

MEMORANDUM

To: ABA and NCCUSL Drafting Committees for Proposed Junction Box Statute

From: William H. Clark, Jr.
George W. Coleman
Jon T. Hirschoff

Date: October 28, 2003

Re: Policy Issues for Discussion at November 9, 2003 Meeting

Introduction

This memorandum outlines our thoughts on the major issues that need to be resolved as we begin the joint effort to draft a comprehensive junction box statute. Our hope is that the reporters will come away from the November 9th meeting with enough guidance to be able to produce a full draft for review at our next meeting.

As you all know, our joint project will be working against the backdrop of previous junction box drafting projects. To try and keep things straight, we suggest the following set of terms:

- Joint Project = the current effort to draft a comprehensive junction box statute being undertaken jointly by NCCUSL and the ABA Business Law Section.
- MBCA Ch.9 = the Model Business Corporation Act, Chapter 9. These provisions were added to the Model Business Corporation Act in August 2002. They deal with domestications and conversions. The MBCA also contains provisions authorizing cross-entity mergers, which are found in Chapter 11. For simplicity's sake, we include the cross-entity merger provisions in Chapter 11 in the term MBCA Ch.9.
- UEnTA = the Uniform Entity Transactions Act. This is the junction box statute that was previously being drafted by NCCUSL.
- MITA = the Model Inter-Entity Transactions Act. This is the junction box statute that was previously being drafted by the Ad Hoc Committee on Entity Rationalization of the ABA Business Law Section. An exposure draft was published at 57 Bus. Law. 1569 (August 2002). A copy of MITA accompanies this memorandum.
- META = the Model Entity Transactions Act that will be drafted by the Joint Project. This title is used in Bill Henning's memorandum describing the agreement between NCCUSL and the ABA to conduct the Joint Project. We think it is a useful name because it is different from the names of the other

junction box projects, and our guess is that it is likely to survive through the end of the Joint Project.

Issues

1. Scope. The most obvious initial questions to be resolved relate to the scope of META. The issues can be seen by looking at the scope of the existing junction box proposals:

- UEnTA requires that a domestic unincorporated entity be a party in some capacity to any transaction under UEnTA. Thus UEnTA would not apply to the conversion of a domestic corporation to a foreign limited liability company.
- MBCA Ch.9 is similar in approach to UEnTA because MBCA Ch.9 requires a domestic business corporation to be a party to a transaction. Thus MBCA Ch.9 does not apply, for example, to a conversion of a limited partnership to a limited liability company. That type of transaction could be accomplished under MBCA Ch.9, but it would require two steps: conversion of the limited partnership to a domestic business corporation, and then conversion of the corporation to a limited liability company.
- MITA applies to any transaction that involves more than one form of entity. Thus MITA would permit the conversion of a domestic corporation to a foreign limited liability company that is not possible under UEnTA, and would also permit the conversion of a limited partnership to a limited liability company that is not possible under MBCA Ch.9.

Our proposal for discussion on November 9th is that META include all forms of private entities other than estates and trusts. UEnTA and MITA are largely in agreement as to the forms of unincorporated organizations that should be allowed to use a junction box statute. UEnTA and MITA also both provide optional provisions that can be used by enacting states to exclude special types of entities for public policy reasons. We think a comprehensive scope for META is inherent in the nature of the Joint Project, but we also think it is useful to reaffirm that we share a common vision at the outset of the project.

A scope issue relating to the types of transactions authorized by META is discussed below.

2. How to integrate META with existing entity laws. Assuming META is to include all forms of entities, how should META be integrated with a state's existing entity laws? The approach proposed by UEnTA is to replace all of the merger, conversion and domestication provisions of existing unincorporated entity laws with the UEnTA provisions. MITA, in contrast, proposes to leave in place the merger provisions of existing entity laws, but limit them to mergers just involving entities of the type formed under each law. The reason MITA takes that approach is because most conversions can be accomplished under existing law by establishing a new entity of the desired form and merging into it the entity that is to be converted.

Our proposal for discussion on November 9th is that META leave in place existing entity law provisions with respect to same species mergers and use the procedures for approving those mergers when approving any type of transaction under META. We believe that leaving existing merger procedures in place will be more palatable to the states because it will seem much more familiar. Leaving existing merger provisions in place also solves issues such as when dissenters rights should be available by simply carrying over existing law in each state on which transactions involving which forms of entities give rise to dissenters rights. Perhaps the most important problem that using merger procedures will solve is the question of the vote required to approve a transaction.

A final reason for leaving existing merger provisions in place is that it will make it easier to integrate corporations into META. We believe it is important for all forms of entities to be treated in the same manner in META.

3. Approval of transactions. Those people who have been involved in the drafting of UEnTA know that we have had lengthy discussions about the default vote to approve a transaction under UEnTA. For the background of those not familiar with the drafting of UEnTA, it proposes that the default rule to approve a merger, etc. under UEnTA be the unanimous vote of the owners of each entity. That unanimous vote requirement represents a significant change in existing law. Under current law:

- 29 states require less than a unanimous vote of the members of a limited liability company to approve a merger;
- of the 33 states that authorize mergers of limited partnerships, 17 states require only a majority vote of the limited partners along with a unanimous vote of the general partners; and
- no state requires a unanimous vote of shareholders or members to approve a merger of a corporation.

If we adopt the approach proposed under item 2, above, and apply existing voting requirements for mergers between the same type of entity to all transactions under META, the default vote issue disappears.

4. Nonprofit transactions. UEnTA permits a nonprofit entity to merge into a for-profit entity, or to convert to for-profit form. UEnTA is silent, however, about preserving restrictions on the use of any charitable assets held by the nonprofit entity. MITA, on the other hand, provides expressly that charitable assets may not be diverted from their restricted purpose except in accordance with state cy pres procedures. Our proposal is to include provisions protecting charitable assets held by nonprofit entities.

* * * * *

We are sensitive to the fact that the preceding discussion could be seen simply as an endorsement of MITA at the expense of UEnTA. The last thing we want to do is to cause problems between the two drafting committees working on META. In fact, the

reason we prefer the approach taken by MITA to the issues discussed above over the approach taken by UEnTA to date is simply because MITA was drafted to be a comprehensive junction box, in contrast not only to UEnTA but also to MBCA Ch.9. Since the focus and scope of MITA are closer to what we want to accomplish in the Joint Project, we believe MITA makes a better starting point.

We look forward to seeing everyone in Chicago on November 9th.

W.H.C.,Jr.

G.W.C

J.T.H.