Business Law Update

Drake General Practice Review CLE
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Today's Presentation: Three Areas

Legislative Developments

1) UPSA—New Series LLC Legislation takes effect
2) IBCA changes (to conform to MBCA (2016)) expected to be enacted in 2021

Case Law Developments--Commercial Law

Case Law Developments—Business Associations

Legislative Developments: Series LLCs

What is a "Series LLC" and why might your client want to use one?

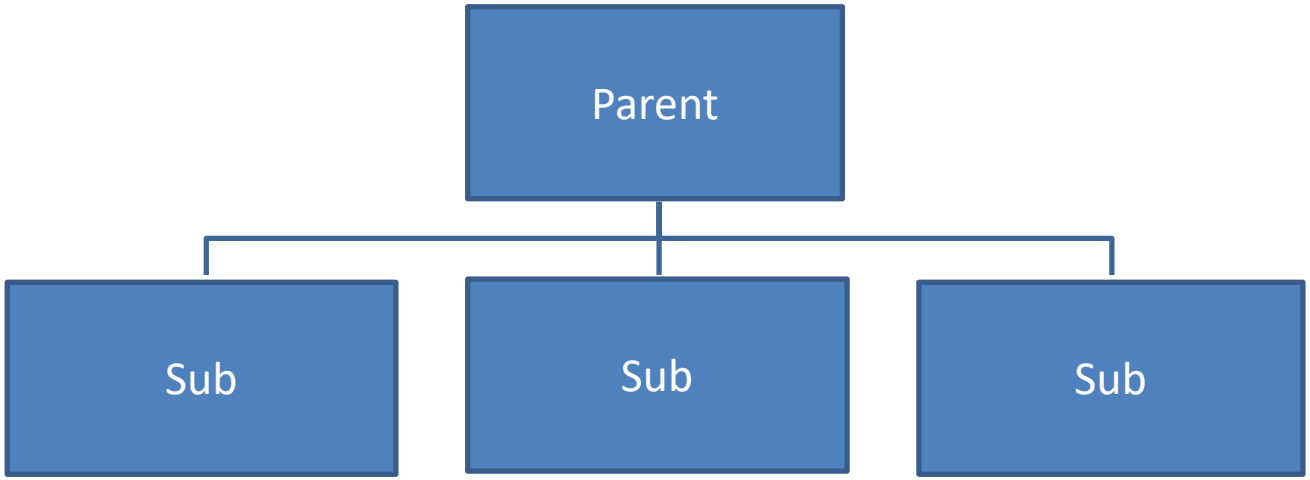
Basic Concept: Analogous to a Parent Corporation with multiple Wholly-Owned Subsidiaries, but uses a single LLC entity with built-in firewalls.

The Articles or Certificate of Organization of a Series LLC allow for unlimited segregation of membership interests, assets, liabilities and operations into separate independent silos—AKA "Series" or "Protected Series" of the LLC.

Legislative Developments: Series LLCs

Traditional Parent – Sub Structure

Parent and Subs could be Corporations or LLCs



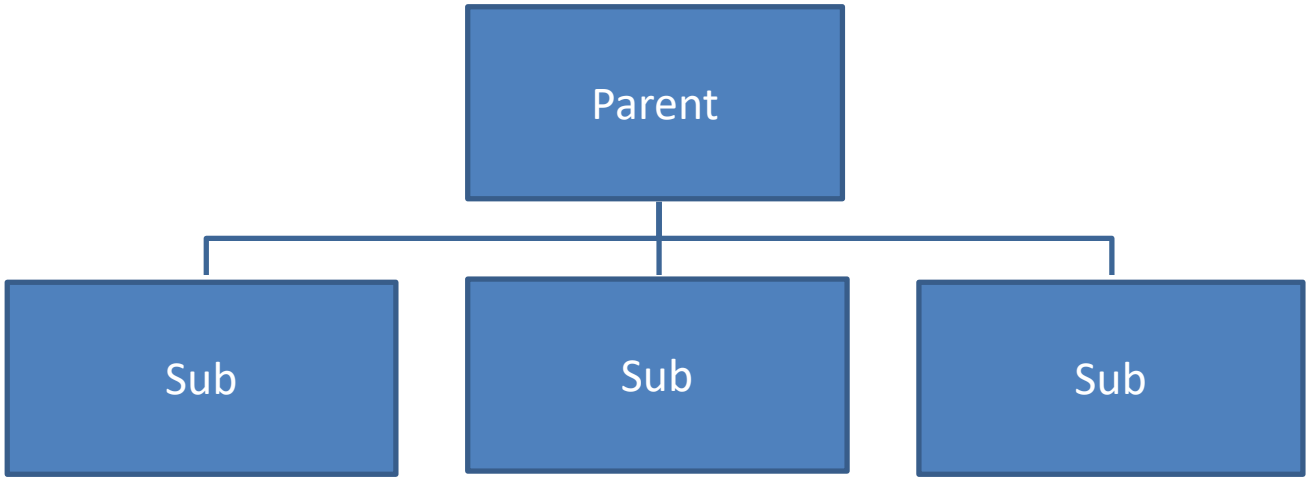
If Corporations: Parent is not liable for Subs' debts. Each Sub is separate from the other.

But each Sub is an asset of Parent, so an unpaid judgment creditor of Parent could become an owner of a Sub by levying on Sub stock and purchasing at judicial sale.

Legislative Developments: Series LLCs

Traditional Parent – Sub Structure

Parent and Subs could be Corporations or LLCs



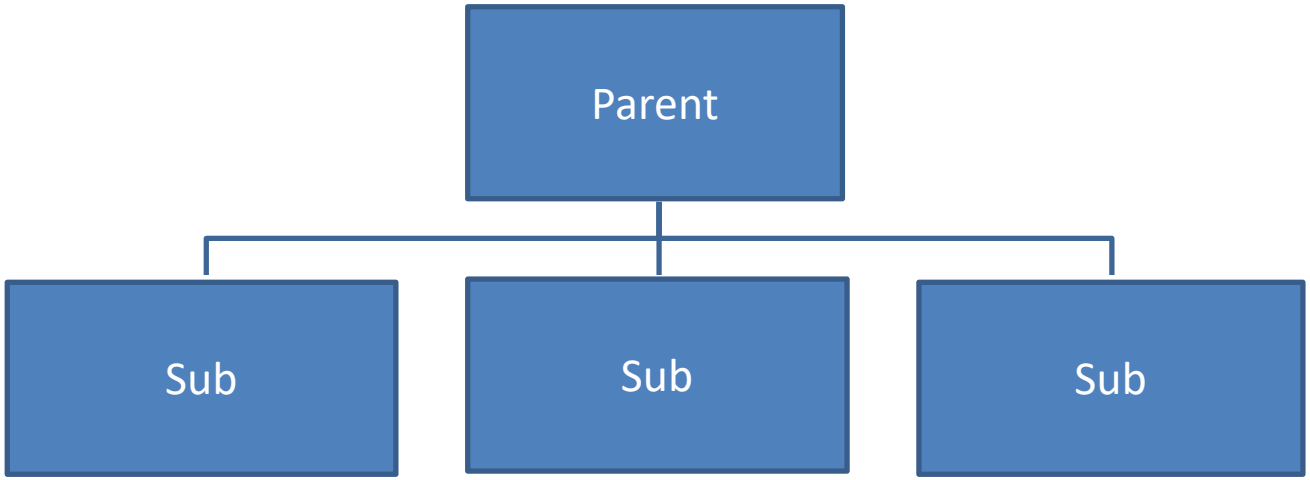
If LLCs: Parent is not liable for Subs' debts and each Sub is still separate.

But each Sub is still an asset of Parent. An unpaid judgment creditor of Parent could get a "charging order" to capture financial distributions by Sub LLCs to Parent LLC.

Legislative Developments: Series LLCs

Traditional Parent – Sub Structure

Parent and Subs could be Corporations or LLCs



Downsides of this structure:

*Costs of forming separate entities, e.g. formation, registered agents

*No "vertical shield" since Subs are assets of Parent.

Legislative Developments: Series LLCs

What is a "Series LLC" and why might your client want to use one?

Basic Concept: Analogous to a Parent Corporation with multiple Wholly-Owned Subsidiaries, but uses a single LLC entity with built-in firewalls.

Each "series" within the LLC is effectively treated as a separate entity.

A series can segregate membership, governance, assets and liabilities from other series of the LLC (horizontal shield).

In addition, the "parent" LLC is not a member of any series, establishing a vertical shield that separates each series from debts of the "parent" LLC.

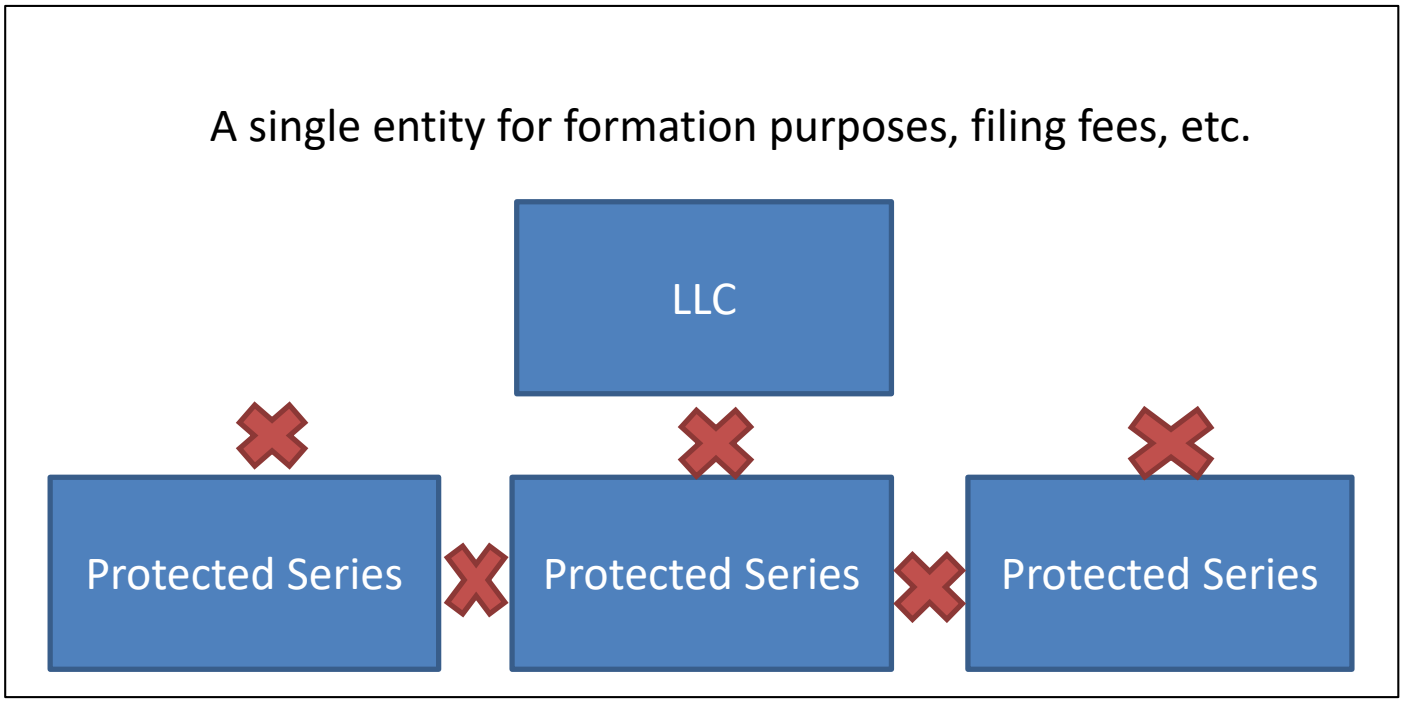
To achieve this result, a state LLC statute must provide for organizing "series LLCs." Procedures typically entail public filings (disclosure) and separation requirements—

E.g., each Series has its own Designation / Name (so the public is aware)

each Series has separate Operating Agreement, Bank Accounts, Membership, etc.

LLC Issues: Series LLCs

A "Series" LLC with Multiple Protected Series



By statute, each Protected Series is "deemed to be" separate with its own assets and liabilities, members and managers. A "vertical shield" separates each Protected Series from the initial "parent" LLC, which does not "own" any of the Protected Series.

In addition, a "horizontal shield" separates each Protected Series from each other.

LLC Issues: Series LLCs

Uses: ***Real Estate Investment Firms that own and operate multiple properties.***

A chain of separate business operations.

Separate "series" of the LLC can each own and operate different assets, and have discrete liabilities and creditors. Each series can have its own management and its own investor / members.

May be operationally simpler and cheaper (e.g., fewer filing fees) than traditional parent-subsidiary relations.

Downsides?

Confusing. AND COMPLICATED!

Not all states recognize.

Tax treatment?

Bankruptcy?

LLC Issues: Series LLCs

Developments for Iowa Series LLCs

Iowa is one of 14 jurisdictions with an LLC Act that provides for series LLCs.

The "template" for Iowa's current LLC Act (Iowa Code Ch. 489) = Revised Uniform Limited Liability Company Act (2006) (RULLCA). ***RULLCA had no series provisions (originally), so Iowa inserted Ch. 490A's series LLC provisions into Ch. 489 when Iowa adopted RULLCA.***

The ULC's "Uniform Protected Series Act" (UPSA) is a new RULLCA "Article" that provides for series LLCs. UPSA offers more comprehensive and thorough series LLC provisions than the old Ch. 490A series provisions that were added to Ch. 489.

In 2019 the General Assembly added the UPSA (SF 569) to Iowa Code Ch. 489—to take effect July 1, 2020. A new "Article 14" – Section 489.14101 through Section 489.14804. ***40 new sections added to Ch. 489!***

The Legislative Appendix materials provide a two-page summary of the UPSA.

Transition Rules:

Iowa's existing series LLC rules will apply to any series LLC organized *before* July 1, 2020.
On July 1, 2021, the new UPSA provisions will govern *all* Iowa series LLCs.

ISBA Proposed Legislation to Amend IBCA

Iowa Business Corporation Act is patterned on ABA's Model Business Corporation Act.

The ABA Corporate Laws Committee continually proposes revisions / updates to MBCA. Iowa last added MBCA changes about 10 years ago.

Starting in 2017, the ISBA Business Law Section Corporation Committee began reviewing the MBCA changes that Iowa has not yet adopted.

In Fall 2019, the ISBA Committee recommended many of these changes for the IBCA, in some cases adapting them to conform to Iowa practice or special concerns.

The ISBA Board of Governors approved the Committee's recommendation in Fall 2019.

The ISBA Bill (summarized in the Legislative Appendix materials) was introduced in 2020 Session as S.F. 2339. Due to the shortened COVID session, S.F. 2339 did not pass, but a substantially identical bill will be introduced in the 2021 session.

If passed, these IBCA changes will take effect Jan. 1, 2022.

ISBA Proposed Legislation to Amend IBCA
Key Changes Include:

New provisions providing procedures for ratification of "defective corporate actions" and for shares that may have been improperly issued.

Examples:

failure of incorporator to validly appoint an initial BOD
corporate action taken without authorizing resolutions from BOD
corporate action taken without required shareholder approval
defective procedures when issuing shares
"overissue" of shares

Remedies under the proposed new Ratification provisions:

* **internal corporate voting (directors and/or shareholders) to cure defect**
* **new statutory provisions make the curing action "retroactively effective"**
* **publicly filed "articles of validation" describe procedures followed and add or correct public filings as needed**
* **judicial procedure also authorized to confirm ratification or as an alternative route to ratification**

ISBA Proposed Legislation to Amend IBCA
Key Changes Include:

Corporate Articles may include an optional provision that limits or eliminates, in advance, the duty of a director or other person to bring a business opportunity to the corporation.

ISBA Proposed Legislation to Amend IBCA
Key Changes Include:

Corporate Bylaws may include provisions:

that provide "proxy access" for shareholder nominees to the BOD

that authorize reimbursement of shareholder expenses for proxy solicitations in connection with BOD elections

that require a director to resign if the director does not receive a majority of votes cast in an uncontested election

ISBA Proposed Legislation to Amend IBCA
Key Changes Include:

Corporate Articles or Bylaws may include "forum selection" provisions that choose Iowa as the forum for adjudication of internal corporate claims.

These would include breach of fiduciary duty claims vs. directors and officers, derivative proceedings, claims based on provisions of the IBCA or the corporation's articles or bylaws, or other claims governed by the "internal affairs" choice of law rule.

ISBA Proposed Legislation to Amend IBCA
Key Changes Include:

Under current IBCA Section 490.709 a BOD may authorize shareholders to participate in a special or annual shareholders meeting using means of "remote communication" (e.g., telephone conference call, internet streaming) so long as the corporation implements appropriate measures to verify shareholder identity, etc. identity, etc.

The proposed legislation expands Section 490.709 to allow an annual or special shareholder meeting to be conducted *wholly* through means of remote communication (again, so long as the corporation implements appropriate safeguards to verify shareholder identity, etc.).

Note: Under various COVID Proclamations Gov. Reynolds has issued, "all remote" shareholder meetings are currently authorized for 2020.

ISBA Proposed Legislation to Amend IBCA
Key Changes Include:

Conversions and Domestications

The IBCA currently authorizes Iowa corporations to *convert* to other entities (e.g., a domestic or foreign LLC) and authorizes non-corporate domestic or foreign entities to convert to Iowa corporations. Under the proposed IBCA bill, these conversion provisions are modified slightly (but in non-substantive ways) and moved to a new location in the IBCA (Article 9).

Article 9 of the amended IBCA (to be codified as Section 490.901 et seq.) also includes provisions authorizing *domestication* of Iowa corporations and foreign corporations.

"Domestication" is a transaction whereby an Iowa corporation becomes a foreign corporation or a foreign corporation becomes an Iowa corporation. Iowa's Uniform LLC Act already authorizes domestication transactions for LLCs. As with conversions and other fundamental transactions (like mergers), a domestication requires (1) board and shareholder approval of a "plan of domestication" following full disclosure, (2) authorization by the governing law of both Iowa and the foreign state, and (3) appropriate public filings in both places.

ISBA Proposed Legislation to Amend IBCA
Key Changes Include:

Benefit Corporations

The proposed legislation includes a new Article authorizing creation of "benefit corporations" under the IBCA. More than two-thirds of the U.S. states already have benefit corporation legislation, and the proposed new IBCA Article is part of the latest MBCA revision.

A benefit corporation is a domestic corporation whose purpose is defined in its articles of incorporation as pursuit of "one or more identified public benefits." A "public benefit" is

> **a positive effect, or reduction of negative effects, on one or more communities or categories of persons or entities (other than shareholders solely in their capacity as shareholders) or on the environment, including effects of an artistic, charitable, economic, educational, cultural, literary, medical, religious, social, ecological or scientific nature.**

When operating the corporation, benefit corporation directors are required to consider not just shareholder interests, but also the interest of the stakeholders identified in the public benefit clause. There are also related reporting requirements.

Case Law Developments – Commercial Law

General Principles of Priority for Security Interests in Personal Property

Subject to limited exceptions, various provisions of UCC Article 9 (Iowa Code 554.9101 et seq.) make clear that a perfected security interest in personal property collateral has priority over

later perfected security interests in that collateral,

any unperfected security interests in that collateral,

as well as subsequent liens (e.g., judicial liens) that attach to that collateral.

Several Iowa decisions in 2020 tested the strength of this priority rule, but the rule held firm.

Case Law Developments – Commercial Law

MidWestOne Bank v. Heartland Coop, 941 N.W.2d 876 (Iowa 2020)

Priority Contest: Grain buyer sought to offset costs of drying and storing Borrower's grain against a lender with a prior perfected security interest in the grain.

Coop purchased grain at various times from Borrower and remitted sale proceeds to MidWest, but with deductions for Coop's drying and storage costs. When MidWest noticed the deductions, it sued Coop for conversion. Borrower was insolvent.

Issues: 1) What statute of limitations applied to MidWest's claim vs. Coop?
2) Was MidWest's perfected security interest in the grain subject to Coop's claims for unjust enrichment (based on the storing and drying costs).

Held: 1) Two-years from date of sale of the farm products. Iowa Code Sec. 614.1(10)
Court also ruled that no "discovery rule" exception applied.
2) No—MidWest's security interest had priority over the Coop's claims absent concrete evidence that it had consented to the charges or waived its priority rights.

Postscript: H.F. 500, a bill creating a statutory lien in favor of parties like the Coop, was introduced in the 2019 Legislative session, but failed to pass.

Case Law Developments – Commercial Law

Shenyang Jinli Metals & Minerals Imp. & Exp. Co., Ltd. v. Sivyer Steel Corp. and TBK Bank, *942 N.W.2d 14 (Iowa Ct. App. 2020) (unpublished disposition)*

Priority Contest: Judgment Creditor / Garnishor vs. Bank with perfected SI in deposit accounts.

TBK had a perfected security interest in Sivyer's deposit accounts. Sivyer defaulted on TBK's loan, but TBK agreed to forbear enforcing its security interest. During the forbearance period, Shenyang, which was owed money for selling raw materials to Sivyer, obtained a judgment against Sivyer and garnished the deposit accounts. TBK answered the garnishment by asserting its perfected security interest. The district court held that Shenyang was entitled to garnish the accounts during TBK's forbearance period, ***but subject to TBK's perfected security interest.*** The court then granted TBK's later motion to reclaim the funds after TBK declared Sivyer to be in default. Shenyang appealed.

Issue: *Whether TBK's inaction during the forbearance period, when Sivyer was allowed to use the deposit accounts funds to continue its business, extinguished TBK's security interest?*

Held: *NO.*

Case Law Developments – Commercial Law

Rebuttable Presumption Rule in Deficiency Cases—Iowa Code Sec. 554.9626

Article 9 imposes various notification requirements when the Secured Party conducts a self-help foreclosure sale. See Section 554.9611-.9614. The Debtor may use the Secured Party's failure to provide proper notice as a defense in a deficiency action. However, under Revised Article 9 (which Iowa has adopted), the notice problem no longer creates an Absolute Bar to the Secured Party's right to collect a deficiency.

Rather, under the provisions of Section 554.9626, the deficiency is presumed to be Zero. The Secured Party may collect a deficiency only if the Secured Party rebuts the presumption by proving the amount the foreclosure sale would have produced had the Secured Party complied with Article 9 when conducting the sale.

Case Law Developments – Commercial Law

RSB Entertainment, LLC v. Heritage Bank, N.A., *942 N.W.2d 3 (Iowa Ct. App. 2020) (unpublished disposition)*

Rebuttable Presumption Rule Applies

Bank enforced mortgage and security interest against a bowling alley (real property and fixtures) and conducted a commercially reasonable private foreclosure sale of the fixtures. However, Bank failed to timely notify Debtor RSB of the sale of the fixtures, as required by Article 9. RSB raised the notice problem as a defense in the deficiency action.

Held: Section 554.9626 replaces Iowa's former case law rule (an Absolute Bar to a deficiency where the Secured Party fails to comply with Article 9 when disposing of collateral). The Court remanded the case to allow Bank to prove the amount of the deficiency that Debtor would have owed had the Bank complied with Article 9.

NOTE: Although Bank lost this appeal, because the foreclosure sale was a commercially reasonable *private sale*, Bank will likely be able to establish the same deficiency amount on remand, as providing proper notice would not have altered to the deficiency amount.

Case Law Developments – Commercial Law

Priority of "Agricultural Liens" on Crops and Livestock

The Iowa Code creates various statutory liens against crops and/or livestock in favor of those who provide goods or services on credit to farming operations.

Examples include the Landlord's Lien, Ag Supply Dealer's Lien, Veterinarian's Lien, Harvester's Lien.

The provisions creating many of these liens, as well as Article 9 itself—which defines such liens as "Agricultural Liens"—requires that the liens be perfected as if they were security interests. See Iowa Code Sec. 554.9109.

And an unperfected Agricultural Lien is subject to the same priority rules as apply to an unperfected Article 9 security interest. See, e.g., Iowa Code Sec. 554.9322.

Case Law Developments – Commercial Law

In re Keast Enterprises, Inc., *2020 WL 534717, 68 Bankr. Ct. Dec. 75, 101 UCC Rep. Serv. 157 (S.D. Iowa 2020)*

Priority Contest: Unperfected Ag Lien vs. Bankruptcy Trustee

Larsen sold over $400,000 of agricultural products on credit to Keast Enterprises, Inc. The Ag Supply Dealer's Lien (Iowa Code Ch. 570) created a lien on Keast's crops / livestock in Larsen's favor. *Problem: Larsen filed a financing statement against Keast's principal, Russell Keast, but not against Keast—the farm operation*.

When Keast Enterprises filed bankruptcy, the Trustee objected to Larsen's Proof of Secured Claim based on Larsen's failure to perfect its Ag Lien. The Court sustained the Trustee's objection in this opinion. Article 9 makes clear that if the filed Financing Statement does not include the Debtor's correct name (here Keast Enterprises, Inc.), the filing is not effective. See Iowa Code Sec. 554.9502.

NOTE: Iowa Code Sec. 554.9506 saves a financing statement that does not provide the debtor's correct name if the error is "not seriously misleading." The test: does a search of debtor's correct name retrieve the filed financing statement with the incorrect name? The Court determined that this provision did not work in Larsen's case.

Case Law Developments – Commercial Law

Enforcement of Judgments

The Iowa Code (Chapter 626) provides various remedies to an unpaid judgment creditor, including enforcement of the judgment through writs of execution against the judgment debtor's non-exempt personal property. Ch. 626's list of intangible personal property that may be levied on includes "judgments and things in action."

Various exemptions in the Iowa Code provide the primary limit on a judgment creditor's use of Ch. 626. In the following case, the Iowa Supreme Court recognized an additional public policy exception where the "thing in action" the judgment creditor levies on is a legal malpractice claim against the judgment debtor's attorney.

Case Law Developments – Commercial Law

***Gray v. Oliver**, 943 N.W.2d 617 (Iowa 2020)*

Judgment creditors used the Iowa execution process to acquire a chose in action belonging to the judgment debtor, namely, a chose in action representing the judgment debtor's right to bring a malpractice claim against his attorney in the original action.

The judgment creditors had prevailed in a civil suit that was based on an outrageous incident of child sexual abuse. The defendant's attorney had rejected a number of attempts at settlement, and did little to defend the action, which resulted in a $127 million judgment vs. his client. Nonetheless, the judgment debtor had NOT asserted a malpractice claim against the attorney.

The district court held that the involuntary assignment of any malpractice action under Iowa Code Ch. 626 was invalid, and the Iowa Supreme Court affirmed.

The Court's decision (McDonald, J.) explores precedent on this question from other states, most of which disallows either voluntary or involuntary assignments of legal malpractice claims. The decision highlights a variety of policy concerns with assignment of legal malpractice claims, including invasion of the attorney client relationship and perverse incentives for litigants where the defendant is under-insured.

Case Law Developments – Business Associations Law

***Homeland Energy Solutions v. Retterath**, 938 N.W.2d 664 (Iowa 2020)*

HES, an Iowa LLC, sued Retterath, its largest member, to enforce an agreement for repurchase of his interests in the LLC for $30 million.

HES and Retterath entered into a Membership Interest Repurchase Agreement (a "MURA"). When Retterath realized that the MURA would trigger adverse tax implications, he resisted enforcement on a variety of grounds, including alleged conflicts with the HES Operating Agreement. Following trial the district court granted HES request for specific enforcement of the MURA and awarded attorney's fees. Retterath appealed.

The bulk of the Court's decision (Wiggins, J.) addressed and rejected Retterath's assertions that various provisions of HES's Operating Agreement or Iowa Code Ch. 489 were in conflict with the MURA and thus precluded enforcement.

E.g., Retterath claimed that the MURA required a vote by HES's members because the OA called for member approval if HES acquired securities from one of its directors (and Retterath was a director). The Court rejected the argument based on a more specific OA provision that set conditions for repurchase of a member's interest in the company but did not include a member-vote requirement.

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E.g., Retterath claimed that the MURA was an action outside HES's ordinary course of business and thus required a vote by HES's members under Iowa Code Sec. 489.407(3)(d)(3). The Court rejected the argument based in part on OA provisions that defined the scope of the company's business.

Case Law Developments – Business Associations Law

***Homeland Energy Solutions v. Retterath**, 938 N.W.2d 664 (Iowa 2020)*

HES, an Iowa LLC, sued Retterath, its largest member, to enforce an agreement for repurchase of his interests in the LLC for $30 million.

Lessons:

Members have no obligation to sell their membership interests back to the LLC (nor any right to require the LLC to repurchase them), unless the Operating Agreement or other contract provides that right.

Courts interpret Operating Agreements using ordinary contract construction principles.

Case Law Developments – Business Associations Law

Juliet: "What's in a name? That which we call a rose
By any other name would smell as sweet."

But what about an LLC?

Jeremy Hollingshead v. DC Misfits, LLC, *937 N.W.2d 616 (Iowa 2020)*

Iowa's Dramshop Law requires that the injured party notify the bar's insurer. The notice must include the name of the bar's liquor licensee.

In the above dramshop suit, plaintiff's notice to the insurer included the name of a prior owner of the bar, **"Leonard LLC DBA Misfits,"** that had been administratively dissolved. The name of the LLC that operated the bar at the time of the incident was **"DC Misfits, LLC."** The District Court granted summary judgment on the basis of the defective notice, and a divided Court of Appeals affirmed. The Iowa Supreme Court reversed on further review.

The Court reasoned that the notice gave the insurer notice *"that the claim was against the bar known as Misfits, no matter who owned it"* and thus substantially complied with the Dramshop Act's requirements.

Justice McDonald dissented, reasoning that the two "Misfits" LLCs were separate legal persons under Iowa law, so that "the bar known as Misfits" was not sufficient notice.

Case Law Developments – Business Associations Law

Potpourri of Iowa Court of Appeals Rulings:

Burden of Proof, LLC Piercing: **Nesset, Inc. v. Jones,** 2020 WL 1879582, *4 (Iowa Ct. App. 2020) (unpublished disposition)

"[W]e read the case law as placing the burden on Weber Paint, as plaintiff, to show exceptional circumstances exist to warrant imposing personal liability on Jones, as a member of the LLC that owns the Sokol buildings.").

See also Doré, Iowa Practice—Business Organizations § 15:4, fn. 4 (collecting cases for the proposition that "[t]he party who wants the court to ignore the corporation's separate existence bears the burden of proof").

See also **Truenorth Companies, L.C. v. TruNorth Warranty Plans of North America, LLC,** 423 F.Supp. 3d 604, 605 (N.D. Iowa 2019) (plaintiff's petition allegation that defendant corporation was the alter ego of a commonly-owned corporation was not backed by evidence of any of the supporting factors considered by Iowa courts, leading the court to dismiss for lack of personal jurisdiction).

Case Law Developments – Business Associations Law

Potpourri of Iowa Court of Appeals Rulings:

Common Law actions for Securities Fraud: Morrissey v. Tim Watts and Int'l Workshop, LLC, 2020 WL 3264375 (Iowa Ct. App. 2020) (unpublished disposition)

Affirming plaintiff's verdict in a common law action for fraud and misrepresentation in connection with business investments.

Case Law Developments – Business Associations Law

Potpourri of Iowa Court of Appeals Rulings:

Service of Process on Iowa Business Associations

Iowa Rule of Civil Procedure 1.305 provides that service may be accomplished on corporations and partnerships (which presumably include not only general partnerships but also limited liability partnerships and limited partnerships) "by serving any present or acting or last-known officer thereof, or any general or managing agent … or … the general partner of a partnership."

For a recent discussion and application of this rule, see **Ackelson v. Aquawood, LLC,** 2019 WL 8376268 (S.D. Iowa 2019) (holding that service on outside attorney for a limited liability company did not qualify as proper service on the company under this rule but indicating that rule would permit service on the company through service on its former president).

Case Law Developments – Business Associations Law

Potpourri of Iowa Court of Appeals Rulings:

Iowa Business Judgment Rule

Iowa Farm Bureau Feder. v. Daden Group, Inc., 2020 WL 1049820 (Iowa Ct. App. 2020) (unpublished disposition).

A corporation sued one of its directors for refusing to approve a proposed debt swap between the corporation, which was struggling financially, and another company. The Court of Appeals agreed with the trial court that the business judgment rule protected the defendant director because he made his decision in good faith and was motivated by what he believed was the corporation's best interests.

Case Law Developments – Business Associations Law

Also worth a look (from the Iowa Business Specialty Court):

Application of a Common Law Right to Inspect Corporate Records Under Iowa Law

Gregory M. Shepard v. EMC Insurance Group, Inc., Case No. CVCV058747 (Polk Co. Dist. Ct. Sept. 10, 2019)

and

Exploring Procedural Requirements for Beneficial Owner of Publicly-Traded Shares to Perfect Claims for Appraisal

EMC Insurance Group, Inc. v. Gregory M. Shepard, Case No. LACL146273 (Polk Co. Dist. Ct. April 5, 2020)