

MEMORANDUM

TO: Commissioners

FROM: Harry J. Haynsworth, Chair Record Owners of Business Organizations
Drafting Committee Project **HJH**

DATE: June 17, 2008

RE: **Proposed Amendments to the Uniform Limited Liability Company Act (2006)**

This Drafting Committee project was approved by the Executive Committee in July 2007. The basic charge to the Committee was to draft amendments to all the uniform unincorporated business entity acts that require the filing of a certificate or articles of organization in the office of the Secretary of State as part of their formation to deal with issues raised by proposed legislation co-sponsored by Senators Carl Levin (D-MI), Norm Coleman (R-MN) and Barack Obama (D-IL) that would mandate the filing of business entity beneficial ownership information in the office of the Secretary of State to be made available to law enforcement officials. This proposed federal legislation, which was officially introduced on May 1, 2008 as S. 2956 and referred to the Committee on Homeland Security and Governmental Affairs, was based on claims by several federal and international law enforcement agencies that the lack of business entity ownership information in state filing records impeded law enforcement efforts in combating terrorism, money laundering, and other criminal activities.

What business entity documents are filed and the content of those documents has always been dealt with by state business entity statutes. An important objective of this drafting project is to continue this state law nexus by crafting amendments to the existing state business entity acts that would effectively address the legitimate concerns of law enforcement officials and therefore make federal legislation unnecessary.

The ABA Committee on Corporate Laws, which has promulgated the Model Business Corporation Act (MBCA), also established a Task Force in 2007 to draft amendments to the MBCA in response to this proposed federal legislation. The Chair and Reporter of that Task Force is also the Reporter of this NCCUSL Drafting Project. A second major objective is to have a coordinated set of amendments to both the unincorporated entity acts and the MBCA.

At the 2008 NCCUSL Annual Meeting only the proposed amendments to the Uniform Limited Liability Company Act (2006) will be read and discussed. Since the proposed amendments to the other unincorporated business entity acts (Uniform Partnership Act (1997), Uniform Limited Partnership Act (2001), the Uniform Limited Cooperative Association Act (2007), and the proposed Uniform Statutory Entity Trust Act) will all follow the same pattern, discussion of the limited liability company act amendments at this annual meeting should be sufficient to get helpful advice and direction from the floor on all the essential policy and drafting issues.

The following is a brief description of the differences between the proposed amendments to the unincorporated and corporate business entity acts and S. 2956 and also the potential differences between the proposed amendments to the unincorporated entity acts and the proposed MBCA amendments:

1. S. 2956 only covers corporations and limited liability companies but Section 5 envisions coverage of "State partnerships, trusts, or other legal entities" based on a report to be filed one year after enactment by the Comptroller General on whether these other entities require the same disclosures as are required by S. 2956. The proposed amendments cover all filing entities since all of them have the same disclosure issues and alleged deficiencies, and it makes sense to have only one global enactment effort.

2. S. 2956 requires the filing of beneficial ownership information at the time an entity is formed. A revised list of beneficial owners must be filed as part of the entities' annual report to the Secretary of State. The beneficial ownership information must be maintained by the Secretary of State for five years after the entity's termination. A beneficial owner is defined as "an individual who has a level of control over, or entitlement to, the funds or assets of a . . . company that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the . . . company." A state can determine that this beneficial ownership information is part of the public records or is maintained in a separate non-public database that shall be provided upon receipt of "a civil or criminal subpoena from a state agency, Federal agency, or congressional committee or subcommittee requesting such information." The Drafting Committee concluded that the beneficial ownership concept was inappropriate for several reasons and that the ownership information should not be filed in the office of the Secretary of State. The proposed amendments to the uniform unincorporated entity acts and to the MBCA provide that an entity designate in a public filing an individual known as a "records contact" who has access to information about the record owners of an entity (this is the only type of information currently required to be maintained by business entities) and will "promptly" produce the list of record owners and their voting power "upon appropriate request by an authorized agent of a governmental body." An individual record owner that is a nominee (*e.g.*, a trustee) must disclose that fact and a record owner that is an entity must disclose the jurisdiction under whose laws it is formed. There are also additional requirements for a foreign formed entity that is a record owner (*e.g.*, a certification designating an individual whose principal residence is in the United States who qualifies as a records contact.)

3. S. 2956 contains a provisions stating that the "civil penalty of not more than \$10,000," a fine under Title 18 of the United States Code and "imprisonment for not more than 3 years" for filing false beneficial ownership information or failing to provide updated beneficial ownership information. These sanctions are stated to be "in addition to any civil or criminal penalty that may be imposed by a State." The proposed amendments to the entity acts provide that filing false information of any kind with the Secretary of State constitutes perjury. The proposed amendments do not contain any specific penalty provisions for failure of the records contact person to provide ownership information. The records contact individual would be subject, however, to the normal penalties for violation of a subpoena.

4. Although not specifically mentioned in S. 2956, concerns have been raised by several governmental agencies about potential problems with bearer ownership interests in

business entities. The proposed amendments to both the unincorporated entity acts and the MBCA prohibit the issuance of bearer form certificates. This is not controversial because no one on the Drafting Committee knew of any instance where a business entity had issued bearer ownership certificates (as opposed to bearer bonds, which are debt instruments).

5. S. 2956 exempts all SEC reporting companies and any business entity formed by them. The proposed amendments to the entity acts only cover closely held companies, which are defined as a business entity "that has not more than 50 members" because various government officials have consistently indicated that all the problems they have encountered have involved business entities with a small number of owners.

6. S. 2956, as currently worded, seems to deal only with "beneficial owners." In the past few months, however, informal discussions with one official in the Treasury Department, who is an Observer to the Drafting Committee, have indicated that, in his opinion, the entity act amendments should also cover information about the managers of a company and that the names and addresses of all the managers should be disclosed in public filings. The MBCA currently requires the names and addresses of directors and principal officers to be in a corporation's annual report, and the proposed amendments to the MBCA include new provisions requiring that the initial annual report be filed at the time the articles of organization are filed and that changes in the directors and officers be reflected in amendments to the annual report on a continuing basis. The unincorporated acts do not currently require any information about managers in the annual report. This issue was discussed at the time the unincorporated acts were adopted. The majority of the Commissioners at the Drafting Committee meeting on June 7, 2008 when this issue was first considered decided not to change the prior decisions concerning the content of annual reports, but rather to require that the records contact person produce the required information about managers in addition to record owner information. The vote on this issue was 3-2 and several commissioners on the Drafting Committee were not able to attend this meeting. As Chair of the Drafting Committee I made a decision that because of the close vote, potential importance of this issue in the acceptability of the proposed amendments by various federal officials and the potential inconsistency between the unincorporated acts and the MBCA on this issue, two versions of proposed amendments to the Uniform Limited Liability Company Act (2006) should be presented at this Annual Meeting. Version 1 is the version approved by the majority of the Drafting Committee. Version 2 incorporates amendments that would make the unincorporated acts have the same annual report filing and disclosure requirements as the MBCA. Presenting two versions rather than the more usual technique of having section by section alternatives will be less confusing given the complexity of this issue and the significant differences between them.