

THE DISTRICT OF COLUMBIA BUSINESS ORGANIZATIONS CODE IMPROVEMENTS OVER CURRENT DISTRICT LAW

A. Introduction

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District’s current laws concerning business organizations, codified in Titles 29 and 33 of the D.C. Code, are sorely out of date.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 District’s laws are not in tune with modern business practices. 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The Business Organizations Code (the “Code”) would replace these outdated laws with an enacted Title 29 of the D.C. Code that is comprehensive, up to date, and efficiently organized. The Code will encourage businesses to form in and remain in the District and will help make the District a national center for business.

B. Overview

The Code consists of 12 chapters. Ten chapters are based on up-to-date uniform or model acts developed by the Uniform Law Commission (“ULC”), the American Bar Association (“ABA”), or both organizations working jointly. These are Chapter 1 (General Provisions); Chapter 2 (Entity Transactions); Chapter 3 (Business Corporations); Chapter 4 (Nonprofit Corporations); Chapter 6 (General Partnerships); Chapter 7 (Limited Partnerships); Chapter 8 (Limited Liability Companies); Chapter 10 (Limited Cooperative Associations); Chapter Unincorporated Nonprofit Associations); and Chapter 12 (Statutory Trusts). The other two chapters, Chapter 5 (Professional Corporations) and Chapter 9 (General Cooperatives), retain current District law because there are no corresponding uniform or model acts.

The process by which these 10 uniform and model acts were developed was thorough and painstaking. It involved participation from practitioners, judges, consumers, and other stakeholders at the national level. These acts embody the best practices of the country in entity laws. Most of these acts are revisions of earlier versions of the acts based on developments in the law and the experience with these acts in the numerous states in which they have been enacted.

Uniformity and consistency among the laws of the jurisdictions in the United States is particularly important for business laws because many businesses operate in multiple jurisdictions. Moreover, these acts have been, or will be shortly, enacted widely

throughout the country. Thus, appellate decisions in other states on particular issues arising from these acts will provide guidance to the District of Columbia Courts if there are no local decisions on point. District lawyers, judges, and business owners and operators will benefit from the practical experience, judicial decisions, scholarly treatises and articles, and educational courses – all at the national level.

One of the distinct advantages of using uniform and model acts drafted by the ULC or ABA is that each section of each act is accompanied by detailed, official comments, which explain the need for and significance of the section and how the section interrelates with other sections of the act, other relevant laws, and business practices. In order to facilitate use of these official comments, parallel reference tables have been prepared, which match each provision of the Code with the corresponding section of each source uniform or model act.

In addition, because the Code is based on uniform and model acts, it will be easy for the Council to keep it up to date. The ULC and ABA have standing committees of experts that routinely develop amendments to respond to new business practices, changes in federal laws, and other significant legal developments. The District does not have the resources to develop such revisions by itself. Therefore, the Council will be able to maintain the Code with minimal burden by adopting amendments officially proposed by the ULC and ABA.

Finally, the fact that the Code will be an *enacted* title of the D.C. Code, will make it easy for the Council to maintain on the administrative level. Current Titles 29 and 33, which are not enacted into law, can be amended only by amending the corresponding provisions of underlying statutes, many of which are old and have undergone numerous revisions and additions, such as the 1901 Code. Having an enacted title makes the amendment process simple, clear, and certain.

C. The “Hub and Spoke” Structure

The Code is based on a “hub and spoke” structure, in which provisions common to all entities are placed in the first chapter (the “hub”) and the provisions applicable only to particular entities are placed in separate chapters (the “spokes”). The hub of the Code is Chapter 1 (General Provisions), which is based on the ABA/ULC Business Organizations Act, which was finalized in 2009. The hub-and-spoke structure has been successfully utilized in other business laws, notably the Uniform Commercial Code (“UCC”), which has been enacted by all states. Chapter 1 of the UCC contains general provisions applicable to all types of commercial transactions. *See* D.C. Code § 28:1-101 *et seq.* (2001).

Chapter 1 of the Code contains groups of provisions applicable to all entities namely:

- (1) Definitions of 50 generally applicable terms.
- (2) Administrative filing requirements.
- (3) Registration and reservation of entity names.
- (4) Registered agents
- (5) Foreign entities
- (6) Administrative dissolution

Placing these common provisions in one chapter avoids the need to repeat them in the chapters pertaining to individual entities. The hub-and-spoke structure results in a streamlined, consistent, user-friendly, and easily maintainable body of laws.

The “hub and spoke” approach is clearly the best practice for a comprehensive revision of a jurisdiction’s entity laws. Those states that have recently revised their business entity laws, or are in the process of doing so, use the same “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 Nonprofit Entities Act. Similar efforts are underway in Pennsylvania and Colorado.

Many provisions of Chapter 1 resulted from the active participation in the drafting process of the International Association of Commercial Administrators (“IACA”), a professional association for government administrators of business entity record systems, which includes the Department of Consumer and Regulatory Affairs (“DCRA”). Among the improvements directly resulting from IACA’s participation are:

- (1) Standard requirements for a biennial report to be filed by all filing entities.
- (2) A standard set of provisions applicable to all forms of entities that are required to designate in a public filing an agent for service of process.
- (3) Elimination of provisions designating the Mayor as the default agent for service of process. These provisions impose burdens on the District and rarely result in actual receipt of service, which is fundamental unfair. The Code substitutes the modern approach for serving entities in the federal and local rules of civil procedure, which permits service not only on an agent but any officer or manager of the entity. *See*

FED.R.CIV.P. 4(h); SUPER.CT.CIV.R. 4(a). The recipient of the service is likely to have the knowledge to whom the service should be passed on and the motivation to do so.

Another very useful provision, proposed D.C. Code § 29-102.09, makes the signing of a record the equivalent of an affirmation under oath, analogous to a declaration under penalties of perjury under 28 U.S.C. D.C. Code § 1746. This obviates the cumbersome requirement of notarization and enhances the efficiency of the filing process.

In addition, the requirement of a “registered office” has been eliminated as obsolete because the common practice today is for entities to use as their registered agents businesses whose principal activity is the provision of registered agent services, and thus the address of the registered agent has become divorced from any real connection with the business activities of the represented entity. Moreover, the Code expressly permits all entities, including nonfiling entities such as partnerships and unincorporated nonprofit associations, to appoint either a “commercial registered agent,” or a “noncommercial registered agent,” who may be simply an officer of the entity, like its general counsel, to receive any process, notice, or demand served on the entity.

D. Entity Transactions - Flexibility in Restructuring

Chapter 2 (Entity Transactions) authorizes mergers, conversions, interest exchanges, and domestications involving all entities in the Code. This permits entities to restructure, which may be critical for the entities’ survival. Current District law permits only *some* of these transactions by *some* of these entities. 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.

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 applies. Flexibility in entity transactions facilitates the restructuring of businesses respond to changing economic conditions.

E. Business Corporations

The District’s current business corporation act is antiquated. The act, codified in D.C. Code § 29-101.01 *et seq.* (2001), was enacted in 1954, and is based on the 1950 ABA Model Business Corporations Act (“MBCA”). There have been a few amendments to the act over the years to address discrete issues. However, although the ABA has revised the MBCA laws several times, the District did not adopt any of these revisions. The most recent revision was completed by the ABA in 2008. Thirty-three states have

adopted a more recent version of the MBCA than the 1950 MBCA, on which the District's current law is based.

Chapter 3 (Business Corporations) would enact the 2008 MBCA and integrate it into a hub-and-spoke structure. The improvements over the District's current business corporations law are numerous. Among the provisions updated are those related to:

- (1) liability for unlawful distributions;
- (2) directors' conflicting interest transactions;
- (3) directors liability limitation;
- (4) derivative proceedings;
- (5) non-public corporations;
- (6) indemnification;
- (7) shareholder meetings and voting;
- (6) electronic filings;
- (7) standards of conduct and liability for directors;
- (8) standards of conduct for officers;
- (9) inspection rights and notices;
- (10) appraisal rights;
- (11) requirements for fundamental changes;
- (12) corporate governance;
- (13) dissolution;
- (14) extrinsic facts and terms of shares and options;
- (15) domestication;
- (16) the role and responsibilities of directors, including qualified directors;
- (17) the functions of officers;
- (18) director's conflicting interest transactions; and
- (19) business opportunities.

Whereas current District corporation law was drafted before the age of computers, the Code brings the law with respect to corporations and other entities law up to date with the e-mail and the Internet. It broadly validates the use of electronic technology, and uses current terminology consistent with the Uniform Electronic Transactions Act, which the District adopted recently, D.C. Code §§ 28-4901 to 28-4918 (Supp. 2009).

Updating the District's business corporation law, will also update the District's laws governing two specialized types of corporations – professional corporations, D.C. Code § 29-401 *et seq.* (2001) (included in Chapter 5 of the Code), and general cooperative associations, D.C. Code § 29-901 *et seq.* (2001) (included in Chapter 9 of the Code). The District's laws pertaining to these entities are built on the foundation of the general business corporations law and contain a relatively small number of provisions pertinent to these specific types of corporations. The Code integrates the District's existing laws pertaining to these two subtypes of entities into the hub-and-spoke format.

F. Nonprofit Corporations

The District's nonprofit corporations act, D.C. Code § 29-301.01 *et seq.* (2001), is similarly antiquated. It was enacted in 1962, and is based on the 1952 ABA Model Nonprofit Corporations Act ("MNCA"). In addition, the District has three specialized nonprofit corporation laws, enacted originally in 1870, and codified in the 1901 Code, on institutes of learning; religious societies; and charitable, educational, and religious associations. D.C. Code § 29-601 *et seq.*, 29-701, *et seq.*, 29-801, *et seq.* (2001).

The ABA has updated the MNCA twice, most recently in 2008. Twenty-four states have adopted a more recent version of the MNCA than the 1952 Act, which is the current law of the District. Among the improvements in Chapter 4 are the following:

(1) It provides a comprehensive treatment of charitable corporations.

(2) It has special provisions on religious nonprofit corporations. It recognizes the role of canon law (§ 29-401.20). Directors and officers may rely on religious authorities (§§ 29-406.30(f)(4), 29-406.42(c)(3)). A receiver may not be appointed for corporation engaged in religious activity (§ 29-412.22(f)). A corporation engaged in religious activity may limit rights of members to demand financial information (§ 29-414.10(a))

(3) It permits the establishment of "designated bodies," which are defined as "a person or group, other than a committee of the board of directors, that has been vested by the articles of incorporation or bylaws with powers that, if not vested by the articles or bylaws in that person or group, would be required by this chapter to be exercised by the board or the members." § 29-401.02(8). Some, but less than all, the powers, authority or functions of the board may be vested in a designated body; and if that is done: (1) laws relating to the board of directors apply to the designated body; (2) the directors are relieved from their duties and liabilities to the extent they have been replaced by a designated body; and (3) members of the designated body are entitled to indemnification and exoneration from liability. (§ 29-406.12). Permitting nonprofit corporations to create designated bodies gives them considerable flexibility to provide alternative governance arrangements and to delegate responsibilities within the corporation.

(4) It eliminates cumulative voting because it is unnecessary for nonprofits and potential disruptive, but grandfathers in existing provisions in bylaws.

(5) It provides comprehensive and modern provisions concerning liability of directors, including an automatic liability shield for directors of charitable corporations and an optional liability shield available for directors of other corporations, and indemnification provisions following the MBCA.

(6) It broadly validates the use of electronic technology for operations and transactions..

In addition, Chapter 4 incorporates the recent revisions in Nonprofit Organizations Oversight Improvement Amendment Act of 2007 to the extent that it does not already contain similar provisions.

Three additional sections will be proposed to Chapter 4 at the hearing – one to add a section that was inadvertently omitted and two to retain useful provisions of existing law enacted by the Council.

(1) A new § 29-401.05 (Restrictions and required approvals) is based on § 9.03 of the MNCA. It provides that a nonprofit corporation may not sell its assets without approval of the Attorney General or other pertinent District official or agency and provides that property dedicated to a charitable purpose may not be diverted from its purpose without an appropriate order of the Superior Court specifying the disposition of the property to the extent required by and pursuant to the law of this state on *cy pres* (a doctrine under which charitable property that can no longer be applied to its original purpose may be applied to a similar charitable purpose) or otherwise dealing with the nondiversion of charitable assets.

(2) A new Subpart H (Limitations on Liability of Volunteers and Employees), including § 29-406.80 (Immunity from civil liability for a volunteer of the corporation) and § 29-406.81 (Limited liability for an employee of the corporation), continues current law. D.C. Code §§ 29-301.113, 29-301.114 (2001). These sections were added to the District's nonprofit corporations act by the Council in 1993 (D.C. Law 9-222). They are common additions to the MNCA in other state nonprofit corporation statutes.

G. Partnerships - General and Limited

Current District laws pertaining to unincorporated entities are out of date, with the sole exception of the laws pertaining to general partnerships. The District's partnership law, an enactment of the Revised Uniform Partnership Act, D.C. Code § 33-101.01 *et seq.* (2001), is integrated into the hub-and-spoke format of the Code, as Chapter 6 (General Partnerships), without substantive change.

Chapter 7 (Limited Partnerships) updates the District' law in this area with the Revised Uniform Limited Partnership Act. Currently, the District has the original 1985 Uniform Limited Partnership (ULPA), D.C. Code § 33-201.01 *et seq.* (2001). 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 the limited partner 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 the limited partner 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.

H. Limited Liability Companies

More limited liability companies (LLCs) are now being formed each year in the country than corporations. As LLCs have increased in economic importance, the law in this area has rapidly evolved. The District’s LLC law, D.C. Code § 29-1001 *et seq.* (2001), enacted 15 years ago, is now considerably out of date.

Chapter 8 (Limited Liability Companies) replaces the District’s LLC law with a fourth-generation LLC act. Among the improvements are the following:

(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. This is an extremely important practical benefit to nonprofits in the District.

(3) 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.

(4) 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.

(5) It continues the charging order mechanism, in which a creditor can satisfy a judgment with an income stream from a member of an LLC, but clarifies the statutory language, including its protections against outside interference in an LLC's activities.

(6) It permits a member to seek a court order dissolving the LLC for oppressive or harmful conduct, but does not permit a transferee to do so.

(7) It includes provisions for special litigation committees, including provisions for judicial review.

(8) It includes a provision authorizing "series LLCs," which permits a single LLC to offer a number of different investment opportunities.

I. Unincorporated Nonprofit Associations

An unincorporated nonprofit association (UNA), like a general partnership, is a "non-filing entity," whereas all other entities are "filing entities." A filing entity may be formed only by filing the appropriate documents with the appropriate governmental office, in the District's case, DCRA's Corporations Division, and paying the requisite fees. A nonfiling entity, however, is formed by the agreement or conduct of the members to engage in an activity – the general partners or the members of a UNA. The only difference between a partnership and a UNA IS that the latter is nonprofit and the former is for-profit.

Chapter 11 (Unincorporated Nonprofit Associations) updates the District's law in this area with the 2008 Revised Uniform Nonprofit Associations Act. Currently, the District has the original Uniform Unincorporated Nonprofit Association Act, D.C. Code §§ 29-971.01 *et seq.* (2001). 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. Chapter 11 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.

J. Filling Voids in the District’s Entity Laws

The District’s law pertaining to entities is not only out of date; it is incomplete. In addition to updating the laws pertaining to entities recognized by existing District law, the Code authorizes formation of two new unincorporated entities, which are utilized in other states for various commercial enterprises, but which are not recognized by current District law – limited cooperative associations and statutory trusts.

1. Limited Cooperative Associations

Chapter 10 (Limited Cooperatives) enacts the 2007 Uniform Limited Cooperative Association Act and integrates it into the hub-and-spoke structure. This chapter authorizes 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.

Chapter 10 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.

2. Statutory Trusts

Chapter 12 (Statutory Trusts) enacts the 2009 Uniform Statutory Trust Entity Act and integrates it into the hub-and-spoke structure. This chapter permits the creation in the District of a new type of business entity, 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. Under the Code, 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.

CONCLUSION

In conclusion, the Code will replace the District’s antiquated and incomplete hodgepodge of business entity laws with a state-of-the art Code, which will bring this critical body of the District’s laws into the 21st Century to the benefit of District businesses and residents.

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