Business Law Update

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Contents

Federal Legislative Developments

New Beneficial Ownership Information Reporting Requirements for Business Entities Under the Federal Corporate Transparency Act (CTA), 33 U.S.C. § 5336

Beginning on January 1, 2024, the CTA will require many companies in the United States to report information about their beneficial owners, i.e., the individuals who ultimately own or control the company. Reporting companies will have to provide the information to the Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of the Treasury. The CTA is being implemented through regulations that were finalized by the Treasury Department in 2022. *See* 31 CFR § 1010.380.

Overview of CTA Requirements:

- The CTA was passed and is being implemented to combat money laundering and other illicit activities through shell corporations and similar entities. The CTA requires a "Reporting Company" to disclose certain basic company information (e.g., name, business address, jurisdiction of formation, tax i.d. number), as well as "Beneficial Ownership Information" (BOI), described below, in reports filed with FinCen through an electronic interface.

- "Reporting Companies" under the CTA include entities that are created or registered by filing a document with a secretary of state or similar offices at the state level. Reporting Companies thus include corporations, LLCs, LLPs, LLLPs, and non-profit corporations, but not general partnerships or sole proprietorships.

- An entity that otherwise qualifies as a Reporting Company does not need to file reports under the CTA *if* the entity meets the requirements for an exemption from reporting. Exempt entities generally include heavily regulated business entities or large operating companies, and non-profits that are tax exempt under IRC § 501(c)(3). The vast majority of private businesses, and many non-profit businesses, will NOT qualify for an exemption.

- A Reporting Company's BOI must cover the following persons, all of whom are caught by the "Beneficial Owner" definition:

  (1) individuals who own or control at least 25% of the company's ownership interest;
  (2) individuals who exercise "substantial control" over the company, like the CEO, CFO, COO, and general counsel;
  (3) individuals who hold the power to appoint or remove a majority of the company's governing board or senior officers; and
  (4) individuals who direct, determine, or have substantial influence over important decisions made by the Reporting Company, like organic transactions, major expenditures, issuance of debt or equity, and approval of the Reporting Company's operating budget.

- Specified personal identifying information included in BOI must include each Beneficial Owner's name, date of birth, physical residence address, and unique identifier number from a recognized issuing jurisdiction (e.g., driver's license or passport) and a photo of that document.

- For Reporting Companies formed on or after January 1, 2024, BOI must also be reported for "Company Applicants" (i.e., incorporators and organizers), including those who directed the formation filing. In the case of a Company Applicant, however, a business address may be provided rather than a residential address.

- BOI in the reports filed with FinCen will not be publicly available, but will be accessible by federal and state law enforcement agencies.

- A Reporting Company or a Beneficial Owner for whom BOI must be reported can provide the necessary information to FinCen through a registration process that results in a FinCen Identifier, which can then be used in lieu of BOI for reporting purposes.

- A Reporting Company formed on or after January 1, 2024 will have 30 days to file the intial report with FinCen.

- A Reporting Company in existence on January 1, 2024 will have one year (i.e, all of calendar year 2024) to file the intial report.

- After an initial report is filed, a Reporting Company must promptly (i.e., within 30 days) file updates with FinCen if relevant information changes.

- There are civil and criminal penalties for non-compliance.

The above summary is by no means a complete description of the CTA's requirements. Helpful resources include:

- FinCEN's BOI Webpage: https://www.fincen.gov/boi
  FinCEN's Small Business Resources: https://www.fincen.gov/boi/small-business-resources
  FinCEN's Reference Materials: https://www.fincen.gov/boi/Reference-materials
  FinCEN's Small Entity Compliance Guide: Small Entity Compliance Guide | FinCEN.gov
  FinCEN's Frequently Asked Questions resource: Beneficial Ownership Information Reporting | FinCEN.gov

- Many published articles are available on-line. *See, e.g.*, William E. Quick, *The Corporate Transparency Act: Deniers Beware*, BUSINESS LAW TODAY, July 10, 2023

Iowa Legislative Developments

1. **HF 655** amends Iowa Code Ch. 489 (Iowa's Revised Uniform Limited Liability Company Act) to conform substantially to the 2013 edition of the ULC's Uniform Limited Liability Company Act.

   - For detailed information, see the Appendix to this Outline—a 30-slide Powerpoint presentation authored by David Walker and Bill Boyd (hereafter *Appendix Slides _*).

   - The LLC materials in my *Iowa Practice—Business Organizations* volumes for 2023-24 (forthcoming from Thomson Reuters and available now on Westlaw) also reflect HF 655's revisions to Ch. 489.

   - History of Iowa's LLC Laws and Importance of LLCs *See Appendix Slides 2-9.*

     - Ch. 490A *1992-2008*
     - Ch. 489 (based on RULLCA 2006) *2009-2023*
     - Ch. 489 as amended by HF 655 (based on ULCCA 2013) *2024-?*

   - Overview of Ch. 489 as amended by HF 655

     - Substantial continuity from Ch. 489 as enacted in 2008
     - New definitions and some re-numbering
     - Better coordination with IBCA and other entity acts
     - A few key changes (see below)

   - Key Changes to Ch. 489

     - New definitions and/or re-numbering include several critical concepts, like the "Operating Agreement" (OA). The OA definition is unchanged but is now in § 489.102(19).

     - Permissible OA variations and other rules on the effect of OAs are now in §§ 489.105-489.107. The revised provisions reflect a modest increase in flexibility for terms that may be included in OAs. *See Appendix Slides 13-15.*

     - The "Registered Office" concept disappears for Iowa LLCs and is replaced by a requirement that the LLC's "Registered Agent" must have a place of business in Iowa.

     - The "Duty of Care" in an LLC is modified to require the fiduciary to *"refrain from engaging in grossly negligent or reckless conduct, willful or intentional misconduct, or knowing violation of law."* The new language reflects a relaxation of the duty of care from the former version of Ch. 489, which used "ordinary care" language. However, the

former "ordinary care" standard was explicitly subject to a statutorily-defined "business judgment rule" that afforded substantial discretion to fiduciaries. *See Appendix Slide 18.*

- Charging order rules in § 489.503 now provide that if a charging order is foreclosed against a membership interest in a sole-member LLC, the purchaser at the foreclosure sale succeeds to the member's management rights, as well as to the member's economic interests. *See Appendix Slide 21.*

- "Administrative dissolution" is added as an event of dissolution in § 489.701 *(see Appendix Slide 24).*

- Although § 489.701(d) still includes authority for judicial dissolution of an LLC on the basis of "oppression," transferees may no longer invoke that remedy.

- There are two new important rules regarding LLC derivative suits. *See Appendix Slides 25-26.*

  - Under § 489.802 (formerly § 489.902) derivative suits are now subject to a "universal" demand rule *with no "futility" exception*.

  - Under new § 489.806 an LLC may establish a "Special Litigation Committee" (SLC) in response to a derivative suit. While an LLC's OA may not modify § 489.806's requirements for a valid SLC, the OA may provide that the LLC may not appoint an SLC.

- Rules for foreign LLCs are now in Part 9 of Ch. 489 and substantially conform to foreign corporation registration provisions in the IBCA. Rules for merger, conversion, and domestication transactions involving LLCs remain in Part 10 of Ch. 489 but now include "interest exchange" transactions and track parallel provisions in Parts 9 and 11 of the IBCA. *See Appendix Slide 27.*

2. **HF 352** *establishes a state and local tax limit workaround that would allow certain individual income taxpayers (owners of partnerships and S Corporations who make a voluntary election) to pay an Iowa income tax through their pass-through partnership or S Corporation.*

3. **HF 553** *allows a "covered entity," as defined by the legislation, to establish an affirmative defense to a tort claim alleging failure to implement reasonable information security controls resulted in a data breach concerning personal or restricted information.*

4. **HF 675** *amends Iowa's Uniform Money Services Act to become the Uniform Money Transmission Modernization Act.*

Case Law Developments

Federal Decisions:

1. **Mallory v. Norfolk S. Ry. Co., 600 US 122, 143 S.Ct. 2028 (2023)**, turned away a Due Process challenge to a Pennsylvania statute that subjects out-of-state corporations that register to do business in Pennsylvania to general jurisdiction. As summarized in an on-line Supreme Court Business Docket report by Wachtell, Lipton, Rosen & Katz:

   The Court, in an opinion authored by Justice Gorsuch and joined by Justices Thomas, Alito (in part), Sotomayor, and Jackson, grounded its analysis in a pre-International Shoe precedent from 1917, which it deemed controlling, and the notion that registering foreign corporations effectively "consented" to personal jurisdiction—a waivable defense, after all. The immediate implications of the decision of Mallory are limited, as Pennsylvania's statutory scheme, at the moment at least, stands alone in its breadth. But as Justice Barrett warned in dissent, "[i]f States take up the Court's invitation to manipulate registration," the Court's general jurisdiction precedents—which generally limit such all-purpose jurisdiction to a corporation's state of incorporation and principal place of business—"will be obsolete."

   Whether Justice Barrett's forecast comes to pass will also depend on whether statutes like Pennsylvania's can survive a challenge under the dormant Commerce Clause. In a notable concurrence providing the Court's fifth vote, Justice Alito explained that while he could not agree that the Pennsylvania statute violated the defendant corporation's Due Process rights, "there is a good prospect" it violates the dormant Commerce Clause's implied restrictions on discriminating against out-of-state corporations and unduly burdening interstate commerce. Such challenges are likely to gain traction in light of Justice Alito's concurrence, particularly if other states follow in Pennsylvania's footsteps.

2. **BH Mgmt. Serv., LLC v. B.H. Prop., LLC, 2022 WL 18780124 (S.D. Iowa 2022)**, applied Iowa piercing / alter ego tests and concluded that, under those tests, a corporate subsidiary's contacts in Iowa did not subject the subsidiary's parent to personal jurisdiction in Iowa.

   The Iowa Federal District Court acknowledged that Iowa alter ego analysis *could be* applied to determine whether a corporate parent has so controlled the affairs of its subsidiary that the parent should be subject to personal jurisdiction based on its subsidiary's activities. The court also correctly noted that under Iowa piercing analysis, the following factors are relevant to piercing:

   > Undercapitalization, failure to keep separate books and finances, failure to observe corporate formalities, use of the corporation to commit fraud or illegality, and other

evidence that the corporation "is a mere sham." [Citing Cemen Tech, Inc. v. Three D Indus., LLC, 753 N.W.2d 1, 6 (Iowa 2008) and other authorities.]

For more information on Iowa piercing tests, s*ee generally* Matthew G. Doré, *Lifting the Veil on Iowa Piercing Jurisprudence and Suggestions for Reform*, 67 DRAKE L. REV. 619 (2019).

However, the BH Management court found that plaintiff had not satisfied these piercing tests and thus evaluated the parent's minimum contacts on their own. The court ultimately determined that the parent corporation's Iowa contacts were not sufficient to support personal jurisdiction in Iowa.

3. **Grant v. Zorn, 2023 WL 4358717 (S.D. Iowa 2023)**, denied a plaintiff's request to enforce a judgment against the owner of the corporate defendant based on Iowa veil-piercing theory, but nonetheless concluded that piercing might be a basis for such a result. The court therefore authorized post-judgment discovery on the issue of piercing and scheduled a supplemental evidentiary hearing on that issue.

State Court of Appeals Decisions:

1. **Hopper v. City of Waterloo, 977 N.W.2d 115, 2022 WL 610321(Iowa Ct. App. 2022) (table, unpublished disposition)**, affirmed a trial court's ruling that real property had been abandoned to the city, rejecting a challenge from an investor of the corporate owner of the property.

   The property in question had been sold to Dynasty Investment Group, Inc. (DIG), an Iowa corporation, on contract for deed. Hopper, who claimed to be a DIG shareholder, was in federal prison when the City sued for abandonment of the property. Hopper sought to intervene in the proceeding on DIG's behalf on several theories, including an argument that he had standing to participate as DIG's alter ego.

   The Court of Appeals properly rejected the attempt, finding that DIG was the real party in interest, and noting that the Iowa courts had consistently rejected "reverse piercing" claims of the type Hopper asserted.

2. **Hopp v. Leistad Systems, Inc., 991 N.W.2d 539 (Iowa App. 2023) (table, unpublished disposition)**, affirmed a summary judgment ruling that no partnership existed between a distributor and associate distributors where there was no sharing of profits, no co-ownership of assets, and no filing of partnership tax returns.

3. **Postma v. Wedebrand, 995 N.W.2d 817, 2023 WL 3856337 (Iowa Ct. App. 2023) (table, unpublished disposition)**, made several decisions relating to corporate shareholders' meetings under the Iowa Business Corporation Act (IBCA).

   As regards the validity of actions taken at a shareholders' meeting, the court held that failure to provide a shareholder with proper notice of the meeting as required by the IBCA rendered actions taken at the meeting **void**. The court rejected the argument that the

complaining shareholder waived his right to receive notice of the challenged shareholders' meeting by failing to complain about notice problems for several prior shareholder meetings.

The court also held that *unsigned minutes* of a shareholders' meeting at the corporation were not admissible as proof that a corporate buy-sell agreement had been amended at that meeting.

Collectively, the two rulings in *Postma* reflect the importance of attending to required notice rules for corporate shareholders' meetings, as well as the importance of creating proper written minutes of meetings.

4. **Hora v. Hora, 991 N.W.2d 785, 2023 WL 1809035 (Iowa Ct. App. 2023) (table, unpublished disposition)**, involved derivative suit claims for breach of fiduciary duty against a director/officer of a family farm corporation and the director/officer's son, an employee of the corporation. The district court dismissed the claims after an 11-day trial, but the Iowa Court of Appeals reversed most of this ruling, concluding the district court erred in applying the law applicable to self-dealing and fiduciary duty.

   The Court of Appeals held that Keith Hora, the director/officer, was liable for damages to the corporation because he failed to obtain disinterested approval for self-dealing transactions that improperly benefitted him, including personal expenses paid with corporate funds and improper vehicle reimbursements. Keith's son, Kurt, an employee of the corporation, had misappropriated some of the farm corporation's corn crops, and the court also held Keith liable for those transactions.

   The court acknowledged that Keith could have avoided liability for these duty of loyalty violations by showing the challenged transactions were "fair to the corporation" within the meaning of Iowa Business Corporation Act (IBCA) Section 490.863. However, the court concluded that Keith had failed to meet this burden for both sets of transactions. With respect to self-dealing claims based on the director's improper reimbursement for personal expenditures from corporate funds, the court stated:

   > While there is some record evidence suggesting that the total compensation Keith received could have been appropriate, an arms-length transaction would not include athletic tickets and personal shopping paid for with crop and infrastructure accounts or the double-dipping vehicle reimbursements.

   With respect to self-dealing claims based on the theft of corn from the corporation by Kurt (Keith's son), the court stated:

   > We find that Keith has not carried his burden. At core, what Keith enabled was civil conversion or criminal theft of HFI corn by his son Kurt … .

   It is important to appreciate that although the court properly refused to apply the business judgment rule to the above-described self-dealing transactions, the court concluded the business judgment rule *did* apply to other claims in the case. The complaining shareholders

had also alleged that Keith had diminished the value of the corporation's shares through poor record-keeping and bad management.

Although the court concluded (as described above) that Keith and his son, Kurt, had engaged in improper self-dealing and misappropriation (claims for which they owed damages to the corporation), the court held that the separate record-keeping and mismanagement claims against Keith were "either shielded by the business-judgment rule or not supported by sufficient record evidence that would allow us to find bad faith, dishonesty, intention to harm, or unfairness to the corporate interest."

5. **Safe Bldg. Compliance & Tech. v. Bernholtz, 995 N.W.2d 109, 2023 WL 3083534 (Iowa Ct. App. 2023) (table, unpublished disposition)**, involved claims for misappropriation of funds against a former director of Safe Building Compliance & Technology, an Iowa non-profit corporation organized under Iowa Code Ch. 504.

   The director, Michelle Naughton, admitted she had improperly used some corporate funds for personal expenses, but challenged other expenses as either approved by the board of directors or spent after she resigned as a director. The Iowa Court of Appeals affirmed the Iowa District Court's ruling (following a bench trial) that Naughton was liable for damages for the challenged transactions, which the court treated as self-dealing transactions, and thus violations of Naughton's duty of loyalty as a director.

   The challenged transactions concerned payments the non-profit corporation made when it leased and made improvements to a building that belonged to a corporation owned by Naughton and her husband. Naughton's family also lived in the building, with utilities paid for by the non-profit. In addition, the non-profit paid for life and disability insurance policies on Naughton and her husband.

   Naughton acknowledged that these transactions entailed conflicts of interest, but asserted that the corporation's board was aware of the transactions and provided the requisite disinterested approval for them under Iowa Code Section 504.833. The court rejected the defense based on the non-profit corporation's bylaws, which set out specific procedures for approval of self-dealing transactions. Naughton's failure to follow those procedures was fatal, the Iowa Court of Appeals concluded, because Section 504.833 expressly allows corporations to impose *additional* requirements for approval of conflict-of-interest transactions.

   Note: If a for-profit corporation organized under Iowa Code Chapter 490 had articles or bylaws that imposed special requirements for approval of conflict-of-interest transactions, a director who failed to follow those procedures might also be challenged on good faith grounds, even if the director otherwise complied with the disinterested approval processes set forth in Iowa Code Chapter 490 (Sections 490.860-490.863).

6. **Aterra 144, 1960 Grand Avenue, WDM, LLC v. David B. Anders, 992 N.W.2d 239, 2023 WL 2148774 (Iowa Ct. App. 2023) (table, unpublished disposition)**, affirmed a

district court's ruling (following a bench trial) that enforced a former LLC member's guarantee of a restaurant lease.

Anders was one of several members of an LLC that leased premises in a West Des Moines shopping center for a chicken restraurant in 2005. Anders executed a guaranty that covered *"time payment of rent and all other charges to be paid by [the LLC] under the Lease."* The guaranty also provided it *"would remain in full force and effect as to any renewal or extension of the Lease regardless of any modification of the Lease."*

When the LLC defaulted on the lease and the landlord sued Anders, he contended the landlord had abandoned the guaranty or alternatively, was barred by the doctrine of accord and satisfaction. Anders relied on the fact that the lease default occurred *after* other members purchased his interest in the LLC, and *after* the lease was renewed and modified with several addenda, and *after* new guarantees were executed to support the lease. In addition, the original landlord had sold the building where the restaurant premises was located. Anders also claimed the original landlord had orally advised him that his guaranty was released, although Anders had no signed writing to support that contention.

The district court ruled, and the Iowa Court of Appeals affirmed, that none of these facts established that the landlord had abandoned Anders' guaranty and accepted other guaranties in its place, and did not amount to accord and satisfaction.

7. **Bagby v. First St. Deli II, LLC, 2023 WL 5092833 (Iowa Ct. App. 2023)**, reversed a district court ruling (following a bench trial) that a loan contract was not enforceable on grounds of unconscionability.

Bagby loaned $10,000 to First Street Deli, and its owners—Harker and her daughter—under terms of a written loan agreement that required repayment of $15,000 over six months. Payments were to be made in bi-weekly installments of $750 each, with a late fee provision of $25 per day. Borrowers repaid $11,500 on the loan, though many payments were late.

Bagby sued to collect over $50,000—his calculation of payments due when late fees were factored in. The district court refused to enforce the loan agreement as written, finding its terms unconscionable and that the late fees were an unenforceable penalty, and ruled that borrowers owed nothing more on the loan. Bagby appealed, and the Iowa Court of Appeals reversed.

The court noted that a finding of unconscionability can be based on procedural or substantive grounds, but concluded that neither was present here. Bagby's loan terms were clear—with no fine print or convoluted language—and the substantive terms of the loan (repayment of $15,000 for a $10,000 loan) were similar to those initially proposed by the borrowers, who had been unable to secure traditional financing. The court further held that the loan agreement's late fee provision was not unenforceable as a penalty because the borrowers had not met their burden of proof on that issue.

The New Iowa Limited Liability Company Act

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Background I – Current Act

- The Uniform Law Commission ("ULC") finalized its work on the Revised Uniform Limited Liability Company Act ("RULLCA") in 2006.
- The ULC's prior LLC Act, like Iowa's Ch. 490A, was written before the IRS' "Check-the-Box" regulations discarded the Kintner Rules, before limited liability partnerships were authorized and became widespread, and without the benefit of a decade of law practice.
- The Iowa State Bar Association proposed, and with selected non-uniform provisions Iowa enacted, RULLCA, in 2008.

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Background II – Amendments

- After adoption of RULLCA, the ULC undertook to examine its other Uniform Unincorporated Organization Acts— like the Uniform Partnership and Limited Partnership Acts—and continued work on RULLCA.
- The purposes included
  - harmonizing the language of RULLCA and the ULC's other Uniform Unincorporated Organization Acts to use the same language if the same thing was intended,
  - clarifying terms of RULLCA as well as other Acts,
  - addressing matters that RULLCA didn't address but the other Acts did, and
  - in some cases, updating RULLCA in a way that involved substantive change.
- As a result, the ULC approved "Harmonized" entity Acts, and in particular, the Uniform Limited Liability Company Act (2006) (Last Amended 2013).

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ISBA Study and Endorsement

- For decades the Business Law Section of the ISBA has been committed to seeking keep Iowa's business laws current, reflecting best practices expressed in good form and clear language.
- That includes extensive, three-year review and revision of Chapter 490, patterned after the Model Business Corporation Act's 4th Edition and its enactment in 2021. One of the chief reasons for the 4th Edition was the increasing integration of corporations with the ULC's unincorporated entity Acts, like the 2013 Uniform LLC Act.
- In 2022 the Limited Liability Company Committee of the ISBA's Business Law Section reviewed the 2013 Uniform Act and proposed adoption of ULLCA 2013; and the ISBA Board of Governors endorsed it.

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Iowa's Enactment of the ULC's 2013 Act and What Other States Have Done

- HF655 was signed into law by the Governor in June 2023.
- The new LLC Act becomes effective on January 1, 2024.
- To date, 17 of the 19 states that have adopted a uniform limited liability company act since the "harmonized" LLC Act was pre-released in 2011 or officially approved in 2013 have adopted the 2013 Uniform LLC Act—known simply as "ULLCA." These States include Arizona, Arkansas, Connecticut, D.C., North Dakota, Washington, Utah, Wisconsin, and Pennsylvania.
- Some States continue to have the ULC's 2006 version.
- Some States continue to have the much earlier 1995 version.

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Selected Iowa Business Entity Demographics* and The Importance of LLCs

• **Domestic LLCs**	**148,094**
• Foreign LLCs	17,272
• For-Profit Corporations	44,577
• Foreign For-Profit Corporations	14,284
• Domestic LLPs	4,035
• Foreign LLPs	214
• General Partnerships	79
• Domestic Limited Partnerships	1110
• Domestic LLLPs	499
• Foreign Limited Partnerships	510
• Foreign LLLPs	23

* Source: Iowa Secretary of State (Last Visited October 2, 2023)

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"New" Iowa Limited Liability Company Act Is *Not* a Whole New Act

- An LLC remains a creature of contract, indeed becomes even more so.
- The architecture of the Uniform Act and Chapter 489 remain the same.
- The central role of the operating agreement remains and is expanded.
- The Act remains a "default Act," meaning that with few exceptions the Act's provisions apply only when not displaced by the operating agreement.
- Sections on the nature, purpose, duration and governing law are the same.
- Formation of the LLC by filing a certificate of organization remains.
- "Pick your partner" and limited liability principles remain clear.
- Continued focus on facilitating business practice and service to clients.

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Coordination with Other Law, and Specifically, the Iowa Business Corporation Act (Ch.490)

- The drafters of ULLCA and the MBCA 4th intentionally coordinated significant parts of the two pieces of legislation to facilitate general business practice and also to address the increasing number of inter-entity transactions, *e.g.,* corporation-LLC.
- Examples of such areas are provisions dealing with the following:
  - Definitions
  - Registered Agents
  - Administrative Dissolution
  - Foreign LLCs
  - Direct and Derivative Litigation
  - Fundamental Changes (Merger/Interest Exchange/Conversion/Domestication)
- Synergy went both ways: MBCA 4th's foreign corporation article followed ULLCA 2013's foreign LLC article, and likewise, registered agents.

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Coordination with the Iowa Secretary of State

- Business Law Section's LLC Committee included Iowa SOS Director of Business Services Carl Dietz, and members of the Committee intentionally coordinated provisions of ULLCA 2013 with current Iowa business legislation, like the 2006 ULLCA and Chapter 490:
- Names
- Filings
- Registered Agents
- Biennial Reports
- Administrative Dissolutions

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Article I of ULLCA (2013)

- Contains definitions—some new, some revised that track the MBCA and the new Article 10 on Fundamental Changes, and some revised but without substantive change, *e.g.*, "Distribution."
- Contains general provisions, including sections dealing with Names, Registered Agents, Service of Process, Fees, Authority to Deliver Records by Electronic Transmission, and the General Assembly's Reservation of Power to Amend or Repeal the Chapter.
- Contains provisions defining and dealing with the operating agreement and relocates them from §§ 110-112 to §§ 105-107.

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Article I: The LLC Operating Agreement: Definition and Functions Remain the Same

- The definition of "operating agreement" is unchanged (§ 489.102(13)):
  "the agreement, whether or not referred to as an operating agreement and whether oral, implied, in a record, or in any combination thereof, of all the members of a limited liability company, including the sole member, concerning the matters described in § 105(a). The term includes the agreement as amended or restated."
- Functions remain the same (§ 489.105(1)). Subject to restrictions and allowed variation, the operating agreement governs the
  - relations among members as members and between members and the LLC;
  - rights and duties under ULLCA of a person in the capacity as manager;
  - activities and affairs of the LLC, the conduct of those activities and affairs; and
  - the means and conditions for amending the operating agreement (§§ 489.106(4) and 489.107(1), which are unchanged and authorize restrictions on amendments to a signed writing and to 3rd party approval or satisfaction of a condition).

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Article I: The Operating Agreement (OA)—ULLCA Is "Default Legislation" But OA Is Subject to Limitations

- ULLCA (2013) remains "default legislation," meaning that ULLCA only applies "to the extent the operating agreement does not provide for a matter described in subsection 489.105(1)" as one of its functions, *unless* the operating agreement is prohibited from doing so.
- § 489.105(3) states 15 things "an operating agreement may not [do]," *e.g.,*
  - OA may not vary any provision relating to registered agents or the secretary of state;
  - OA may not "relieve or exonerate a person from liability for conduct except as" provided in §489.105(6);
  - OA may not unreasonably restrict information rights and duties under §489.410 but may impose reasonable restrictions on availability and use of information and provide remedies for breach; and
  - OA may not vary language of §489.805 (authorizing special litigation committees) but may provide that the LLC "may not have a special litigation committee."

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Article I: Expansion of Freedom of Contract in the Operating Agreement

- Under §489.105(3), the OA may not "alter or eliminate the duty of loyalty or the duty of care, except as otherwise provided in subsection (4)."
- But Section 489.105(4) has been clarified in a way that expands on the notion that an LLC is a creature of contract and extends greater freedom to parties to express their deal and rely on contractual duties, not statutory duties, again, "if not manifestly unreasonable."
- Similarly, the operating agreement may not eliminate the contractual obligation of good faith and fair dealing under §489.409(4) but it may state the standards for measuring performance of the obligation, again, "if not absent manifestly unreasonable."

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What the Operating Agreement May Do

- Section 489.105(4)(c) states, "If not manifestly unreasonable, the operating agreement may do all of the following:
  - (1) Alter or eliminate the aspects of the duty of loyalty stated in section 489.409, subsections 2 and 9;
  - (2) Identify specific types or categories of activities that do not violate the duty of loyalty;
  - (3) Alter the duty of care, but may not authorize conduct involving bad faith, willful or intentional misconduct, or knowing violation of law; and
  - (4) Alter or eliminate any other fiduciary duty."
- So it's clear that ULLCA (2013) authorizes extensive freedom of contract.
- But it wasn't intended by the ULC to thereby adopt a totally contractarian view of an LLC and look at it as if it were solely an "arm's length transaction." The "if not manifestly unreasonable" limitation prevents that.

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What Is "Manifestly Unreasonable" and Who Decides? See § 489.105(5).

- "The court shall decide as a matter of law whether a term of an operating agreement is manifestly unreasonable under [subsection 3(f) or subsection 4(c)]. All of the following shall apply:
  - (a) The court shall make its determination as of the time the challenged term became part of the operating agreement and by considering only circumstances existing at that time.
  - (b) The court may invalidate the term only if, in light of the purposes, activities, and affairs of the limited liability company, it is readily apparent that any of the following apply:
    - (a) The objective of the term is unreasonable.
    - (b) The term is an unreasonable means to achieve the term's objective."

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Article 2—Formation: Certificate of Organization & Other Filings

- There are slight changes in the certificate of organization but it remains simple—it must state:
  - The name of the LLC, which has to comply with § 489.112;
  - The street and mailing addresses of the LLC's principal office; and
  - The name and street and mailing addresses in this state of the LLC's registered agent.
- Different from the Uniform Act, the LLC is formed when the certificate becomes effective, which under § 489.207 occurs on the date and at the time of filing by the SOS, or a later date if specified in the certificate.
- If upon filing the LLC has no members, its capacity to do any act or engage in any activity is limited to admitting a member, dissolving, or making certain filings with the SOS, *e.g.,* an amendment to the certificate. §489.109.

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Article 3: Relations of Members and Managers to Persons Dealing with the LLC

- Section 489.301 is unchanged—members have no agency authority "solely by reason of being a member;" it's determined by Agency Law.
- Provision for a "Statement of Limited Liability Company Authority" ("SOA") in 489.302 is unchanged, including a non-Uniform provision the Real Property Section and the Bar advanced that makes an SOA continuously effective until amended or cancelled.
- Section 489.304(1)'s important statement of limited liability of members and managers is unchanged except for the clarifying addition of one sentence, "*This subsection applies regardless of the dissolution of the company*." (Emphasis added)

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Article 4: Relations of Members to Each Other and to the LLC: Three Changes

- Section 489.409(3)'s statement of the duty of care has been changed to parallel the language of the standard utilized in the Uniform Partnership Acts.
  - Amendment adopts as measure of standard of care the "refrain from engaging in grossly negligent or reckless conduct, willful or intentional misconduct, or knowing violation of law" standard expressed in the Partnership (Section 486A.404(3)) and Limited Partnership (Section 488.408(3) Acts, which Iowa has adopted.
  - ULC never intended an "ordinary negligence" standard of liability, and the language in the current law drawing on the corporate standard, preceded by "[subject] to the business judgment rule," was thought to invoke the gross negligence standard; but as to action and conduct not clearly involving the exercise of Board-like judgment, *e.g.*, members' activities working for the LLC, it was feared it could be read that way.
- § 489.401(3)(d): if the last member dies, the LLC may avoid dissolution by admitting a new member upon the consent within 90 days of "transferees owning the rights to receive a majority of distributions as transferees at the time the consent is to be effective," *not* the last member's legal representative.
- § 489.409(9)(e): in a manager-managed LLC, an act or transaction that would violate the duty of loyalty *can only be ratified by the members, not the managers.*

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Article 4: Some Reminders

- Under § 489.404 there is no right to receive a distribution before dissolution, only if the company decides to make an interim distribution; and if it does, the default is that the distribution must be in equal shares.
- Under § 489.407, whether in a member-managed or manger-managed LLC, unless the operating agreement ("OA") provides otherwise, any transaction outside the ordinary course of business—merger, interest exchange, conversion, domestication, or amendment of the operating agreement—requires the consent of all of the members.
- There is no substantive change in § 489.410 on Information Rights, but don't forget the change in § 489.105 explicitly authorizing the OA to impose "reasonable restrictions on availability and use of information" and appropriate remedies for breach, including liquidated damages.

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Article 5: Transferable Interests and Rights of Transferees and Creditors

- Under §§ 489.501 and 489.502 a member's "transferable interest" is personal property, and transfer in whole or in part is permissible. That is a default provision, however, and because transferees can be disruptive, the parties may restrict and prohibit transfer in the operating agreement.
  - Note: §489.502(4) and (6) provide that a transferable interest may be evidenced by a certificate, and a "transfer of a transferable interest in violation of a restriction contained in the OA is ineffective if the transferee has knowledge or notice of the restriction at the time of transfer."
  - UCC §§ 9-406 and 9-408 in terms have voided statutory and contractual restrictions on prohibitions of assignments or transfers, but the ALI and ULC have amended these UCC sections to provide they don't apply to LLCs because they are contrary to the firmly established "pick your partner" principle. Numerous States have adopted that position; a bill doing so will be introduced in Iowa.

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Article 5: Substantive Revision – Charging Orders

- IC § 489.503 authorizes a judgment creditor of a member or of a transferee to obtain a charging order against the transferable interest of the judgment debtor entitling the judgment creditor to receive any distributions that would otherwise be made to the judgment debtor.
- ULLCA (2013) added a new subsection to deal with a judgment debtor who is the *sole* member of a single member limited liability company.
- New § 489.503(6) recognizes that when an LLC has only one member, the "pick your partner" concept is inapposite; and in that situation, the court may foreclose on the charging order so that the purchaser obtains not just the economic rights but also the management rights of the debtor, thus becoming the member and dissociating the judgment debtor as a member.

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Article 6: Dissociation

- Other than editing or style changes, no real substantive changes.

- New 489.602(3) takes into account the new provision in Section 489.503 authorizing foreclosure by a judgment creditor upon the entire interest of the judgment debtor who is the sole member of an SMLLC.
- Existing 489.602(3) [person is expelled as a member pursuant to operating agreement] is moved without change to new 602(4), and additional subsections change in sequence.
- In 489.602(4)(C), "[if] the person is a corporation . . . "is changed to "[if] the person is an entity" in order to encompass a broader array of entities than simply a corporation; and in 489.602(4)(d), "if the person is limited liability company or partnership that has been dissolved or whose business is being wound up" is changed to "an unincorporated entity" in order conceptually to encompass a broader array of such entities.
- Section 489.602(6) [formerly .602(5)] adds "or a member in a direct action under Section 801" to recognize a *direct* action by a member to have another member expelled for any of the three reasons articulated (without substantive change) in Section 489.602(6).
- Section 602(13) adds "an interest exchange" to the other fundamental changes (merger, conversion, domestication) under the plans for which a person may cease to be a member and be dissociated.
- Section 602(16) changes the word "terminates" to "dissolves and completes winding up" to clarify when a member is dissociated, *i.e.*, before which time the person continues to be a member.

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Article 7: Dissolution and Winding Up

- For the most part, there are only editing or style changes, and the default provisions of Article 7 substantively remain the same.
- One exception is a replacement of the current rule that if an LLC ceases to have any members for 90 days, dissolution occurs unless
  - The last person to have been a member, *or the legal representative of that person*, designates a person to become a member (emphasis added); and
  - The designated person consents to become a member.
- As discussed earlier under Article 4 and § 489.401 [Becoming a Member], the new rule provides that the decision to admit a new member or to proceed with dissolution in winding up rests with the transferees holding the rights to receive a majority of the distributions as transferees at the time consent is to be given, **not** the last member's designated representative.

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Article 7: Dissolution and Winding Up— Two Other Changes

- Following application of assets to discharge obligations to creditors, and then distribution of surplus reflecting contributions which members have made that haven't been returned, there is change in the current rule of §489.708(2)(b) regarding distribution of what's left.
- After distributions reflecting return of contributions, the new rule in requires distribution of remaining assets *not* in equal shares, as the Iowa law provided, *but* in proportion to the transferable interest holders' respective rights to share in distributions immediately before the LLC's dissolution.
- Administrative dissolution is added as an event causing dissolution; and new § 489.709 [Administrative Dissolution] tracks Ch. 490, as do § 489.704 - § 489.706, dealing with treatment of known and unknown claims and court proceedings.

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Article 8: Actions by Members--Changes

- This Article has been Article 9 in Chapter 489. It's now Article 8.
- Sections 489.801 and 802 differentiate direct and derivative actions.
- Section 489.802 continues the "universal demand" rule in the current LLC Act and in Chapter 490 and eliminates "futility" of demand as an excuse for not making one. Plaintiff(s) may commence suit earlier if notified of rejection or if "irreparable injury to the company would result by waiting for the expiration of the ninety-day period."
- The new LLC Act authorizes an LLC to appoint a special litigation committee if it is named or made a party in a derivative action. Current Iowa law did not enact the 2006 provision authorizing one. (Nonetheless, the OA was not prohibited from authorizing one.)

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Article 8--Section 489.806 Special Litigation Committee

- Iowa law and Iowa's Business Corporation Act, in § 490.744, have long authorized a corporation to appoint a special litigation committee ("SLC") and stated the terms for its appointment and duties. RULLCA did, too, but on account of objection, the Iowa bill did not include it.
- Under new § 489.105(3)(l), the OA may prohibit appointment of an SLC;
- If not prohibited, new § 489.805's terms may not be varied; they require:
  - SLC members must be disinterested and independent;
  - SLC members are appointed by members or managers who are not named as defendants, or if all are, by a majority of same;
  - SLC members are charged with investigating the claims asserted and determining whether pursuing the action is in the best interest of the company;
  - SLC members must do so in good faith, independently, and with reasonable care, on all of which points the SLC has the burden of proof;
  - If proven, "the court shall enforce the determination of the committee."

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Other Articles

- **Article 9** deals with Foreign Limited Liability Companies, and as previously stated, its provisions track the provisions on foreign corporations in Iowa's Business Corporation Act--IC 490.1501-.12.
- **Article 10** deals with Merger, Interest Exchange, Conversion, and Domestication—Fundamental Changes—and track Articles 9 and 11 of Iowa's Business Corporation Act.
- **Article 11** deals with Professional Limited Liability Companies.
  - Incorporates amendments made to the Iowa Professional Corporation Act in 2003 to allow for a professional corporation to convert to a business corporation in the event it ceases activities that required the entity to be a professional corporation.
  - Amendments would allow PLLC to elect to no longer be a PLLC but instead be a regular limited liability company in similar circumstances.

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Unique Iowa Provisions

- There are a number of unique Iowa provisions in the current Iowa Act that will remain in the proposed legislation. These include:
  - Section 489.106 (currently 489.111(4)) providing, "An operating agreement in a signed record that excludes modification or rescission except by a signed record cannot otherwise be modified or rescinded."
  - Section 489.201 not requiring an LLC to have a member before formation by filing a certificate of organization, and section 489.109 limiting an LLC's powers until it has a member.
  - Section 489.604 on a member's power to dissociate under certain circumstances (a holdover from Iowa's 1992 Act).
  - Real estate provisions that were originally requested by the ISBA Real Estate Section (current Iowa Code section 489.407A). Correlative sections added as Iowa Code section 558.72 (real estate transfers by certain entities) and Iowa Code section 614.14A (Real estate transferred by certain entities).

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Series LLCs

- Iowa adopted the ULC's Uniform Protected Series Act in 2019. It appears as Article 14 of Chapter 489, and those provisions will remain the same in the new Limited Liability Company Act.

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Questions and Comments?

The End

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