

DRAFT
D.C. BUSINESS ORGANIZATIONS CODE
SUMMARY & OVERVIEW

BACKGROUND: Work of the Drafting Committee

An *ad hoc* committee of members of the D.C. Bar (the committee) has been working over the past two years in response to a request by a member of the Council of the District of Columbia on recommendations for modernizing the laws of the District of Columbia dealing with business entities. The committee has drafted and voted on a "Business Organizations Code" that would completely revise and recodify the business organization laws of the District of Columbia. The draft, which will be transmitted to the D.C. Council, is now being circulated for review and endorsement by interested bodies.

THE COMMITTEE'S FINAL DRAFT, AN EXPLANATORY MEMO,
AND COMMENTS RECEIVED FROM INTERESTED PERSONS ARE
MAINTAINED ON-LINE AT:

<http://www.williamsmullen.com/dcbusinesslaw>

The purpose of the committee's efforts was to create a modern and comfortable legal environment that will encourage businesses and nonprofit organizations to form and locate their operations in the District of Columbia and that will provide clear and efficient rules for those that do. The proposed draft statute would provide a complete and coordinated legal structure for the following types of entities, some of which have never been enacted in the District before:

- Business corporations
- Nonprofit corporations
- Professional corporations
- Partnerships and limited partnerships
- Limited liability companies
- Cooperative associations
- Statutory trusts

An overview of the principal provisions of the draft DC Business Organizations Code, explaining the function and source for each article, begins on page 3 of this report.

The draft statute is based entirely on model law developed by the National Conference of Commissioners on Uniform State Law (“NCCUSL”), by the American Bar Association (“ABA”), or by both jointly, with changes proposed by participating local attorneys. The committee made the draft statute available on its website for comment and criticism from practicing attorneys, academics and others who work with or study the DC business laws. Comments received have been published on the Committee’s website. Not all comments received have been incorporated into this draft, and additional comments are anticipated. The committee believes these comments deserve careful consideration by the Council as it moves forward with the legislative process.

The work of the committee was coordinated by John Mitchell of the law firm of Williams Mullen, whose practice focuses on corporate and general business law. James McKay of the Office of the Attorney General of the District of Columbia, a Uniform Law Commissioner, provided crucial help in the form of model drafts and his wide knowledge of reform efforts underway in other jurisdictions. Other members of the drafting group included: Nicholas Karambelas, a corporations lawyer with the D.C. firm of Sfikas & Karambelas, LLP, Lawrence H. Mirel of Wiley Rein LLP, Esther Bushman of the D.C. Office of Zoning, James M. Goldberg of Goldberg & Associates, PLLC, Heidi Schooner, Professor, Catholic University School of Law, and Phillip Kardis of K & L Gates LLP. Roy Kaufmann of Jackson & Campbell also contributed to the process.

Any comments or suggestions should be sent to Mr. Mitchell at the following e-mail address: jmitchell@williamsmullen.com.

SUMMARY: Overview of Draft Legislation

The “District of Columbia Official Code Title 29 (Business Organizations) Enactment Act of 2009” is a comprehensive, up-to-date, and well-organized Business Organizations Code. There is great need for this legislation. The District’s current laws concerning business organizations, codified in Titles 29 and 33 of the D.C. Code, are sorely out of date. With few exceptions, they were enacted between 1870 and 1962. These laws are not consistent or coordinated as a result of being enacted separately over a century. The antiquated state of the District’s laws has a negative effect on the District’s ability to attract and maintain the businesses. The Business Organizations Code would replace these outdated laws with an enacted Title 29 of the D.C. Code.

The Business Organizations Code uses a “hub and spoke” approach similar to that used by the Uniform Commercial Code, in which Chapter 1 is the “hub,” containing common provisions, and the other chapters are “spokes,” which govern specific types of commercial transactions, such as sales, leases, secured transactions, etc. All states comprehensively revising their business organizations laws have taken a hub-and spoke approach. Texas was the first to enact such a Code and was followed by Alabama, which on May 14, 2009, enacted a Business and Non-profit Entities Code. Similar legislative efforts are underway in Pennsylvania, and Utah. This approach results in an internally consistent, streamlined, user-friendly, and easily maintainable Code. The 12 chapters of the bill are, with two exceptions, based on uniform or model acts prepared by the Uniform Law Commission (ULC), the American Bar Association (ABA), or both organizations jointly.

The Business Organizations Code relies to a great extent on the considerable efforts and expertise of a joint committee of the ULC and ABA to Draft a Business Organizations Act. This committee, after examining of all of the uniform and model acts relating to business organizations, over several years, has drafted a “hub” with general provisions applicable to all business organizations. In addition, it has prepared detailed instructions as to the changes necessary to fashion these stand-alone uniform and model acts into the “spokes” of a comprehensive Code.

There are distinct advantages in using uniform and model acts as the basis for this Code. Each act was developed by the foremost experts in the field, with input from all major stakeholders, and has undergone lengthy scrutiny over a period of years. Many of these uniform and model acts have been enacted widely by state legislatures. Uniformity is especially important in business laws because businesses often operate in more than one state. Each act is accompanied by detailed official comments, explaining the history of, reasons for, and purposes of each section. Many of these acts are the subject of learned treatises, law review articles, and bar journals. Moreover, many of these acts have been interpreted by appellate courts throughout the country. Finally, each act is subject to continuing scrutiny by the ULC or ABA or both and, if necessary, updated.

The bill would enact into law a new Title 29 of the D.C. Code with 12 chapters. A summary of each chapter follows:

CHAPTER 1. GENERAL PROVISIONS

Chapter 1 (General Provisions) contains provisions applicable to all business organizations. Consolidating these provisions in a “hub” results in an internally consistent, streamlined, user-friendly, and easily maintainable Code. These common provisions are contained in seven subchapters: Subchapter 1 (General Provisions) includes general definitions applicable to the entire Code. Subchapter 2 (Filing) includes procedural requirements for filing documents with the District and filing fees. Subchapter 3 (Name of Entity) includes procedures for reserving and registering names and requirements for names of particular entities. Subchapter 4 (Registered Agent), based on the ULC’s Model Registered Agents Act, includes procedures for designating, listing, and changing commercial and noncommercial registered agents and service of process on entities. Subchapter 5 (Foreign Entities) includes requirements and procedures for out-of-state entities to do business in the District. Subchapter 6 (Administrative Dissolution) provides the grounds and procedures for administrative dissolution and reinstatement of entities. Subchapter 7 (Miscellaneous Provisions) includes general provisions found in many entity laws, including those promoting uniformity and consistency of construction, expressly reserving the power to amend or repeal, and a savings clause that preserves the effect of acts taken and proceedings commenced before the effective date of the Code.

CHAPTER 2. ENTITY TRANSACTIONS

Chapter 2 (Entity Transactions) simplifies and expands the ability of businesses to restructure, which is often necessary to respond to economic changes. The District has no general law on entity transactions. Four types of entity transactions are facilitated – mergers, interest exchanges, conversions, and domestications. Chapter 2 is based on the Model Entities Transactions Act (META), which was drafted by a joint committee of the ULC and ABA. META has been described as a “junction box.” While some existing statutes permit some of these transactions by some of these entities, Chapter 2 expands this authority by permitting entity transactions among and between all of the entities covered by the Code. Without such authority, restructuring transactions often must be completed in two or three indirect steps, rather than directly in a single transaction, or may not be feasible at all. Following the recommended approach of META, Chapter 2 applies to all “cross-type” transactions, such as the merger of a corporation and a limited liability company, or a conversion from one entity to another, but leaves intact provisions in the “spokes” permitting “same-type” transactions – *i.e.*, a merger or interest exchange between two corporations, unless the law relating to the individual entity lacks such provisions, in which case Chapter 2 would apply..

CHAPTER 3. BUSINESS CORPORATIONS

Chapter 3 (Business Corporations) is based on the 2007 version of the ABA Model Business Corporation Act (MBCA). This Act is the product of decades of work by the ABA’s Corporations Committee. It is a comprehensive, up-to-date statute governing for-profit corporations. The MBCA has been enacted in whole or substantial part by 30 states and is the foundation of state corporation law in the United States. Chapter 3 would replace the District’s existing laws on business corporations (codified in Chapters 1, 2, and 11 of Title 29 of the D.C. Code), which were enacted by Congress between 1870 and 1954, and have only been sporadically amended, and would make them consistent with the laws of most of the states. Significantly, the District’s 1954 Act was itself based on the 1950 version of the ABA Model Business Corporation Act. *See* H.R. REP. NO. 198, 83d Cong., 1st Sess. 2

(1953). The bill would update the District’s law by replacing the 1950 version with the 2007 version of the ABA Model Business Corporations Act.

CHAPTER 4. NONPROFIT CORPORATIONS

Chapter 4 (Nonprofit Corporations) is based on the 2008 version of the ABA Model Nonprofit Corporations Act (MNCA). The MNCA was drafted to be consistent with the MBCA and has been adopted widely throughout the United States. The recent revision by the ABA is based on the practical experience of nonprofit corporations operating the states with the MNCA and the appellate decisions interpreting provisions of the MNCA. The bill would update the District’s current laws on nonprofit corporations, which are codified in Chapter 3 of Title 29 of the D.C. Code. The District’s current nonprofit corporation statute was enacted by Congress in 1962. Significantly, the District’s 1962 Act was itself based on an earlier version of the ABA Model Nonprofit Corporation Act. *See* H.R. REP. NO. 1032, 87th Cong., 1st Sess. 2 (1961). The bill would update the 1962 Act with the 2008 revision of the ABA Model Nonprofit Corporations Act. The bill would also replace three archaic and seldom used statutes pertaining to particular organizations – *i.e.*, Chapter 6 (Institutions of Learning); Chapter 7 (Religious Societies); and Chapter 8 (Charitable, Educational, and Religious Associations). These statutes were originally enacted by Congress in 1870.

CHAPTER 5. PROFESSIONAL CORPORATIONS

Chapter 5 (Professional Corporations) would incorporate without substantive change the District’s current law on professional corporations, the “District of Columbia Professional Corporations Act,” which was enacted by Congress in 1971, and is codified in Chapter 4 of Title 29 of the D.C. Code. There are no model or uniform acts for professional corporations. The statute is fairly short because it only includes laws applicable to professional corporations and refers to the general business corporations act for topics not expressly covered. The bill integrates the statute into the hub-and-spoke structure of the Code.

CHAPTER 6. GENERAL PARTNERSHIPS

Chapter 6 (General Partnerships) would incorporate without substantive change the District’s current law, codified in Chapter 1 of Title 33 of the D.C. Code, which is an enactment of the Revised Uniform Partnership Act. This statute is the only business organization statute in the District that is up to date. The bill would integrate the statute into the hub-and-spoke structure of the Code.

CHAPTER 7. LIMITED PARTNERSHIPS

Chapter 7 (Limited Partnerships) would update the District's law in this area with the Revised Uniform Limited Partnership Act. Currently, the District has the original Uniform Limited Partnership (ULPA), which is codified in Chapter 2 of Title 33 of the D.C. Code. RULPA was completed by NCCUSL in 2001 to update ULPA in light of modern business practices and current IRS rulings. RULPA does not change the basic structure of limited partnerships as defined in ULPA but provides limited partnerships with more flexibility and serves the interests of partners and third parties conducting business with the partnership. RULPA includes provisions to meet the needs of sophisticated, manager-entrenched commercial deals whose participants commit for the long term, and also addresses the modern needs of estate planning arrangements, so-called "family limited partnerships." Whereas ULPA depends on the Uniform Partnership Act, RULPA is self-contained, providing comprehensive rules for limited partnerships. A fundamental change from ULPA involves the liability of limited partners and general partners for the partnership debts. Under ULPA a limited partner could be held liable for the entity's debts if he participated in the control of the business and the third-party transacted business with the partnership with the reasonable belief that the limited partner was a general partner. Under RULPA, a limited partner cannot be held liable for the partnership debts even if he participates in the management and control of the limited partnership. Concerning general partners, under ULPA, liability was complete, automatic, and formally inescapable. Under RULPA, limited liability limited partnership status is expressly available to provide a full liability shield to all general partners.

CHAPTER 8. LIMITED LIABILITY COMPANIES

Chapter 8 (Limited Liability Companies) would update the District's law in this area with the Revised Uniform Limited Liability Company Act (RULLCA). Chapter 8 would replace the District's first-generation limited liability company (LLC) law, enacted in 1994, with a fourth-generation LLC act, which would improve the District's law in a number of ways: (1) It better delineates the extent to which the LLC's operating agreement may define or alter aspects of fiduciary duty and authorizes it to relieve members and managers from liability for damages arising from breach of duty, subject to specific limitations. (2) It permits formation of LLCs by nonprofit organizations, which desire to use LLCs to hold real property, but which are not permitted to do so under current law. (3) It permits an organizer to pre-file a certificate of organization without a person "waiting in the wings" to become a member upon formation. (4) It rejects statutory apparent authority by position, under which a member may bind a member-managed – but not manager-managed – LLC because the management structure is not apparent from the LLC's name and because the rule is unsuitable to the needed flexibility of an LLC, and, instead, deals directly with the power of the LLC's participants to bind it. (5) It retains the manager-managed and member-managed structures as options for members to use in configuring their *inter se* relationship and the operating agreement as the vehicle by which the members chose the management structure. (6) It continues the charging order mechanism but clarifies the statutory language, including its protections against outside interference in an LLC's activities. (7) It permits a member to seek a court order dissolving the LCC for oppressive or harmful conduct, but does not permit a transferee to do so. (8) It includes provisions for special litigation committees, including provisions for judicial review. (9) In addition, the bill includes a provision authorizing "series LLCs," which permits a single LLC to offer a number of different investment opportunities.

CHAPTER 9. GENERAL COOPERATIVE ASSOCIATIONS

Chapter 9 (General Cooperative Associations) would incorporate the District’s current law on professional corporations, the which was enacted by Congress in 1940, and is codified in Chapter 9 of Title 29 of the D.C. Code. There is no model or uniform act for general cooperative associations. The District’s statute is fairly short because it only includes laws that apply to general cooperative associations and refers to the general business corporations act for topics not expressly covered. The bill does not make substantive changes to existing law but updates the language and integrates the statute into the hub-and-spoke structure of the Code.

CHAPTER 10. LIMITED COOPERATIVE ASSOCIATIONS

Chapter 10 (Limited Cooperative Associations) would enact the Uniform Limited Cooperative Association Act (ULCAA). It would permit the creation in the District of a new type of business entity, which is used by a variety of enterprises in other states. A limited cooperative association is a statutorily-defined entity that combines traditional cooperative values with modern financing mechanisms. A limited cooperative association may be organized to pursue any lawful purpose. ULCAA combines the cooperative value of individuals getting together to democratically own, run, and share in the benefit of their business with modern financing techniques. It builds on traditional law governing cooperatives, but recognizes a growing trend toward the “new generation cooperative,” which may include combinations of features not readily available under traditional law, such as legally binding delivery contracts or the opportunity for outside equity investment. It is more flexible than most current law, and provides a default template that encourages planners to utilize tested cooperative principles for a broad range of entities and purposes. It would permit formation of various types of limited cooperative associations, including marketing, advertising, bargaining, processing, purchasing, real estate, and worker-owned cooperatives.

CHAPTER 11. UNINCORPORATED NONPROFIT ASSOCIATIONS

Chapter 11 would update the District’s law in this area with the Revised Uniform Nonprofit Associations Act (RUNNAA) completed in 2008. Currently, the District has the original Uniform Unincorporated Nonprofit Association Act, which is codified in D.C. Code §§ 29-971.01 to 29-971.15. An unincorporated nonprofit association (UNA) is a default entity. Like a general partnership, which is the analogous default for-profit organization, a UNA is formed by the acts of persons coming together to engage in an activity. There are hundreds of thousands of UNAs in the United States including unincorporated nonprofit philanthropic, educational, scientific and literary clubs, sporting organizations, unions, trade associations, political organizations, churches, hospitals, and condominium and neighborhood associations. The District’s current statute deals with only a limited number of issues. The RUNNAA updates the original uniform act with respect to the following issues: (1) definition of the types of organizations covered; (2) the relation of the principles to other existing laws; (3) the recognition that a UNA is a legal entity and the legal implications flowing from this status, including the ability of a UNA to own and dispose of property and to sue and be sued in its own name; (4) the contract and tort liability of a UNA and its members and managers; (5) internal governance, fiduciary duties, and agency authority; and (6) dissolution and merger.

CHAPTER 12. STATUTORY TRUST ENTITIES

Chapter 12 (Statutory Trust Entities) would enact the Uniform Statutory Trust Entity Act (USTEA). It would permit the creation in the District of a new type of business entity in the District, which is the entity of choice for several categories of business transactions – namely, organization of mutual funds, asset securitization, and tax-advantaged real estate transactions. At least 30 states have statutes permitting such trusts. Currently, business trusts may be formed under the common-law. However, their use is limited because such a trust is not a juridical entity. It must sue, be sued, and transact in the name of an individual trustee in the trustee’s capacity as such. A statutory trust is a juridical entity separate from its trustees and beneficial owners, with the capacity to sue, be sued, and transact in its own name. Chapter 12 contains detailed provisions for the formation of statutory trust entities, their powers, the duties and responsibilities of the trustees, the rights of beneficiaries of the trust, and the dissolution and winding up of a statutory trust entity. In addition, the chapter authorizes the creation of “series” statutory trust entities, which permits the creation of a single statutory trust entity with a number of different investment opportunities.

OTHER PROVISIONS

The bill also contains comprehensive conforming amendments, which would repeal or amend laws replaced by this bill and which would update cross-references in other titles of the D.C. Code.