). This section, overall, clarifies who has the exclusive right to reserve a company, name and the procedures for reservation of the chosen name.

§ 5. Registered office and registered agent.

Montana Comment: This section is modeled after § 105 of the ABA Prototype Act, which is based on § 105 of the RULPA. This section requires a limited liability company to designate a registered agent and provides the company with attending powers to change the address. This section sets forth the procedures for designing or changing an address and lists the requisite contents of the statement indicating such change.

§ 6. Purpose.

Montana Comment: This provision is based on MCA § 35-1-114 and follows the current Montana scheme of not allowing business organizations with limited liability to engage in the business of banking or insurance. Banks and insurance companies must incorporate under the banking and insurance statutes.

Certain types of professional service business may only organize as professional limited liability companies. *See* § 2 (19).

§ 7. Powers.

Montana Comment: This section names the powers held by the limited liability company. Except for subsections (14) and (15), this section is modeled after an earlier version of the ABA Prototype Act, which relied on Wyo. Stat. § 17-5-103 (1977) as its source. Subsections (14) and (15) have been added to conform to MCA § 35-1-115.

While the ABA Prototype Act no longer includes a powers section, the drafters of the Montana Act included a powers section to clarify the powers of an LLC are as broad as those of business corporations.

§ 8. Formation.

Montana Comment: This section is modeled after § 201 of the ABA Prototype Act. This section clarifies the procedures involved in the formal formation of a limited liability company.

It is anticipated that the secretary of state will follow procedures similar to those described in MCA § 35-1-1309 when filing documents. If a document delivered to the secretary of state satisfies the statutory requirements, the secretary of state shall have the obligation to file it.

The Subcommittee debated whether to permit one-owner limited liability companies. The advantage to permitting one-person limited liability companies is obvious – a one-person business could receive the benefits of limited liability without having to comply with corporate formalities. The disadvantage to permitting one-person LLCs is that elimination of the statutory requirement of association of two or more will jeopardize the

ability of an organization finding itself with only one member to receive partnership-type tax treatment.

It is clear that at formation, an LLC must have at least two members to secure partnership tax treatment. Treas. Reg. §§ 1.761-1(a). Individuals forming LLCs with one member should be aware of the cautions set forth in the ABA Commentary to § 201 of the Prototype Act:

> "LLCs must have at least two members at formation to initially secure partnership status for federal tax purposes, and must continue to have at least two members at all time to avoid terminating for tax purposes. The Internal Revenue Code defines the term partnership to include a "syndicate, group, pool, joint venture, or other unincorporated association" that carries on any business. I.R.C. §§ 761(a) and 7701(a)(2) (1986). The very essence of a partnership contemplates two or more partners joining together as coproprietors to engage in business and share the profits. Treas. Reg. §§ 1.761-1(a), 301.7701-3(a); Commissioner v. Culbertson, 337 U.S. 773 (1949); Luna v. Commissioner, 42 T.C. 1067 (1964); Ian T. Allison, 35 T.C.M. (CCH) 1069 (1976). Moreover, the regulations state that a partnership's business is no longer carried on by the partners if there is only one remaining partner; consequently, such partnership will terminate. Treas. Reg. § 1.708-1(b)(1)(i). *See generally* Keatinge, Ribstein, Hamill, Gravelle, and Connaughton, "The Limited Liability Company, A Study of The Emerging Entity," 47 Business Lawyer 375 (1992); Gazur and Goff, "Assessing the Limited Liability Company," 41 Case Western Reserve L. Rev. 387, 396-98 (1991)."

Ultimately, the drafters of the Montana Act agreed that it is advisable to permit one person LLCs, even though the one person LLC will not be taxed as a partnership. The drafters of the Montana Act agreed with the following Commentary to § 201 of the ABA Prototype Act:

> "Section 201 does not require an LLC to have two or more members at the time of its formation because of the concern that such a requirement may raise questions about the proper organization of an LLC that fails to have two or more members at the time of its formation. If, for example, the ministerial act of signing and filing articles of organization with the Office of the Secretary of State occurs on a Monday, and a written operating agreement among several members is finalized on the next day, a question may arise as to whether the LLC was properly formed. Although for tax purposes the LLC will not be recognized until the LLC has at least two members, failure to have two members at the time of formation should not result in the LLC not being properly formed for other purposes."

§ 9. Articles of organization.

Montana Comment: Except for subsections (1)(d) and (1)(e), this section is modeled after § 202 the ABA Prototype Act.

Section (1)(e), based on the Utah Limited Liability Company Act, provides for some additional public accountability and is consistent with the Limited Partnership Act's requirement of disclosure of partners.

Subsection (1)(f) is not part of the ABA Prototype, but is designed to provide for professional limited liability companies.

In its original draft, the Subcommittee followed the Wyoming, Texas and Nevada statutes by allowing a thirty-year maximum period. The Subcommittee originally thought that the thirty-year period was desirable in order that the perpetual life aspect of corporations not exist for tax purposes. Upon further consideration the Subcommittee deleted the thirty-year maximum life. The Subcommittee recognized that a thirty-year maximum was cumbersome and would create traps for those who did not extend the corporate life at the end of the thirty-year period. The drafters of the Montana Act were persuaded by the following analysis of Wayne Gazur and Neil Goff:

> "The limitation of the duration of an LLC to a term of thirty years could reduce its appeal to the participants of a long-term business undertaking. Although LLC members would arguably not be precluded from agreeing to reform an expiring LLC, the uncertainty attending the statutory limitation on LLC duration represents a disadvantage when compared with the competing corporate or limited partnership alternatives, which are not similarly restricted.
>
> "The origin of the LLC's limited duration might lie in the limited partnership association statutes of Michigan, New Jersey, and Ohio, which contained twenty-year limitations. The thirty-year limitation should be eliminated if it is based on the precedent of limited partnership associations or on misplaced fears of adverse federal income tax entity classification." Gazur & Goff, *Assessing the Limited Liability Company*, 41 CASE WESTERN RES. L. REV. 399-400 (1991).

Treasury Regulations § 301.7701-2(b)(3) should eliminate any fear that a statutory maximum term is required to eliminate the corporate aspect of perpetual life. It states

> "(3) An agreement establishing an organization may provide that the organization is to continue for a stated period or until the completion of a stated undertaking or such agreement may provide for the termination of the organization at will or otherwise. In determining whether any member has the power of dissolution, it will be necessary to examine the agreement and to ascertain the effect of such agreement under local law. For example, if the agreement expressly provides that the organization can be terminated by the

will of any member, it is clear that the organization lacks continuity of life. However, if the agreement provides that the organization is to continue for a stated period or until the completion of a stated transaction, the organization has continuity of life if the effect of the agreement is that no member has the power to dissolve the organization in contravention of the agreement. Nevertheless, if, notwithstanding such agreement, any member has the power under local law to dissolve the organization, the organization lacks continuity of life. Accordingly, a general partnership subject to a statute corresponding to the Uniform Partnership Act and a limited partnership subject to a statute corresponding to the Uniform Limited Partnership Act both lack continuity of life."

§ 10. Amendment of articles of organization; restatement.

Montana Comment: This section is modeled after § 203 of the ABA Prototype Act which derived its provisions from the Colo. Stat. §7-80-209. Subsection 4 is not based on the Colorado Act. Subsection (4) allows the secretary of state to provide additional rules governing the form and manner of amendments.

The rules for when and how the members may amend the articles of organization (e.g. by majority or unanimous vote) are to be determined by the operating agreement.

§ 11. Execution of documents.

Montana Comment: This section is modeled after § 204 of the ABA Prototype Act.

§ 12. Filing with the secretary of state.

Montana Comment: This section is modeled after § 205 of the ABA Prototype Act, which is based on § 206(a) of the RULPA. It has been adapted to conform with Montana practice.

§ 13. Effect of delivery or filing of articles of organization.

Montana Comment: This section is modeled after § 206 of the ABA Prototype Act.

§ 14. Filing of a facsimile copy.

Montana Comment: This provision is not from the ABA Prototype, but is adapted from MCA § 35-12-645. It clarifies the requirements of filing a proper facsimile copy and the extent of the facsimile's effect.

§ 15. Annual report for secretary of state.

Montana Comment: This provision is not from the ABA Prototype Act. The drafters of the Montana LLC Act recommend inclusion of this provision because:

- annual reports provide information to the public. Because owners of limited liability companies provide members with protection from liability for the debts of the organization, it is desirable to provide the public with some information about limited liability companies.

- the legislation should allow the secretary of state to remove inactive limited liability companies from its records. If a corporation fails to file an annual report the secretary of state is allowed to administratively dissolve the corporation.

This section is patterned after MCA § 35-1-1104(1), (3)-(5) (Annual Reports for Corporations). It sets forth the required contents of an annual report and the procedure for effective delivery and filing. The information required is generally no greater, however, than that required of limited partnerships. See MCA § 35-12-611 (Application for Certificate of Renewal). The proposed legislation also borrows from MCA § 35-4-209 (Annual Reports for Professional Corporations) by requiring professional limited liability companies to file a statement that all of the members and not less than 50 percent of their managers are persons holding the appropriate professional license.

The Subcommittee spent considerable time determining whether the names of owners should be disclosed. In the event management is separate from membership, the Subcommittee agreed on the need for public disclosure of managers' names to add certainty to commercial transactions. Those dealing with purported managers could, to some degree, verify the individual was a manager. Instead of requiring disclosure of each and every member, the Committee decided disclosure of one member's name would be sufficient.

§ 16. Administrative dissolution.

Montana Comment: This section is not from the ABA Prototype but is instead adapted from MCA § 35-6-102(1)(e). This section clarifies that the secretary of state has the power to dissolve the limited liability company if the entity has failed to comply with certain secretary of state requirements.

§ 17. Reinstatement of dissolved limited liability company.

Montana Comment: This section is not from the ABA Prototype but is instead adapted from MCA § 35-6-201. This section clarifies the procedures for reinstatement of a dissolved limited liability company.

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§ 18. Fees for filing, copying and service-rules

Montana Comment: This section is not based on the ABA Prototype, but is consistent with the Montana practice of assessing license fees to organize business entities in which shareholders benefit from limited liability. The license fee equals the license fee for Montana business corporations with up to 50,000 shares. *See,* MCA § 35-1-1207.

§ 19. Fees for filing, copying, and services.

Montana Comment: This section is not from the ABA Prototype, but is based on the Montana tradition of establishing fees by administrative rule. *See, e.g.*, MCA § 35-1-1206. It provides that the secretary of state shall establish fees for filing, copying and services.

§ 20. Agency power of members and managers.

Montana Comment: This section is modeled after § 301 of the Prototype Act. The drafters of this section clarify its purpose in the Commentary to § 301 of the ABA Prototype Act:

> "This Section provides a means by which the members can limit the persons who have authority to bind the LLC in transactions with third parties. It should be contrasted with § 401, which provides for allocation of governance functions within the LLC under the operating agreement. Pursuant to § 401, the members have the flexibility to provide for any form of governance they wish in the operating agreement. Under § 301, the parties' choice of governance form impacts third parties only to the extent that the articles of organization state whether the LLC is managed by managers or by members. By the same token, the enforcement of the management rights and restrictions as between the parties to the operating agreement does not turn on the disclosure in the articles of organization.
>
> "Unless the articles of organization provide for management by managers, this section would cause the act of any member to bind the company to the same extent as the act of a general partner in a general partnership. The agency extends to transactions which are carried on in the usual way of the business *or affairs* of the limited liability company in order to address those situations where it is unclear whether the activities of the limited liability company rise to the level of a business. As under the UPA, acts which are outside the usual course of business may be actually authorized, and acts which otherwise would be apparently authorized are not binding to the extent that creditors know of a restriction on the member's authority. Because this Section is based closely on the UPA, courts are likely to apply partnership precedents."

§ 21. Admissions of members and managers.

Montana Comment: This section is modeled after § 302 of the ABA Prototype. According to the Commentary to § 302 of the ABA Prototype:

> "This provision clarifies that a member or manager's admission or statement is evidence against the firm if it concerns matters within the authority of the member or manager to bind the firm unless it is a statement by a member in a manager-managed firm."

§ 22. Limited liability company charged with knowledge of or notice to member or manager.

Montana Comment: This section is modeled after § 303 of the ABA Prototype, which is based on UPA § 12.

§ 23. Liability of members to third parties.

Montana Comment: This section is modeled after § 306 of the ABA Prototype. The drafters of the Montana Act agree with the Commentary to § 306 of the ABA Prototype that liability is not eliminated when damage occurs from the member's or manager's own acts or omissions:

> This section is not intended to relieve a member from liability arising out of his own acts or omissions to the extent such acts or omissions would be actionable, either in contract or in tort, against the member if he were acting in his individual capacity. For instance, a member may become liable in contract to a third party creditor of the limited liability company through a guarantee or similar arrangement. A member also may become liable in tort for claims against the limited liability company as a result of his negligence in appointing, supervising, or participating in the activity in question with a manager, employee, agent or other member of the limited liability company. Accordingly, with respect to his liability for the debts and obligations oft he limited liability company, a member is analogous to a limited partner or a stockholder. This section does not address a manager's liability for the debts and obligations of the limited labilities company because, like a corporate officer, a manager serves only as an agent of the limited liability company such that, as a general rule, there should be no grounds for imposing liability on the manager.

§ 24. Management.

Montana Comment: This section is modeled after § 401 of the ABA Prototype which relied on identical provisions from statutes in several states. *See, e.g.*, Fla.

Stat. § 608.422, Kan. Stat. § 17-7612; Nev. Stat. § 312; Utah Stat. § 48-2(b)-125, and Wyo. Stat. § 17-15-116.

The drafters of the Montana Act intend to allow for maximum flexibility in the governance of LLCs. The drafters created a "default rule" that LLCs are managed by members in the absence of an operating agreement providing for management by managers. The Montana drafters agree with the following Commentary to § 401 of the ABA Prototype Act.

> "The emerging LLC model adopted by most LLC statutes calls for management directly by the members. This is based on several important factors. First, because LLC interests are not freely transferable, members who are dissatisfied with their investments must resort to active involvement rather than simply exiting the firm like public corporation holders. In this critical respect, LLCs necessarily resemble close corporations. Second, vesting management in one or more managers would generally result in centralized management for tax purposes under § 7701 of the Internal Revenue Code. Accordingly, a company would need free transferability and continuity of life to qualify for partnership tax treatment. Third, although many LLCs may prefer centralized management, default provisions should anticipate the preferences of the relatively small LLCs that are most likely not to incur the costs of entering into a customized agreement. Such firms are likely to prefer management directly by managers."

§ 25. Duties of managers and members.

Montana Comment: This section is modeled after § 406 of the ABA Prototype Act.

This section deals with both the duty of care and the duty of loyalty. The Montana drafters agree with the Commentary to § 406 of the ABA Prototype Act as it describes the duty of care:

> "Section (A) sets forth the gross negligence standard of care for those participating in management. This is similar to that for corporate directors, managing partners, or general partners of limited partnerships. In general, as long as managers avoid self-interested and grossly negligent conduct, their actions are protected by the business judgment rule. With respect to general partnerships, see RULPA § 404(d).
>
> "Although the duty of care has been formulated in similar terms for managers of all types of firms, as noted above there are important differences among firms that may result in variations in applying the general standard. The duty of care may be lower in a general partnership

because the partners' individual liability makes it likely not only that managing partners will manage carefully, but that non-managing partners will at least take an active interest in management. At the other end of the spectrum, limited partners or shareholders in a publicly traded corporation may be removed from management and may rely more heavily on fiduciary duties. LLCs, which have limited liability members, but which can be expected to be closely held because management rights are not freely transferable, may lie between these two extremes. Moreover, there will be differences among LLCs. It is likely that the precise boundaries of the duty will be left to develop by case law and operating agreement rather than by statutory provision."

Likewise, the drafters of the Montana Act agree with the Commentary to § 406 of the ABA Prototype describing the duty of loyalty:

"The duty of loyalty under this Section is defined to include two major components: 'Self-dealing,' or a manger's reaping an individual profit by or through an LLC transaction in which the manager participated, and liability for appropriating for personal use property belonging to the LLC without the firm's consent. Such appropriation would amount to, in effect, unauthorized compensation. This duty follows from the simple fact that LLC property is owned by the firm as a whole rather than by individual managers or members. Note that property is defined to include records of the LLC that are in the manager's control. Because of the similarity of this section with the UPA, the courts undoubtedly will interpret it as imposing duties similar to those in the general partnership, including the duty not to appropriate partnership opportunities."

For an in-depth discussion of the duties of care and loyalty for Montana business corporations, *see* Bahls, *Montana's New Business Corporation Act: Duties, Dissension, Derivative Actions and Dissolution*, 53 MONT. L. REV. 3-52 (1991).

§ 26. Voting.

Montana Comment: This section is modeled after § 403 of the ABA Prototype. This section establishes as a default rule, per capita voting. The members may modify this scheme if they so desire. Some LLCs will wish to allocate voting rights according to their capital continuations, as in corporations. If limited liability companies chose to allocate voting on the basis of capital contributions, the operating agreement should make it clear whether a member's unperformed promise to contribute cash, property or services should be considered.

§ 27. Limitation of liability and indemnification of members managers.

Montana Comment: Except for subsection (2) and the ability to limit the liability of members, this section is modeled after § 404 of the ABA Prototype.

Subsection (2) is adapted from MCA § 35-1-216 in order to follow the existing Montana public policy regarding elimination of liability when an intentional infliction of harm is involved.

Just as a manager's default liability should be comparable to that of a corporate director, the liability should also be subject to variation by agreement. This section allows the limited liability company flexibility when dealing with manager liability and requires less formality than the corporate statute, which is designed for firms with very dispersed holders (members).

§ 28. Records and information.

Montana Comment: This section is modeled after § 405 of the Model Act. The drafters of the Montana Act agree with the Commentary to § 405 of ABA Model Act:

> "Subsection (1) is permissive in the sense that it only specifies where the relevant documents must be kept *if* they are prepared. Although the benefits of producing certain fundamental information regarding the limited liability company outweighs the costs of potential abuses and added litigation, it is not clear which records should be required, or what should be the consequences of failing to prepare the records. LLCs generally will keep the records listed in this Section for business and tax reasons. Moreover, most written agreements relating to such matters as contributions and events of dissolution would fall within the broad definition of an operating agreement and therefore would be required to be maintained by this Section."

§ 29. Contributions to capital.

Montana Comment: This section is modeled after § 501 of the ABA Prototype, which relied on RULPA § 501 as its source. It clarifies the acceptable form of a contribution to the limited liability company.

§ 30. Liability for contribution.

Montana Comment: This section is modeled after § 502 of the ABA Prototype which relies on RULPA § 502(c) as its source for subsection (3)(b). The ABA had much discussion about this section and urges that 3(b) must be included in this statute to

provide the creditor who has relied detrimentally upon an obligation a right to proceed on the obligation.

§ 31. Sharing of profits and losses.

Montana Comment: This section is modeled after § 503 of the ABA Prototype Act. Profits and losses on the basis of capital interests. The proposed Montana LLC Act distributes profits and losses on a per capita basis. The Subcommittee believed that an equal distribution presumption is the appropriate default rule. While a "capital interest" method of distribution may be more appropriate in capital intensive limited liability companies, the equal distribution rule may be more appropriate in service limited liability companies. As capital intensive limited liability companies are more likely to be represented by attorneys than service limited liability companies, it was decided that default rules should protect the unrepresented. Further, for those businesses desiring a capital interest method of allocating profit and losses, it is probably impossible to generalize how and when those businesses wish to compute capital interests.

This section is intended to establish the scheme upon which profits and losses will be allocated among the members and distributions made to them in the absence of a specific agreement.

§ 32. Sharing of distributions.

Montana Comment: This section is modeled after § 601 of the ABA Prototype. This section provides for a per capita default method of sharing of profits and losses. The last sentence is intended to set forth the time for distributions other than on withdrawal or distribution.

§ 33. Distributions on an event of dissociation.

Montana Comment: This section is patterned after § 602 of the ABA Prototype Act.

§ 34. Distribution in kind.

Montana Comment: This section is modeled after § 604 of the ABA Prototype which relied on RULPA § 605 as its source. This provision provides that no member may demand property in kind unless the operating agreement calls for it. As well, it intends to place an appropriate restriction on the limited liability company's ability to "dump" a disproportionate amount of undesirable property on a member.

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§ 35. Distributions.

Montana Comment: This section is from § 605 of the ABA Prototype, but has been modified for clarity. This section draws heavily from a corresponding provision concerning restrictions on distribution contained in the Model Business Corporation Act. This section is designed to assure that a distribution will not render a corporation insolvent under either of two tests.

§ 36. Liability upon wrongful distribution.

Montana Comment: This section is modeled after § 606 of the ABA Prototype, but has been modified for clarity. The third subsection of § 606 of the ABA Prototype providing for a separate statute of limitations has been deleted. This section is intended to hold certain members or managers personally liable to the limited liability company for wrongful distributions. It allows members or managers who are liable for an unlawful distribution to demand contributions from other members and managers who meet certain conditions.

§ 37. Right to distribution.

Montana Comment: This section is modeled after § 607 of the ABA Prototype Act. The Commentary to § 607 of the ABA Prototype Act describes the purpose of this section:

> "The benefit of this provision is that it allows a limited liability company to convert equity to debt rather than actually paying out cash without fear that later payment of that debt will subject members or managers to liability. This is an important aspect of redemption agreements. Clearly if the limited liability company could have paid cash, it should be able to retain the cash and pay later, if that is in the best interest of the limited liability company."

§ 38. Ownership of limited liability company property.

Montana Comments: This section is modeled after § 701 of the ABA Prototype Act, which is based on the partnership law. The first sentence of subsection one is from the Uniform Partnership Act (1992). The second sentence is from the Delaware Limited Partnership Act. The Committee agrees with the following Commentary to § 701 of the ABA Prototype Act:

> "This section clarifies that, unlike a partnership under the UPA, LLC property is owned by the firm itself rather than nominally or otherwise by the members. This ensures that the "tenancy in partnership" which has confused partnership law will not plague LLC's. It is implicit in this Section that a member may

be able to use LLC property for LLC purposes provided he is authorized to do so."

§ 39. Transfer of real property.

Montana Comment: This section is modeled after § 702 of the ABA Prototype Act, which is based on partnership law.

§ 40. Nature of membership interest.

Montana Comment: This section is modeled after § 703 of the ABA Prototype Act, which is derived from § 701 of the RULPA.

§ 41. Assignment of membership interest.

Montana Comment: This section is modeled after § 704 of the ABA Prototype Act, which is based on § 14-9-702 of the Georgia Uniform Limited Partnership Act. Interests in limited liability companies are not freely transferable. Lack of free transferability of interests helps insure favorable partnership tax treatment.

It is intended that the personal representative, successor or other legal representative of a deceased, incompetent or dissolved member is treated as assignee of a member's interest.

The Committee agrees with the following Commentary to § 704 of the ABA Prototype Act:

> "With respect to subsection (1)(a), unlike a corporate shareholder, but like a partner, an LLC member can freely transfer only financial rights, at least in the absence of contrary agreement. The requirement of a writing is suggested since members would expect to have such a right to assign and should not be denied the right by a mere oral agreement. Note that authority in the partnership context for invalidating restrictions on transferability might be applied to LLC's. Because assignment of a membership interest transfers only financial rights, it follows that a transfer does not constitute a change in membership, and therefore does not dissolve the LLC."

§ 42. Rights of judgment creditor.

Montana Comment: This section is modeled after § 705 of the ABA Prototype and was derived from RULPA § 703, with appropriate changes of terminology for limited liability companies. This section clarifies the rights of a judgment creditor and the responsibilities of a member owing to that creditor.

The Committee agrees with the following Commentary to § 705 of the ABA Prototype Act:

> "This Section provides that unsecured creditors can obtain from a court a charging order, which is a sort of attachment or garnishment, against the member's interest. Under this Section, the charging order is available only to judgment credits of members. It is therefore not available to divorced spouses under alimony decrees and others with rights against members other than those of judgment creditors. It also cannot be used by judgment creditors of members' assignees.
>
> "A charging creditor has the rights of an assignee to the extent that the interest is charged. This implies that the creditor need not foreclose on the interest to acquire the full rights of an assignee."

§ 43. Right of assignee to become a member.

Montana Comment: This section is based on § 706 of the ABA Prototype with some clarifying changes. The ABA Prototype derived these provisions from RULPA § 704(b) & (c) and made appropriate changes. This section clarifies who must approve an assignee for membership and the extent of the rights and obligations of an assignee who becomes a member.

The Subcommittee agrees with the Commentary to § 706 of the ABA Prototype Act that states:

> "A statute that permits variation of the unanimous consent rule by agreement of the members will enable the members to create the corporate characteristic of free transferability of interests for federal income tax classification purposes, perhaps inadvertently. At present, it is not certain whether a majority consent requirement would be sufficient, in the view of the Internal Revenue Service, to avoid the characteristic of free transferability of interests."

§ 44. Admission of members.

Montana Comment: This provision of the Act is modeled after § 801 of the ABA Prototype, which is based on § 301 of the RULPA.

§ 45. Events of dissociation.

Montana Comment: This section is derived from § 802 of the ABA Prototype Act. The Commentary to § 802 of the ABA Prototype Act explains:

"This Section makes clear what constitutes a member dissociation that entitles the member to payment under § 803 whether or not the firm continues after dissociation. Note that this Section refers to member "dissociation," which is a broad term that includes the voluntary act of "withdrawal." The events specified in this Section constitute sufficient dissociation to dissolve a general partnership and to cause the cessation of a general partner's status as such in, and dissolution of, a limited partnership. By contrast, in the absence of contrary agreement, such events apparently do not cause the withdrawal of a limited partner or the dissolution of a limited partnership. LLC members should be treated more like general partners than like limited partners since, under most LLC statutes and the Prototype, LLC members are assumed to be active in management unless the agreement provides otherwise. Accordingly, an event such as death, or dissolution of a member who is a business association, that terminates the member's ability to participate in the firm sufficiently changes the nature of the member's deal that she would expect to terminate her relationship with the firm.

The Montana Act, § (1)(k) differs from the ABA Prototype Act by providing that loss of professional license in a professional limited liability company will be considered dissociation.

§ 46. Dissolution.

Montana Comment: This section is based on § 901 of the ABA Prototype Act. The Montana LLC Act permits the members to continue, by unanimous agreement, the business of the limited liability company, thereby avoiding a dissolution. The purpose is to help assure that, in the normal case, the limited liability company will lack the corporate tax feature of continuity of life. The Subcommittee opts for requirement of a unanimous vote for continuation because of a private letter ruling that a Florida LLC possessed the corporate characteristic of continuity of life when members could continue the business with a mere majority vote. Priv. Ltr. Ruling 90-10-627 (Dec. 7, 1989).

Section 51 of the Act states that "upon the dissolution and the commencement of winding up of the limited liabilities company, articles of dissolution shall be filed in the office of the secretary of state." While it is hoped that dissolving LLCs will file articles of dissolution, dissolution occurs upon the happening of the events described in section 46, whether or not articles of dissolution are in fact filed."

§ 47. Judicial dissolution.

Montana Comment: This section is modeled after § 702 of the ABA Prototype which followed the corresponding provision from RULPA. Examples of when it might not be reasonably practicable to carry on a business are found at MCA § 35-10-605(1). The reasons include:

(1) a member is declared seriously mentally ill in a judicial proceeding or is shown to be mentally incompetent;

(2) a member becomes in any other way incapable of performing his or her part of the operating agreement;

(3) a member has been guilty of such conduct as tends to affect prejudicially the carrying on of the business;

(4) a member willfully or persistently commits a breach of the operating agreement or otherwise so conducts himself or herself in matters relating to the business that it is not reasonably practicable to carry on the business in partnership with him or her;

(5) the business of the limited liability company can only be carried on at a loss; or

(6) other circumstances render a dissolution equitable.

This section provides the district court with the power to dissolve the limited liability company, upon the happening of certain events. Parties may include circumstances such as those listed in the comments in the articles of organization or operating agreement. Upon the occurrence of a named event, and the application by or for a member, a judge may issue a dissolution decree.

Courts should recognize that a decree of dissolution may be an inappropriate, draconian remedy. It may allow one shareholder to hold a sword over the head of the majority. In the corporate case of *Maddox v. Norman*, 669 P.2d 230 (1983), the Montana Supreme Court recognized this problem and fashioned a less drastic remedy. This section is not intended to limit the court's equitable power to further other remedies. For a description of a court's equitable power and considerations courts should analyze when selecting the appropriate remedy, *see* Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 J. CORP. L. 285 (1990).

§ 48. Winding up.

Montana Comment: This section is modeled after § 903 of the ABA Prototype, which followed the corresponding provision from RULPA. This section identifies who may wind up the limited liability company.

§ 49. Agency power of managers or members after dissolution.

Montana Comment: This section is modeled after § 904 of the ABA Prototype.

§ 50. Distribution of assets.

Montana Comment: This section is modeled after § 905 of the ABA Prototype, which is based on the RULPA. It is important to note that members' debts may be subject to equitable subordination in bankruptcy.

§ 51. Articles of dissolution.

Montana Comment: This section is based on § 906 of the ABA Prototype and clarifies the required contents of the articles of dissolution. The ABA Prototype relied on RULPA as its source, but made appropriate changes in terminology. For example, RULPA uses the term "cancellation of certificates" to denote this section. The Prototype appropriately changed this term to "articles of dissolution" as the dissolution of a limited liability company is based upon the filing of articles of dissolution. Subsections (6) and (7) are not from the ABA Prototype. They are included here to increase certainty in commercial transactions.

This section is desirable in order that creditors of the LLC be informed of the dissolution and have ample opportunity to present claims. It is also necessary to enable the secretary of state to maintain accurate lists of active LLCs.

Dissolution is not contingent on filing articles of dissolution. Rather dissolution occurs upon the happening of an event stated in § 46. Limited liability companies have an incentive, however, to file articles of dissolution. Not only does § 51 purport to require a filing, but § 51 allows limited liability companies filing articles of dissolution to limit liability for known claims.

§ 52. Revocation of dissolution.

Montana Comment: This section is not based on the ABA Prototype, but is consistent with the Montana practice of permitting a corporation to take action to revoke its dissolution. This provision of the law is patterned after MCA § 35-1-934.

§ 53. Known claims against dissolved limited liability companies.

Montana Comment: This section is modeled after § 907 of the ABA Prototype, which is similar to MCA § 35-1-936 (Known claims against dissolved corporations). This section clarifies the procedures for making claims against a dissolved LLC and provides a procedure for extinguishing known claims.

§ 54. Unknown claims against dissolved limited liability companies.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-1-937 (Unknown Claims Against Dissolved Corporations). See Bahls,

Montana's New Business Corporation Act: Duties, Dissension, Derivative Actions and Dissolution, 53 MONT. L. REV. 3, 41-51 (1992). This section clarifies the rights and responsibilities of members and managers upon dissolution.

Subsection one is intended to protect the rights of creditors who possess unknown claims. It is consistent with a sound policy of insuring that creditors are satisfied before capital is returned to members. There is no separate limitation period for making claims for unknown debts of an LLC. The statute of limitations applying to unknown creditors of a dissolved LLC is usually tort, contract or other applicable limitation period.

Subsection two codifies the common law trust fund doctrine that provides that the property of a dissolved business is considered a trust fund for the payment of corporate debts. As such, members take assets upon dissolution subject to the claims of creditors. Codifying this doctrine adds certainty to the law.

Subsection three codifies the holding in *North American Asbestos Corp. v. Superior Court*, 180 Cal. App.3d 902, 225 Cal. 877 (1986). This case holds that when the corporate code of the state of incorporation regarding limitation periods for claims against dissolved corporations differs from the corporate code in the jurisdiction where a claim arises, the law of the jurisdiction where the claim arises applies. Subsection three applies this rule to limited liability companies.

§ 55. Authority to transact business required.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-1-1026. It clarifies that a foreign limited liability company must have a certificate of authority from the secretary of state before it may transact business in the state. Further, this section sets forth an unexhaustive list of activities that a foreign limited liability company may engage in without the certificate of authority from the secretary of state.

§ 56. Consequences of transacting business without authority.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-1-1027. It clarifies the consequences and limits of a foreign limited liability company transacting business without a certificate of authority to do so from the secretary of state.

§ 57. Application for certificate of authority.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-1-1028. It clarifies the application requirements for a certificate of authority.

§ 58. Registered office and registered agent of foreign limited liability company.

Montana Comment: This section is not based on the ABA Prototype, but is consistent with the Montana practice of regulating registered offices and registered agents of foreign business entities. This provision of the law is patterned after MCA 35-1-1032.

§ 59. Resignation of registered agent of foreign limited liability company.

Montana Comment: This section is not based on the ABA Prototype, but is consistent with the Montana practice of regulating resignation of registered agents of foreign business entities. This provision of the law is patterned after MCA § 35-1-1036.

§ 60. Change of registered office or registered agent of foreign limited liability company.

Montana Comment: This section is not based on the ABA Prototype, but is consistent with the Montana practice of regulating changes of registered offices and agents of foreign business entities. This provision of the law is patterned after MCA § 35-1-1033.

§ 61. Amended certificate of authority.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-1-1029. It clarifies the requirements for obtaining an amended certificate of authority.

§ 62. Effect of certificate of authority.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-1-1030. It sets forth the powers and limits of a certificate of authority.

§ 63. Name.

Montana Comment: This section is based on § 1004 of the ABA Prototype, which relied on the Virg. Stat. as its source. It requires the foreign limited liability company to satisfy the name requirements that a domestic limited liability company must meet under § 3. In addition, it provides alternatives for filing for a name if § 3 cannot be met.

§ 64. Withdrawal of foreign limited liability company.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-1-1037. It sets forth the application requirements a foreign limited liability company must satisfy to officially withdraw from the state.

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§ 65. Grounds for revocation.

Montana Comment: This section is not based on the ABA Prototype Act but is based on MCA § 35-1-1038. It clarifies the grounds on which the secretary of state may commence a proceeding under § 61 to revoke the certificate of authority of a foreign limited liability company authorized to transact business in the state.

§ 66. Procedure for and effect of revocation.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-1-1039. It sets forth the procedure that the secretary of state will engage in to revoke a certificate of authority and the effect of such revocation.

§ 67. Appeal from revocation.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-1-1040. It provides the procedure for an appeal from revocation of a certificate of authority.

§ 68. Admission of foreign professional limited liability companies — application — revocation.

Montana Comment: This section is not based on the ABA Prototype, but is based on MCA § 35-4-411. It sets forth the application requirements for a certificate of authority that a foreign professional limited liability company must satisfy to transact business in the state, as well as the procedure invoked by the secretary of state for revocation of a certificate of authority.

§ 69. Suits by and against the limited liability company.

Montana Comment: This section is modeled after § 1101 of the ABA Prototype Act.

§ 70. Authority to sue on behalf of limited liability company.

Montana Comment: This section is modeled after § 1102 of the ABA Prototype. This section, under limited circumstances, permits members to bring a derivative-type action.

The Commentary to § 1102 of the ABA Prototype Act is particularly helpful:

> "Under this Section, suits by the LLC are authorized as among the members according to rules similar to those applying to other acts or transactions by the LLC. However, this Section makes clear that the suit may be authorized by

member vote even if the LLC is otherwise managed by managers, and that the member vote must be *disinterested.* Interested members are excluded both as votes and in determining the number of votes necessary for a majority. However, the lead-in to this Section makes clear that the parties may provide for any other voting rule in the operating agreement. Some firms may wish to authorize suit more readily by providing that a member or manager can proceed with a suit in the absence of an explicit vote unless there is an objection by enough members to block the suit within a certain time after receiving notice of the suit. Objections of members not made within a specified time would be waived. For any authorized suit, whether or not it is successful, expenses would, of course, be paid by the LLC, just as for any other acts or transactions by the LLC.

"It is important to emphasize that this Section does not permit derivative suits unless they are provided for in the operation agreement. Derivative suits are intended to deal with the problem that interested members or managers may use their management authority to block claims against them. This Section deals with this problem by providing that (1) a majority of members may always authorize suit, even in manager-managed LLC's; and (2) that the votes or interested members or managers are not counted in determining the requisite number of votes for suit. The suing member may be able to establish a conflict on the basis that the objecting members or managers are defendants in the suit, although this may not be sufficient. Moreover, even members or managers who are not defendants may be sufficiently related financially or otherwise to the defendants that their judgment in voting on the suit could be characterized as impaired . . .

"It is important to keep in mind that this Section is intended as only a default provision. Thus, the members can provide in the operating agreement for other remedies, including a derivative remedy. Some firms may wish to adopt the derivative suit provisions in RULPA (although that does not represent an endorsement by the Committee of those provisions). Drafting such provisions should be cost-justified for the larger firms in which derivative suits may be appropriate. On the other hand, for smaller, more informal, firms for which derivative suits plainly are inappropriate, drafting around the statute may not be cost-justified. These firms may be stuck with the statutory default. . . .

"Note that this Section deals only with suits on behalf of the LLC. LLC members also can sue directly for harms to them individually, including claims for indemnification or for fraud in the sale of an interest in the firm under state blue sky or fraud law or the federal securities laws. These claims may be brought as individual or class actions in accordance with the procedural rules of the relevant court, including Rule 23 of the Federal Rules of Civil Procedure and state rules modeled on it.

"A court may require a plaintiff who essentially seeks recovery for damage to the firm to sue on behalf of the firm rather than directly. For example, a member may be unable to sue individually on a claim that insiders' actions reduced the value of her interest in the firm. There are several reasons for such a rule. First, it conserves litigation costs by avoiding separate suits on the members' identical causes of action. Second, entity-based recovery avoids complex problems of determining precisely how each member was damaged by the fraud. Third, and perhaps most importantly, the direct action usurps the appropriate role of the firm's managers and members in terminating the suit.

"Courts may permit claims that essentially seek redress on behalf of the firm to be brought directly. For several reasons this course of action may be appropriate for closely held firms like the typical LLC. First, in a closely held firm, it is feasible to determine the damages of each member, and therefore to structure a direct recovery. Second, recovery on behalf of the firm may prejudice members of a closely held firm because they cannot "cash in" on the award by selling their shares, so that the firm's recovery may be locked in the control of wrongdoing insiders. Some courts have been lenient in characterizing direct actions in close corporations. *See* Crosby v. Beam, 548 N.E.2d 217 (Ohio 1989). *But see* Bagdon v. Bridgestone/Firestone, Inc., 916 F.2d 379 (7th Cir. 1990) (refusing to characterize close corporation suits generally as direct)."

§ 71. Merger.

Montana Comment: This section is not based on the ABA Prototype, which was rejected as unnecessarily complex. Instead, this section is based on the Utah LLC Act § 48-26-149.

This section does not allow for dissenters rights. The Subcommittee agrees with Robert Keatinge when he states:

"The principal distinction should concern dissenters' rights. Dissenters' rights arguably are important in publicly traded corporations because voting rights alone may not be enough to protect small, passive shareholders. This is less likely to be a problem for more active LLC members, particularly in member-managed firms. Moreover, in a closely held LLC, members may protect themselves from a self-dealing majority by requiring unanimous consent to mergers and other significant transactions, or by exercising their right of withdrawal."

Keatinge, et al., The Limited Liability Company: A Study of the Emerging Entity, 47 BUS. LAW. 375, 394 (1992).

§ 72. Purposes of professional limited liability companies.

Montana Comment: The ABA Prototype Act does not include provisions for a professional limited liability company. Several states' acts such as Colorado, Florida, Kansas, Nevada, Texas, Utah and Wyoming, do provide for such entities.

Attorneys and accountants, in particular, have expressed interest in doing business as LLCs.

> "Because professionals often have complex financial arrangements not susceptible to the simplicity of an S corporation, they may be constrained to use a C Corporation to limit personal liability. Use of the C corporation, however, will subject the entity to a double level of taxation and a higher tax rate. While the double taxation problem may be minimized by paying large salaries and bonuses, the C corporation mays till be an unacceptable tax vehicle for a professional practice. An LLC allows professionals to limit personal liability for the negligence and malfeasance of others in the firm, while avoiding the tax problems of C corporations."

Keatinge, et al., The Limited Liability Company A Study of the Emerging Entity, 47 Bus. Law. 375, 457 (1992).

This section is based on MCA § 35-4-205 governing professional corporations. This section allows for the creation of professional limited liability companies and generally requires such entities, with some exception, to limit their purpose to rendering services within a single profession.

The Subcommittee recognizes that the enactment of this statute alone will not enable many professionals to operate as LLCs without approval of the profession's regulators.

§ 73. Professional limited liability company name.

Montana Comment: This provision is based on MCA § 35-4-206 governing professional corporations. This section lists the requirements for an effective name.

§ 74. Professional limited liability company managers.

Montana Comment: This provision is based on MCA § 35-4-207 regarding professional corporations. It imposes a minimum requirement on the management of professional limited liability companies.

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§ 75. Membership in a professional limited liability company.

Montana Comment: This provision is based on MCA § 35-4-208 regarding professional corporations. It indicates who may be a member of a professional limited liability company.

§ 76. Rendering services.

Montana Comment: This section is based on MCA § 35-4-403 regarding professional corporations. It provides who may render services for the professional limited liability company.

§ 77. Responsibility for services.

Montana Comment: This section is based on MCA § 35-4-404. It clarifies who is and is not liable for any negligent or wrongful act or omission by an employee and the extent of that liability.

§ 78. Relationship to clients and patients.

Montana Comment: This section is based on MCA § 35-4-405. It defines the extent of the relationship involved between an individual rendering professional service as an employee of the professional limited liability company and a client or patient.

February 4, 1993

Exhibit No. 8 is a copy of "Prototype Limited Liability Company Act", draft of July 16, 1992. The original is stored at the Historical Society at 225 North Roberts Street, Helena, MT 59602-1201. The phone number is 444-2694.

EXHIBIT 8
DATE 2-4-93
SB SB-146

EXHIBIT # 9
DATE 2/4/93
HB 396 Whalen

TESTIMONY ON HOUSE BILL 396
BEFORE THE HOUSE JUDICIARY COMMITTEE
THURSDAY, FEBRUARY 4, 1993
ROOM 312-1

My name is Greg Van Horssen and I represent the State Farm Insurance Company in Montana. State Farm opposes House Bill 396 simply because the Bill represents bad public policy. It is the position of State Farm that, if enacted, House Bill 396 would not only remove a substantial disincentive to drinking and driving, but could also work to endanger the drivers of Montana.

Subsection (8) of the Bill on page 3, lines 20 through 24 would require a court order for any member of the public to obtain information on an individual's license suspension. This applies to insurers. To treat information about a driver's license suspension for failure to submit to an alcohol test as confidential information would be to keep from the public very important information about that individual's potential danger to other drivers. The public is entitled to have this information and is entitled to know that an individual may be a threat to highway safety.

To treat the license suspension as confidential information which is discoverable only with a court order would also work a fundamental unfairness to the public in another fashion. We all know what could potentially happen to our auto insurance premiums if we were to have our license suspended as a result of a DUI. Our insurance premiums go up. Why do they go up? Because, as a driver who has a history of driving under the influence, even a short history, we represent a significantly higher insurance risk. The specter of increased insurance premiums or no insurance at all should and does work as an incentive to stay off of the roads when we have had too many drinks. If House Bill 396 passes

into law, insurers would not have access to this information and this incentive would be gone.

With respect to insurance, another benefit to having this type of information easily accessible is that it allows the insurer to allocate the risk to the appropriate areas. In other words, it allows the insurer enough information to isolate a higher risk individual and adjust that individual s premiums accordingly. Without access to this type of information, and without the ability to adjust premiums for a drivers failure to submit to an alcohol test, the insurer would have to spread its increased risk to all of its insureds. This would mean that those people who never drink and drive would necessarily have to pay higher insurance premiums even though they do not represent a higher risk.

If House Bill 396 is passed into law, a driver who is stopped while driving under the influence will always refuse the test and choose to suffer the license suspension and court fine as opposed to the increased insurance premiums or, worse, no insurance at all. House Bill 396 removes one more incentive to remain sober while behind the wheel. For this reason, State Farm urges a DO NOT PASS ON HOUSE BILL 396.

Thank You

Greg Van Horssen

State Farm Insurance Company

HOUSE OF REPRESENTATIVES
VISITOR'S REGISTER

Judiciary COMMITTEE BILL NO. SB 146

DATE Feb. 4, 1993 SPONSOR(S) Waterman

PLEASE PRINT **PLEASE PRINT** **PLEASE PRINT**

NAME AND ADDRESS	REPRESENTING	SUPPORT	OPPOSE
David Owen	MT Chamber of Commerce	✓	
Garth Jacobson	Sec of State	✓	
Thomas C. McCrisken Thomas C. McCrisken	self		
Steve Bahls	Self	✓	
Alan Joscelyn	Self	✓	
Richard M. Baskett	Self	✓	
Tom McNab	MT. TECHNICAL COUNCIL	✓	
Charles R. Brooks	MT. Retail Assoc	✓	

PLEASE LEAVE PREPARED TESTIMONY WITH SECRETARY. WITNESS STATEMENT FORMS ARE AVAILABLE IF YOU CARE TO SUBMIT WRITTEN TESTIMONY.

HOUSE OF REPRESENTATIVES
VISITOR'S REGISTER

Judiciary COMMITTEE BILL NO. SB 78

DATE Feb. 4, 1993 SPONSOR(S) Gage

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NAME AND ADDRESS	REPRESENTING	SUPPORT	OPPOSE
John Connor	MT County Attys Assn	X	
David Hull	City of Helena		X

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HOUSE OF REPRESENTATIVES
VISITOR'S REGISTER

Judiciary COMMITTEE BILL NO. HB 396

DATE Feb. 4, 1993 SPONSOR(S) W. Baker

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NAME AND ADDRESS	REPRESENTING	SUPPORT	OPPOSE
Jacqueline J. Lenmark	Am. Ins. Assoc.		✓
Roger McGlenn	Independent Ins. Agents Assoc of MT		✓
Greg Van Horssen	State Farm Ins.		✓

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HOUSE OF REPRESENTATIVES
VISITOR'S REGISTER

Judiciary COMMITTEE BILL NO. SB 129

DATE Feb 4, 1993 SPONSOR(S) Doherty

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NAME AND ADDRESS	REPRESENTING	SUPPORT	OPPOSE
Cheryl Thares PO Box 2429 GF 59403	Gt Fls Public Schools	X	
Donna Hall GF 7420 Upper River Rd Falls	Hall Transit Mt. School Bus Contractors Asso	X	
Don Waldron	MT. Rural Ed. Assn	✓	

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