

## DOCUMENT RETENTION REQUIREMENTS TO BEWARE AS YOUR REAL ESTATE BROKER CLIENTS CONVERT TO DIGITAL FILING

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As real estate brokers move towards implementing digital filing regimes, they should obtain legal advice on what documents must be retained in their original, paper form. Of particular concern will be whether originals of organizational documents and real estate transactional documents must be retained. Document retention rules found in Virginia laws governing the organization and operation of business entities,<sup>1</sup> and document retention rules for real estate brokers specifically, tend to vacillate between, if not ignore, whether the document retained must be an original or may be a copy. Moreover, none of these laws or regulations attempts to address the preservation of these documents in electronic form. Instead, one is relegated to trying to discern the effect of Virginia's adoption of the Uniform Electronic Transactions Act, § 59.1-479, *et seq.*, on the document retention requirements applicable to real estate brokers set forth in other titles of the VIRGINIA CODE and in the Virginia Real Estate Board's regulations.

### I. IMPACT OF UNIFORM ELECTRONIC TRANSACTIONS ACT

The impact of the adoption by Virginia of the Uniform Electronic Transactions Act (VA. CODE § 59.1-479, *et seq.*) (herein "UETA") has yet to be clearly delineated. UETA applies to "electronic records and electronic signatures relating to a transaction." VA. CODE § 59.1-481(a). According to Official Comment 2 to § 59.1-481, "[t]his Act affects the medium in which the information, records and signatures may be presented and retained under current legal requirements." Similarly, Official Comment 1 to § 59.1-484 states: "The purposes and policies of this Act are: (a) to facilitate and promote commerce and governmental transactions by validating and authorizing the use of electronic records . . . ." Thus, among the purposes of UETA is to modify current legal requirements in other laws governing record retention (which would appear to encompass the document retention requirements for business entities and, in particular, real estate brokers) to authorize the use of electronic records.

This indication is reinforced by UETA's definition of the term "transaction" as "an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs." VA. CODE § 59.1-480(16). Official Comment 12 to § 59.1-480(16) elaborates on the definition of "transaction," stating "[t]he term includes *all interactions* between people for business, commercial, including specifically consumer, or governmental purposes" (emphasis added). At least some of the documents required by business entities to be maintained at their principal or specified office are almost surely included among these interactions; partnership and operating agreements being the most obvious examples. However, other documents required to be maintained may not relate to a "transaction" due to the absence of more than one party, such as in the case of unilateral acts like a single organizer or incorporator organizing a business entity, or the operating agreement of a single-member limited liability company, in which event UETA would not pertain to their retention at all. The result, unfortunately, is a crazy-quilt patchwork of applicability.

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<sup>1</sup> This article does not seek to address any document retention requirements found in state or federal tax or securities laws.

Turning specifically to electronic record-keeping, UETA provides, “If a law requires that a record be retained, the requirement is satisfied by retaining an electronic record of the information in the record which: (1) accurately reflects the information set forth in the record at the time and after it was first generated in its final form as an electronic record or otherwise; and (2) remains accessible for later reference.” VA. CODE § 59.1-490(a). Official Comment 1 to § 59.1-490(a) elaborates: “So long as there exists reliable assurance that the electronic record accurately reproduces the information, this section continues the theme of establishing *the functional equivalence of electronic and paper-based records*. . . . This section assures that information stored electronically will remain effective for all audit, evidentiary, *archival* and similar purposes (emphases added).” The third paragraph of Official Comment 3 to § 59.1-490(a) then addresses the ultimate question for the digitization of records:

This section permits parties to convert original written records to electronic records for retention so long as the requirements of subsection (a) are satisfied. Accordingly, *in the absence of specific requirements to retain written records*, written records may be destroyed once saved as electronic records satisfying the requirements of this section (emphasis added).

Because Official Comment 3 limits its authorization of the destruction of original written records after their conversion to electronic records with the qualifier, “in the absence of specific requirements to retain written records,” one must turn back to the substantive law provisions beyond UETA, governing the organization and operation of business entities and, specifically, real estate brokers, to see where “specific requirements to retain written records” may exist. Also, one must always remember that since UETA only applies to “electronic records . . . relating to a transaction,” and some of the records required to be retained by other substantive laws or regulations derive from unilateral acts, then those records do not relate to “a transaction” and thus the authority for their digital preservation cannot derive from UETA. So, in the absence of a definitive answer in UETA, we must examine the specific substantive document retention requirements for real estate brokers found elsewhere in the VIRGINIA CODE and the Virginia Real Estate Board’s regulations.

## II. LLC ORGANIZATIONAL DOCUMENTS

Under VIRGINIA CODE § 13.1-1028.A, the following documents must be kept *at the principal office of a limited liability company* (emphasis added):

1. A current list of the full name and last known business address of each member, in alphabetical order;
2. A copy of the articles of organization and the certificate of organization, and all articles of amendment and certificates of amendment thereto;
3. Copies of the limited liability company's federal, state and local income tax returns and reports, if any, for the three most recent years;
4. Copies of any then-effective written operating agreement and of any financial statements of the limited liability company for the three most recent years; and
5. Unless contained in a written operating agreement [*which would typically be the case*], a writing setting out:
  - a. The amount of cash and a description and statement of the agreed value of the other property or services contributed by each member and which each member has agreed to contribute;

- b. The times at which or events on the happening of which any additional contributions agreed to be made by each member are to be made;
- c. Any right of a member to receive, or of the limited liability company to make, distributions to a member which include a return of all or any part of the member's contribution; and
- d. Any events upon the happening of which the limited liability company is to be dissolved and its affairs wound up. (emphasis added)

Significantly, neither Section 13.1-1028 nor any other provision of the Virginia Limited Liability Company Act dictates in what medium these records must be retained. VIRGINIA CODE § 13.1-1028.B., however, does confer on members the right to inspect and copy any of the foregoing records. While the member's right to inspect and copy is not inconsistent with digital filing, unless a record relates to a "transaction" under UETA, it would be wise to retain paper originals of these mandated records where there are originally signed documents, and at least a paper photocopy of any mandated records which do not bear signatures. A multi-party operating agreement would likely qualify as a "transaction" under UETA, and thus could be stored digitally, but other documents mandated to be retained, such as articles of organization or income tax returns, should be retained without reference to UETA's provisions.

The foregoing documents are required to be kept at the *principal office of the LLC*. In cases where the real estate brokerage firm is managing properties for third parties, the principal office may not be the broker's office, but may instead be at the third party's office, or even some other location. Care must be taken to determine in these cases, by looking at the LLC's Articles of Organization, whether the principal office of the LLC is at the broker's office, or elsewhere. Often, the location of the principal office of the LLC is a function of whether the real estate broker is managing the affairs of the LLC, by hosting its principal office, or merely providing property management services to a real estate development owned by the LLC. In the latter case, where the principal office of the LLC is elsewhere and the broker is merely the property manager, to the extent the broker possesses documents listed above and wishes to retain them, it may certainly keep them digitally.

### III. LIMITED PARTNERSHIP ORGANIZATIONAL DOCUMENTS

Very similar to the LLC statute, under VA. CODE § 50-73.8, the following documents must be kept at the *specified office of a limited partnership* (the same concept as the principal office of an LLC):

1. A current list of the full name and last known business address of each partner, separately identifying the general partners in alphabetical order and the limited partners in alphabetical order;
2. A copy of the certificate of limited partnership and all certificates of amendment thereto, together with executed copies of any powers of attorney pursuant to which any certificate has been executed;
3. Copies of the limited partnership's federal, state and local income tax returns and reports, if any, for the three most recent years;
4. Copies of any then-effective written partnership agreements and of any financial statements of the limited partnership for the three most recent years; and

5. Unless contained in a written partnership agreement [*which would typically be the case*], a writing setting out:

- a. The amount of cash and a description and statement of the agreed value of the other property or services contributed by each partner and which each partner has agreed to contribute;
- b. The times at which or events on the happening of which any additional contributions agreed to be made by each partner are to be made;
- c. Any right of a partner to receive, or of a general partner to make, distributions to a partner which include a return of all or any part of the partner's contribution; and
- d. Any events upon the happening of which the limited partnership is to be dissolved and its affairs wound up.

Like in the Virginia Limited Liability Company Act, neither Section 50-73.8 nor any other provision of the Virginia Revised Uniform Limited Partnership Act dictates in what medium these limited partnership records be retained. VIRGINIA CODE § 50-73.8.B., however, does confer on partners the right to inspect and copy any of the foregoing records. While the partner's right to inspect and copy is not inconsistent with digital filing, unless a record relates to a "transaction" under UETA, it would be wise to retain paper originals of these mandated records where there are originally signed documents, and at least a paper photocopy of any mandated records which do not bear signatures. A partnership agreement (by definition a multi-party document) would likely qualify as a "transaction" under UETA, and thus could be stored digitally, but other documents mandated to be retained, such as income tax returns, should be retained without reference to UETA's provisions. Similarly, care should be taken (just like with the third-party LLCs, above) to determine whether the specified office of the limited partnership is at the real estate broker's office, or at some other location; and the same document retention analysis used for third-party LLCs, above, applies to third-party limited partnerships.

#### **IV. GENERAL PARTNERSHIP ORGANIZATIONAL DOCUMENTS**

There are no provisions in the Virginia Uniform Partnership Act (VA. CODE § 50-73.79 through 50-73.150) mandating any specific records be kept for a general partnership. However, it would seem prudent to apply the same standards for general partnerships as are mandated for limited partnerships.

#### **V. CORPORATIONS**

Pursuant to VIRGINIA CODE § 13.1-770 and § 13.1-661.B., corporations must keep *as permanent records* the items listed below:

1. A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.
2. A corporation or its agent shall maintain a record of its shareholders, in a form that permits preparation of a list of the names and addresses of all shareholders, in alphabetical order by class and series, if any, of shares showing the number and class and series, if any, of shares held by each. However, the foregoing shall not require the corporation or its agent to maintain, as part of such record of shareholders, beneficial owners whose shares are held by a nominee on the shareholder's behalf except to the

extent that the corporation has established and maintains a procedure for registration of such rights. The current list of shareholders must be capable of being produced for inspection by shareholders during the 10 days prior to, and at, any shareholders' meeting (annual or special).

In addition, corporations, under VIRGINIA CODE § 13.1-770, must keep *copies* of the following records:

3. All appropriate accounting records.
4. Its articles or restated articles of incorporation, all amendments to them currently in effect . . . ;
5. Its bylaws or restated bylaws and all amendments to them currently in effect;
6. All written communications to shareholders generally within the past three years, including the financial statements furnished for the past three years . . . ;
7. A list of the names and business addresses of its current directors and officers; and
8. Its most recent annual report delivered to the Commission. . . .

While the location for these records' retention is not specified, VIRGINIA CODE § 13.1-771 grants shareholders the right to inspect the foregoing documents *at the corporation's principal office* upon five business days' written notice, so it would seem prudent to keep the above-listed documents at the corporation's principal office, or else be prepared to have a third party who has the documents (typically the registered agent) furnish the documents within five business days (which ought not to be a problem). VIRGINIA CODE § 13.1-770.D. does offer corporations a nod in the direction of UETA, stating as a general principle, "[a] corporation shall maintain its records in written form or in another form capable of conversion into written form within a reasonable time."

Lest you consider that language to be *carte blanche* to store *all* corporation records digitally, I would consider the injunction to retain *as permanent records* those documents listed in Item 1 to require that those documents (which generally do not relate to a transaction and thus do not fall within the purview of UETA) be retained in their original paper form, even if the other records are retained digitally. It is a close call whether some of the records in Items 2 through 8, above, are records "relating to a transaction" which may be stored electronically under UETA. But even if some of them do not "relate to a transaction," electronic storage of those records should be permissible, based on the authority of VA. CODE § 13.1-770.D, quoted in the preceding paragraph.

## **VI. VIRGINIA REAL ESTATE BROKERAGE LAW AND VIRGINIA REAL ESTATE BOARD REGULATIONS**

The law and regulations governing real estate brokers mentions two categories of documents that must be preserved:

***Brokerage Disclosures for Executed Purchase Contracts.*** VIRGINIA CODE §§ 54.1-2131 through 54.1-2134 require real estate brokers representing buyers, sellers, landlords and tenants to disclose to the opposing party their brokerage relationship, and pertaining to such disclosures, VIRGINIA CODE § 54.1-2138.D mandates that, "[c]opies of any disclosures relative to fully executed purchase contracts shall be kept by the licensee for a period of three years as proof of having made such disclosure, whether or not such disclosure is acknowledged in writing by the

party to whom such disclosure was shown or given.” Interestingly, the statutory three-year document retention requirement applies only to brokerage disclosures that led to executed purchase contracts; the statute fails to address the retention of brokerage disclosures which led to executed leases. However, this apparent omission is corrected in VREB regulations governing financial record keeping (see next paragraph).

**Financial Records.** While no statute expressly addresses the maintenance or preservation of financial records, VREB Regulation 18 VAC 135-20-185.A does mandate that “a complete record of financial transactions conducted under authority of the principal broker’s Virginia license shall be maintained in the principal broker’s place of business or in a designated branch office.” As to the preservation of financial records (a loosely used term in the regulation), VREB Regulation 18 VAC 135-20-185.C specifically labels as “improper record keeping”:

1. Failing, as a principal or supervising broker, to retain for a period of three years from the date of the closing or ratification, if the transaction fails to close, a complete and legible copy of each disclosure of a brokerage relationship, and each executed contract, agreement, and closing statement related to a real estate transaction, in the broker's control or possession, unless prohibited by law;
2. Having received moneys on behalf of others and failed to maintain a complete and accurate record of such receipts and their disbursements for a period of three years from the date of the closing or termination of a lease or conclusion of the licensee's involvement in the lease. . . .

Thus, the real estate broker must retain for three years disclosures of brokerage relationships *of all types* (including those relating to lease transactions) under the regulation, notwithstanding that the comparable statute is limited to only purchase contracts. In addition, the regulation mandates the real estate broker also retain for three years “all contracts, agreements and closing statements,” which is broad enough to include leases, listing agreements, commission agreements and the like. Finally, the broker must retain all records of receipts and disbursements for three years from the date of the real estate closing or, in the case of leases, *for three years from the termination of the lease or the conclusion of the real estate broker's involvement in the lease* (NOT from the date the lease is signed or the rent commencement date).

VREB Regulation 18 VAC 135-20-185 is not as clear or consistent, however, on the method of retention of these documents. Both VA. CODE § 54.1-2138.D and VREB Regulation 18 VAC 35-20-185.C.1 clearly state that the brokerage disclosure documents can be “copies,” which would permit digital filing of them. However, VREB Regulation 18 VAC 135-20-185.C.1 does not make it clear whether its use of the word “copy” preceding the reference to brokerage disclosures also extends to executed contracts, agreements and closing statements, or whether the original, executed document must be retained and preserved. Harkening back to Official Comment 3 to § 59.1-490(a), we are told, “*in the absence of specific requirements to retain written records*, written records may be destroyed once saved as electronic records satisfying the requirements of this section” (emphasis added). Even though executed contracts, agreements and closing statements clearly are records which relate to a transaction (thereby invoking UETA), given the possible interpretation that the word “copy” in VREB Regulation 18 VAC 135-20-185.C.1 only related to the brokerage disclosures, and not to the executed contracts, agreements and closing statements, one must err on the side of caution and advise that the original executed contracts, agreements and closing statements, even if stored electronically, must also be retained in their original paper form for three years.

Finally, as to the retention of records of receipts and disbursements for three years pursuant to VREB Regulation 18 VAC 135-20-185.C.2, since such records are routinely kept

electronically, and can be printed out on demand, the retention of *paper* copies for three years is not required. Clearly, these records relate to a transaction and fall within UETA. However, as licensees may be required by VREB to produce any record required to be retained within ten (10) days of demand (see VREB Regulation 18 VAC 135-20-240), it is essential that any record stored electronically be readily accessible, even after an upgrade of accounting or computer systems or software may render a prior retention system obsolete.

## **VII. CONCLUSION**

Virginia's business and real estate laws and regulations have yet to fully embrace the flexible document retention policies necessary for a digitized 21<sup>st</sup> Century real estate brokerage office, but there are signs of movement in the right direction. In the meanwhile, however, real estate brokers contemplating digitized records storage must pay careful attention to which documents must be preserved as paper originals. If real estate brokers find drawing such distinctions to be impractical, they and their attorneys should encourage the General Assembly and the Virginia Real Estate Board to re-examine the applicable document retention requirements, with an eye towards affording greater flexibility to real estate brokers in the selection of document storage method, and clarification as to when the permission to use electronic record storage afforded under UETA applies to the records they must retain.