MINUTES OF THE
SENATE COMMITTEE ON JUDICIARY

Seventy-Seventh Session
April 2, 2013

The Senate Committee on Judiciary was called to order by Chair Tick Segerblom at 8:08 a.m. on Tuesday, April 2, 2013, in Room 2149 of the Legislative Building, Carson City, Nevada. The meeting was videoconferenced to Room 4412 of the Grant Sawyer State Office Building, 555 East Washington Avenue, Las Vegas, Nevada. Exhibit A is the Agenda. Exhibit B is the Attendance Roster. All exhibits are available and on file in the Research Library of the Legislative Counsel Bureau.

COMMITTEE MEMBERS PRESENT:

Senator Tick Segerblom, Chair
Senator Ruben J. Kihuen, Vice Chair
Senator Aaron D. Ford
Senator Justin C. Jones
Senator Greg Brower
Senator Scott Hammond
Senator Mark Hutchison

GUEST LEGISLATORS PRESENT:

Senator Ben Kieckhefer, Senatorial District No. 16
Senator Michael Roberson, Senatorial District No. 20

STAFF MEMBERS PRESENT:

Mindy Martini, Policy Analyst
Nick Anthony, Counsel
Suzanne Efford, Committee Secretary

OTHERS PRESENT:

Robert C. Kim, Chair, Business Law Section, State Bar of Nevada
Albert Kovacs
Scott W. Anderson, Deputy for Commercial Recordings, Office of the Secretary of State
Matthew A. Taylor, President, Nevada Registered Agent Association

Randi Thompson, Director, National Federation of Independent Business
Robert W. Marshall
Nicole J. Lamboley, Chief Deputy, Office of the Secretary of State
John P. Sande III, International Game Technology
Carole Vilardo, President, Nevada Taxpayers Association
Kate Marshall, State Treasurer
Steve G. George, Chief of Staff, Office of the State Treasurer
Robert P. Krenkowitz
Russel B. Duckworth, CFA, Duckworth Capital Management, LLC
Robert E. Armstrong
Keith Lee, Sutton Place Limited
Brett Kandt, Special Deputy Attorney General, Office of the Attorney General
Kristin Erickson, Nevada District Attorneys Association

Chair Segerblom:
We will open the hearing on Senate Bill (S.B.) 441.

SENATE BILL 441: Makes various changes to provisions governing business entities. (BDR 7-166)

Robert C. Kim (Chair, Business Law Section, State Bar of Nevada):
Senate Bill 441 is a product of the Executive Committee, Business Law Section, State Bar of Nevada. Every Legislative Session since 1991, the Business Law Section has submitted bills designed to address changes in business law, corporate law and other entity law that we have experienced as practicing attorneys. We propose amendments to existing law to carry forward Nevada's business law entities to make them flexible and attractive for others to use.

Working with the Secretary of State (SOS), we coordinated our efforts to create a bill that would enhance and clarify laws as needed and adopt new provisions and aspects that are trending in the marketplace.

I will provide a small background to each section of the bill that is an addition to the memorandum I have submitted (Exhibit C).

Section 1 of S.B. 441 focuses on an issue addressed by the Nevada Supreme Court in the case of *Consipio Holding BV v. Carlberg*, 128 Nev.___, 282 P.3d 751 (2012). In that case, the Court struggled with the extent to which jurisdiction could be had over a Nevada director or officer who was not

a resident of Nevada. Because of a footnote in this case regarding the potential need for legislative action, we reviewed issues, policies and language from different jurisdictions.

We look to Delaware to determine what it does. We do not necessarily copy what it does; however, it was a good frame of reference to understand what certain markets are willing to adopt.

In this regard, we adopted a proposal that will be part of chapter 75 of the *Nevada Revised Statutes* (NRS), the general chapter of Title 7, which will apply to all entities. It establishes jurisdiction or a means to gain jurisdiction over nonresident Nevada officers and directors.

Senator Ford:
Have you finished explaining section 1?

Mr. Kim:
Yes, I have, from a general perspective.

Senator Ford:
Would you remind us what the Nevada Supreme Court held regarding jurisdiction over nonresident directors and what problem you are trying to fix with this section and how you fixed it?

Mr. Kim:
I do not recall the holding. However, I know it was an issue that the Nevada Supreme Court noted was not addressed in Nevada statutes and the Court wanted to arrive at a better ruling. The underlying case involved a jurisdictional issue, which had delayed litigation for a while without even arriving at the substance of the litigation itself. If officers, directors, managers or other representatives of a Nevada entity want to benefit from the provisions of Nevada laws, the Business Law Section Executive Committee determined it was appropriate to clarify that there is also a level of jurisdiction to which officers, directors, managers or other representatives would be subject. They cannot have the benefit without the burden by acting through a Nevada entity.

Senator Ford:
What was the name of that case?

Mr. Kim:
The name of the case is *Consipio Holding BV v. Carlberg*.

Our proposal is lengthy for a new section. It addresses the standard of who is a nonresident officer and director, identifies how service of process can be achieved and specifies what can be done through registered agents.

The plaintiff can file an affidavit stating that due diligence has been done, and within 40 days thereafter, the defendant officer or director is required to answer. This provides a process through which jurisdiction can be had over the person. If the person does not respond or fails to respond, then the proceedings can progress from there. Failure to respond leads in a default judgment.

Senator Hutchison:
My understanding of section 1 is that we are codifying personal jurisdiction over someone who is an officer or director with a Nevada corporation. There is sufficient minimum contact under our long-arm statute to establish personal jurisdiction over anyone who becomes an officer or director. It does not matter if you live here, send a letter here or make a phone call here; if you do business here and become a Nevada officer or director, that is sufficient to establish minimum contact and you will be subject to jurisdiction in the state of Nevada.

Mr. Kim:
That is correct.

Senator Ford:
That is my understanding as well. How consistent is that? Before this case came up, it was consistently held that merely being a director or an officer was insufficient for purposes of personal jurisdiction, absent some other forms of contact. I want to understand why we bother to codify personal jurisdiction in circumstances like this if, in fact, other jurisdictions do not do that.

Mr. Kim:
Part of the establishment of personal jurisdictions is also actual service of process. This clearly establishes the principles of personal jurisdiction over an officer or director and then establishes the process of service if service cannot be had, so that there is actual jurisdiction. Therefore, there is no way to avoid service in a case.

Senator Ford:
I understand the service part. I am talking about the preliminary issue of whether there is jurisdiction over the person in the first place. It is my understanding that simply being an officer or director of a corporation is insufficient for purposes of personal jurisdiction. Just because there is a corporation somewhere does not mean there is jurisdiction over the officers and directors.

Mr. Kim:
We did not do a state-by-state survey, but we based this bill on a similar statute in Delaware. Unfortunately, as the saying goes, bad facts potentially arrive at bad law. I am not saying this is bad law per se, but in the underlying facts, there was a Nevada corporation being used by persons located in Europe. They never stepped into the State and there was no way to contact anyone. For that reason, we are going through the effort to make laws designed to be worthy of use by others in a principled manner to avoid liability for actions that should not have taken place. It is a good idea to establish jurisdiction if someone benefits from Nevada laws.

Senator Ford:
In addition, as a final point, as I read the summary of the opinion, this makes sense. In the case you mentioned, it appears that the director directly harmed Nevada. Perhaps there was more contact than just being an officer or director.

Mr. Kim:
Section 2 of S.B. 441 addresses the duties of an officer or director when there is a change of control. The purpose of our revisions is to reflect the extent or the applicability of fiduciary duties of officers and directors in the context of a change of control.

Nevada Revised Statutes 78.139 was adopted in 1999 because of a hostile takeover where a board was responding to a change of control brought by a third party. There was a need to clarify that even in that situation, the board of directors should benefit from the business judgment rule presumption contained in NRS 78.138. They should also be able to avail themselves of the considerations set forth in NRS 78.138 when taking actions in response to a change of control.

Obviously, much time has passed and third parties do not necessarily trigger changes of control. For the most part, the changes are done on a consensual basis by a board desiring to do a combination it believes to be in the interest of the stockholders and the corporation as a whole, based on all the interests involved.

It is appropriate to amend NRS 78.139 to reflect that a board of directors or officers should have the benefit of the business judgment rule presumption on any change of control whether the board members are confronted with it, initiated it themselves, or negotiated it with a third party. This makes sense, especially when we have already afforded that presumption, in an extreme context, with respect to a hostile takeover.

That is the purpose for the changes to NRS 78.139. There is also a minor structural change that is neither substantive nor related to this main point.

Sections 3 and 4 of the bill are related to meetings of the board of directors and stockholders. We are clarifying the means by which meetings can be held and attendance verified. Recently, the Model Business Corporation Act (MBCA) adopted new language addressing this issue. Similar to MBCA, we are clarifying the means by which parties can take advantage of electronic communications, videoconferencing, teleconferencing and other technology.

There was an issue because the MBCA noted what it means to be simultaneous and sequential. Taking the MBCA lead, we are clarifying the language in section 3, subsection 3, which provides for verification of attendance and a reasonable means to participate regarding the standards for meetings held electronically, by video or the other forms of technology. This change is also being made to the stockholders meetings.

Section 6 deals with clarifying the statute of limitations for claims against corporations or limited-liability companies (LLC) with respect to actions in existence that were claimed prior to or after dissolution. A footnote or two from the Nevada Supreme Court case, *Canarelli v. Eighth Judicial Dist. Court,* 127 Nev.___, 265 P.3d 673 (2011), also prompted this. The Court noted that statute addresses the statute of limitations regarding predissolution claims, but does not have any guidance with respect to the appropriate cutoff date for claims brought postdissolution.

There were different, ongoing liabilities in this homebuilder case. The entity had actually wound down its affairs and filed a certificate of dissolution to start the winding down process.

Because of the uncertainty of that, we looked to the MBCA and other states and determined it is appropriate to address the needs identified by the Nevada Supreme Court. We propose to amend NRS 78.585 as well as NRS 86.505 in order to clarify a window exists through which postdissolution claims can also be brought.

Senator Hutchison:
Mr. Kim, do you recall what the Court held in those footnotes? Did the Court fall back to the catchall statute of limitations, or did it go to a 3-year fraud rule such as "you should have known"?

Mr. Kim:
I do not recall, but I can find out.

Senator Hutchison:
The bottom line is that the Court footnotes said it is unclear. Therefore, you decided to make it clear for the Court. I was just wondering what the Court applied because I see that a 2-year statute of limitations applied to both of these. I am curious if the Court thought that the fallback, catchall statute applied.

Mr. Kim:
I do not think the Court noted the lack of clear guidance as to claims brought after articles of dissolution have been filed. The struggle was with what that meant, what it could do and how to address a motion to dismiss based on the timing of the statute.

Chair Segerblom:
Do you show your proposals to the business court judges?

Mr. Kim:
We have not done that. We have taken different leads from footnotes before, and we have spoken with some of the business court judges about doing that on purpose to get someone to do something. Occasionally they will send a case to the Nevada State Bar with a note stating please see this footnote and please

do something. It makes sense to complete the circle and advise the courts that we are taking action.

Chair Segerblom:
After this bill passes, we can send it to all the business court judges in the State to review.

Mr. Kim:
The next sections are 12 and 14 of S.B. 441. This series of changes address Nevada LLCs because they have become the vehicle of preference for many enterprises, from family businesses to real estate holdings, to venture capital funds and estate planning. It is appropriate to adopt these amendments to address the constant evolution of LLCs and the sophistication of their use. Nevada needs to set forth affirmatively clear guidance as to how these entities can be used, should be used and how we want them to be used.

Conceptually, the changes clarify that Nevada entities can be used as special purpose entities for bankruptcy remoteness or bankruptcy remote entities. The changes clarify freedom of contract regarding the rights and duties of the parties involving themselves in the LLC. They clarify dissolution entities and dissolution provisions with respect to what is and is not required of the members in the absence of a member, in certain circumstances. They also clarify when articles of dissolution can and should be filed and what the consequences are of filing.

Bankruptcy remoteness touches upon sections 12, 14, 15, 16 and 17 of the bill. These sections address NRS 86.011, 86.151, 86.286 and 86.326 and proposes the adoption of a new section of NRS 86 starting with section 12.

Bankruptcy remoteness is a key feature for entities involved in financing and other business transactions in which a party to a transaction, such as a lender or other capital partner, under certain circumstances, may want to prevent the targeted company receiving the funds from filing bankruptcy. The reasons would be to avoid and discharge claims and things of that nature.

The purpose of the bankruptcy remote feature is to allow the parties to retain the benefit of the bargain when they originally made the loan or financing and not allow other parties to put the company into bankruptcy, retain control and somehow not fulfill its obligations.

Most of the time, the desire is to keep a company out of bankruptcy so that the appropriate remedies already provided for and negotiated for can be exercised without being subject to the automatic stay and the other equitable features of the bankruptcy laws.

The personal representative represents a third party that is not a member of the LLC.

The other revisions regarding bankruptcy remoteness are related to NRS 86.286 and NRS 86.151. We are clarifying the rights of third parties in the LLC so that provisions inserted into LLCs or special purpose entities can be given full force and effect as intended by the parties when they initially entered into their transaction.

In sections 13 and 16 of the bill, a new section is added to NRS 86, and there are additional amendments to NRS 86.286 (Exhibit D). These amendments deal with freedom of contract and the clarification of duties as was mentioned previously.

Limited-liability companies are provided for in statute. Statute already identifies that as a key concept in interpreting operating agreements and deferring to the parties the ability to understand and enter into their own terms and make their own agreements as to what rights and obligations each party should have.

The use of LLCs has increased, in place of corporations, for example. There has been some uncertainty as to whether corporate duties can be imputed or implied in the LLC context as it relates to managers and members. Managers are analogous to directors and members are analogous to stockholders.

The bill includes a proposal to amend NRS 86.286 and adopt a new section 13 to reinforce the fact that the duty of good faith and fair dealing can and will always be a part of LLC law. Because this is a contract-based premise, we know that the duty of good faith and fair dealing is implied in every contract. That cannot be contracted away by a party. However, the remaining duties that one can impute or argue for or bargain for should be provided for in the agreement. That is the purpose of clarifying that.

Chair Segerblom:
Why would you not want to have fiduciary duty?

Senator Jones:
Many LLCs are formed every day in Nevada, and many of them never get to the point of having an operating agreement. What happens in the context of the creation of an LLC if there is no LLC agreement between the parties? I am all for the freedom to contract. The reason we have statutes is that parties do not always do what they are supposed to. In forming contracts, they are supposed to govern their relationships, and if there is no duty left over, from where does it come?

Mr. Kim:
Our statute gave the foundation for parties to enter into the agreement between themselves and provide for the duties they want to have. That language was already there. The goal of these amendments is to make clear that we are leaving it up to the parties to establish their own rights and obligations.

The duties of good faith and fair dealing are in statute already. They will always be there and cannot be removed even by contract. From that perspective, one cannot commit fraud, misrepresent what he or she is doing or act in bad faith. The duty of good faith is part of the statute and is being reinforced as part of these amendments.

I understand the need to provide context, but as a policy over the years, since the adoption of the LLC statutes in the 1990s, the goal has been to provide a framework in which to operate and not be caught up in the details as to how a LLC should be governed.

The Uniform Law Commission adopts different model acts. They spent much time on a model LLC act, which we have flatly refused to adopt because it complicates things by incorporating and making as default things you may not want and may not realize you have as part of your LLC because they have been codified as part of the statute. That path makes someone's specific operating agreement law. There would then have to be scaling back from that with carveouts.

There is a need to have balance, and I understand the desire not to have a situation with no guidance at all. However, our laws establish the principles of contract and the ability of the parties to establish their own rights, obligations and duties amongst themselves. Our goal is to clarify statute so it can be

positioned better for use by different funds or different kinds of business ventures that involve parties that are looking for that kind of clarity.

Senator Jones:
When a firm drafts these agreements, they are pretty good, but the problem is that a lot of attorneys are not well suited to draft operating agreements or do not have any operating agreements. I am concerned that if we do not have a framework to fall back on, a mess is created for the courts. We spend much time in business court, and we do not give the judges a lot of guidance when it is a 50-50 LLC. What happens if there is no operating agreement? I agree that there should be freedom to contract. Many good firms draft good operating agreements, but many LLCs do nothing.

Mr. Kim:
We are not changing the framework, we are just clarifying what the parties can adopt.

Senator Ford:
Mr. Kim used a key phrase that may be worthy of consideration, which is the "fallback position." If we do not have an operating agreement, maybe there is the fallback in that the common-law duties of fiduciaries will take effect.

One of the questions I have is related to the distinction between the contract law the LLCs are built on and common-law fiduciary duties. It is difficult to win a breach of the covenant of good-faith and fair-dealing litigation. It is always difficult to establish a breach. If we only allow litigation on the breach of the covenant of good faith and fair dealing regarding LLC duties, should there be some form of altered standard to protect the people associated with the LLC?

Mr. Kim:
Nevada law does not require operating agreements, and even if there was an operating agreement, it may not be sufficient to address concerns.

The LLCs are not common-law entities as are corporations. This is reinforcing the fact that our statute should clarify that parties need to provide for their rights and obligations amongst themselves. This is a combined effort of the parties to understand what they are getting into. I agree that people take risks when they do not put what they should do in writing. The Executive Committee does not legislate against those who cannot take care of themselves or be in

a position where they should have known better. Otherwise, we would have endless laws.

We are striking a balance in Nevada where we already have a standard and are clarifying it.

Albert Kovacs:
I have submitted written testimony on the logic and the intentions behind S.B. 441 (Exhibit E). To answer Senator Ford, the LLC, as a business entity form, is essentially an invention. It is a deviation from common law and is fundamentally and essentially a grant, from the State, of the ability to create a contractually based business relationship. It is not a corporation. By its very nature, it is intended to be free of the common-law, status-based fiduciary duties. For example, in a corporation, if you are a director, by caselaw in Delaware, by statute in Nevada, you have certain duties. It does not matter if you have any other agreement that limits your role as a director—you have certain duties based on your status.

There is no counterpart to that in the LLC. The LLC is intended to be a blank-slate entity that the parties, through their contractual relationships, can make it what they want it to be. Of course, just like any other contractual relationship, sometimes the parties are not perfect in writing down what they want to accomplish, or sometimes they fail to write things down at all. In which case, you are in the same situation you would be in with any kind of oral contract. You end up looking at a course of dealing to determine the range of authority of the various parties, the responsibilities they have, and infer from that what the parties intended the scope of those responsibilities to be.

The LLC affords, by definition, an exceptional amount of flexibility, adaptability and customizability. With that flexibility and freedom, the parties have a certain amount of responsibility. If the parties avail themselves of the LLC form, they have freedom to decide for themselves how to run their business, who is in charge of what, and what limitations are put on those authorities and powers.

To preserve the essential nature of an LLC, there has to be a pullback from the understandable urge to protect those who may not live up to that responsibility. However, it is best to avoid letting too much sympathy and paternalism into this situation.

Senator Ford:
Do we need to strengthen the breach of the covenant of good-faith and fair-dealing standards when there are no corporate common-law fiduciary duties?

Mr. Kovacs:
To reinforce the fundamental nature of the LLC as a contract-based entity, you would not have to alter the contractual covenant of good faith and fair dealing. You can infer the intentions of the parties regarding the duties and responsibilities from either the wording of the contract or the course of conduct and use contract interpretation principles as you would in any other contract interpretation context.

You do not have to have magic language in an operating agreement that requires fiduciary duties. Courts in Delaware have expressly stated that you can look at either the provisions of the operating agreement or the course of conduct and determine the scope or extent of the fiduciary duties intended by the parties.

Senator Ford:
You mentioned Delaware. Would you explain what Delaware does, what it does not do and the differences and similarities?

Mr. Kovacs:
That gets to the impetus for this proposal, which is to clarify and reinforce the stated policy in NRS 86.286. Operating agreements are interpreted to give maximum effect to the principle of freedom of contract and enforceability. The reason that clarification and reinforcement is necessary is because in a recent string of cases, the Delaware Court of Chancery, which is the primary business court in Delaware, has ignored contract interpretation and imputed that, as a matter of default law, corporate-style fiduciary duties apply in the LLC environment. The Delaware Supreme Court has, on occasion, reacted less than favorably to that approach and suggested that the Delaware Court of Chancery did not need to do that because the contracts themselves clearly indicate what the parties intended.

Because the Delaware Court of Chancery is so influential across jurisdictions, including in Nevada, Nevada courts in the absence of Nevada law will often first look to Delaware for guidance. Chapter 86 of NRS is so deferential to the

parties' agreements and governing documents that there is a concern that the Delaware Court of Chancery's approach of glossing over contract interpretation and applying corporate-style fiduciary duties could be problematic for many businesses, including small businesses, that have carefully negotiated or through their course of conduct have agreed upon their various roles, duties and obligations. The concern is that a court could either alter those by determining they are corporate-style fiduciary duties or imposing duties and liabilities that the businesses expressly did not want.

This clarification reinforces existing Nevada law that says these default corporate-style fiduciary duties do not apply to the LLC. The relationships between the LLC and its parties are what it makes them to be. It has the freedom and responsibility to do that. We are reinforcing the idea already in the law to give maximum effect to the principle of freedom of contract and enforceability.

Senator Hutchison:
Is section 13 intended to be a default provision in the absence of other controlling language in an operating agreement? Can an operating agreement state that members or managers have fiduciary duties?

Mr. Kovacs:
That is correct.

Senator Hutchison:
It is a policy question of whether we want these default provisions to state that if you do not contract, then you have to understand that you do not have fiduciary duties as a member or a manager. Most people in this State think that managers have fiduciary duties. We are saying you have to put that in writing; otherwise by default, and under our statutes, you are not going to have fiduciary duties.

Secondly, the debate is on whether members in an LLC have fiduciary duties. Some states have said they do by either statute or more frequently by court interpretation. From a policy standpoint, we have to decide if we want, as a default matter, members to have fiduciary duties or not.

The horse is out of the barn on this one. We have been using LLCs for a long time and people think that LLCs are corporations. If you want to do something

different, maybe the thing to do is create a different entity which really is a creature of contract. People think that managers are like directors and officers and have similar duties and that members are like shareholders and have similar duties. I do not have a problem with members not having fiduciary duties because shareholders do not have fiduciary duties. Most people think managers have fiduciary duties and they do not think that the default under the law is that they do not. As a policy matter, we can decide that is different and maybe we can tweak that a little bit and work with you.

The breach of the covenant of good faith and fair dealing is also contractual and is either expressed or implied. It is imposed by caselaw and common law on directors and officers. In the absence of an operating agreement, the fallback position is in statute. This is my understanding of the law.

Chair Segerblom:
I would like to point out that it appears we are trying to deviate from Delaware. It seems that we should follow Delaware, but that is the policy decision we have to make.

Mr. Kovacs:
This issue is not, at least among legal scholars and the judiciary in Delaware, an obvious conclusion. There is actually significant disagreement. The Chief Justice of the Delaware Supreme Court has advocated for the approach represented in these statutes. In fact, I also have submitted an article by the Chief Justice analyzing the Delaware LLC act, which has similar provisions (Exhibit F).

Senator Segerblom:
However, Delaware is not there yet. We are jumping ahead of them if we adopt this.

Mr. Kim:
In the *Consipio* case regarding jurisdiction over nonresident officers and directors, that case was remanded back to the District Court for further analysis as to whether jurisdiction was appropriate. There was no published finality in that regard.

In terms of the *Canarelli* case, the Nevada Supreme Court reviewed the context of the MBCA and the fact that the MBCA, at the time that the dissolution statutes were adopted, had a limitation on postdissolution claims. The Court

went ahead and applied their existence as being an oversight in our statutes as well. Our adoption of the limitation would be consistent with the Supreme Court rule, at least in that case.

Sections 15, 17, 18, and 19 of S.B. 441 deal with NRS 86.151, 86.326, 86.491 and 86.495. There are situations when it is determined that the LLC must have a member. However, an LLC must be terminated in other situations if there are no members. The member may have passed away, may be incapacitated or for some other reason is no longer a member, and there is a question as to who has the authority to act and properly dissolve the entity.

We are establishing the concept of the personal representative, which is any third party, including an executor, an administrator, a guardian, a conservator or other legal representative. Our goal is to ensure no gap in our laws regarding an entity that has no member and must be dissolved or not or whether an involved third party can actually make that decision when appropriate.

The next series of sections are 20, 21 and 22 of S.B. 441 that deal with NRS 86.505, 86.531 and 86.541. I have submitted a transitional provision on section 21 of S.B. 441 (Exhibit G).

These sections of NRS are written in a way that presumes that when a certification of dissolution of an LLC has been filed, the business affairs have already settled and all obligations and contingencies have been addressed. This is contrary to the standard in NRS 78, which states that once a certificate of dissolution has been filed, affairs can be settled postdissolution. We are changing the frame of reference in NRS 86 so that the dissolution documents trigger the decision of the members to dissolve and allow the LLC to proceed to settle its business affairs. For example, the existing language refers to the prospective dissolution and not the fact that everything has already been settled.

Section 24 deals with NRS 92A.270. Chapter 92A of NRS addresses all combinations of mergers and exchanges for all Nevada entities. We are clarifying the language regarding domestication because of previous changes to its use and nature. We are making it clear that an undomesticated entity is meant to exist in the jurisdiction from which it came and is not necessarily meant to dissolve. We are adding language to clarify that it could or could not continue its existence in its former jurisdiction.

Conversion is the intended means by which an entity in another state can convert from a Delaware or California entity to a Nevada entity. Domestication covers non-United States entities that want to create a Nevada presence. Its non–United States entity exists but has a Nevada counterpart. Changes that were made a couple of sessions ago blurred those lines, and instead of undoing what has been adopted, we are clarifying the intents.

Section 25 of S.B. 441 would allow a board of directors to adopt dissenter's rights on behalf of stockholders. Transactions involving entities with a large number of stockholders and engaging in a combination of transactions that to the extent they were dissenter's rights would provide a fair value mechanism. We can handle the consummation of those transactions by this process.

Senator Segerblom:
Do any of these changes deal with the Steve Wynn issue?

Mr. Kim:
No, they do not deal with redemption of stock holdings.

Other than some other clarifications to the dissenter's rights statutes, the last item is section 32, which deals with the ability of parties to change venue. This is in response to the fact that we have limited business courts in our State. Sometimes certain matters are filed in districts where there are no designated business courts or anyone willing to have that designation who has dealt with these cases before. The changes to NRS 13.050 would enable the parties to make a change of venue to a business court.

Senator Hutchison:
Do you have any idea of how many cases that would be?

Mr. Kim:
I do not know. For example, a case filed in Carson City where the resident agent is located may be burdensome for the courts and the parties involved. This would allow the parties to agree to go somewhere else.

Senator Hutchison:
Would the case be moved to Washoe County or Clark County?

Mr. Kim:
That is correct.

Scott W. Anderson (Deputy for Commercial Recordings, Office of the Secretary of State):
We support the Business Law Section's efforts to strengthen Nevada's business laws. We do have concerns in sections 3 and 4 regarding the simultaneous and sequential electronic meeting provisions. We added those in the 75th Session and have developed a digital operating agreement around that. I just want to make sure that the language the Business Law Section has added will cover the sequential or simultaneous ability for corporate meetings to be conducted electronically. We need that clarification; otherwise, we fully support the bill.

Senator Segerblom:
Did you want to add language or just put it on the record?

Mr. Anderson:
Mr. Kim might be able to clarify that. In addition, an inconsistency in that language was deleted in section 3 but still remains in section 4.

Mr. Kim:
I agree on the second point. We have submitted a few pages that have some minor editing (Exhibit H) such as the one that Mr. Anderson identified. There was language deleted in section 3 but not in section 4. The goal was to not undermine or reject the simultaneous and sequential concept. The goal is to adopt the concept that was used in the MBCA with respect to concurrence of communications. I will review it, and if there is a concern, I will talk with Mr. Anderson and we will come to a resolution.

Senator Segerblom:
That is not very reassuring. It is our goal to keep the Secretary of State simultaneous. It appears we would want that.

Mr. Anderson:
We would prefer that. We will discuss it with Mr. Kim.

Mr. Kim:
I agree.

Chair Segerblom:
We will close the hearing on S.B. 441 and open the hearing on S.B. 331.

SENATE BILL 331: Exempts certain home-based businesses from the requirement to obtain a state business license. (BDR 7-479)

Senator Michael Roberson (Senatorial District No. 20):
Senate Bill 331 relates to the home-based business exemption for the State business-licensing requirement. *Nevada Revised Statutes* 76.020, subsection 2, paragraph (c), exempts a person who operates a business from his or her home and whose net earnings from that business are not more than approximately $27,000 annually.

Nevada Revised Statutes 87.4309 defines a person to mean "any natural person, corporation, business trust, estate, trust, partnership, association, joint venture, government or governmental subdivision, agency or instrumentality or any other legal or commercial entity."

The Secretary of State's (SOS) Office proposed A.B. No. 78 of the 76th Session to amend NRS 76.020, subsection 2, paragraph (c) to permit only natural persons to claim the home-based business exemption. The unfortunate result of this legislation would have been to increase the financial burden on the smallest of home-based businesses that had opted to use Nevada's limited liability protections under Title 7 of NRS. Needless to say, the bill was one of the more controversial bills of the 76th Legislative Session and did not become law.

However, like a bad penny, it did not go away. In the interim, the SOS's Office proposed regulations to do what it could not accomplish through the legislative process by effectively redefining, through regulation, the statutory definition of a legal person for the limited purposes of qualifying for the home-based business exemption.

First, the SOS's Office attempted to pass the regulation through the Legislative Commission's Subcommittee to Review Regulations and failed. Then, the SOS attempted to pass the regulation through the full Legislative Commission and failed. Finally, in a highly unusual move, Senator Steven A. Horsford pushed the regulation back to the Legislative Commission's Subcommittee to Review Regulations where it passed on a contentious split vote. Many of us in this

building were saddened by that process, believing it was an overreach by the SOS's Office and an obvious end run around the full Legislature.

As I said during the Legislative Commission's hearing on this regulation, we are now forcing home-based businesses, including people who sell Tupperware or other products or services from their homes, to make the difficult choice of waiving the legal protection of our LLC statute or face this additional financial burden. I do not think that this is the time in our economy in this State to be putting those smallest home-based businesses in that difficult position.

In short, S.B. 331 will restore the exemption from the State's business license fee for home-based businesses operating as LLCs or other NRS Title 7 entities and provide needed relief for the smallest of home-based businesses.

Chair Segerblom:
Is the $27,000 you mentioned the net? Someone could make $100,000 in gross income, make substantial write-offs and be left with a $27,000 net. He or she would pay nothing.

Senator Roberson:
I do not know if that is the case or not.

Senator Hutchison:
Was that bill passed out of committee? Did it die in the Assembly? You said it did not pass out of the Assembly.

Senator Roberson:
It passed out of the Assembly and failed on the Senate Floor initially. As one of those deals at the end of the Session aimed to get a bill out of the Session, it narrowly passed the Senate the second time. However, Governor Brian Sandoval vetoed it or did not sign it into law.

Senator Jones:
Will the Governor veto it this time?

Senator Roberson:
I have not spoken to the Governor about this issue. My guess would be if this Committee and the full Legislature pass S.B. 331, I would expect the Governor to sign the legislation.

Matthew A. Taylor (President, Nevada Registered Agent Association):
We are fully in support of this bill because we have seen and been involved in the formation of hundreds of thousands of corporations over the years. I have worked with about 10,000 clients who have formed corporations and LLCs.

In my experience, many small businesses start out with people either protecting a dream or protecting themselves from a dream they are starting. They often seek the protection of the corporation years before they start conducting operations, oftentimes running it out of their houses, applying for patents and working on their business models. Many of those businesses fail; however, some of them do not. Those businesses grow beyond that $27,000 cap, get a commercial location, create jobs and start bringing real revenue into the State.

Unfortunately, through the passage of the $200 business license, we have priced some of those smallest businesses out of the market. The two states we look to as our closest competitors, Delaware and Wyoming, have fees that are roughly one-third of what Nevada charges. While this does not change the fact that larger businesses should pay their fair share, we want to make sure that we get relief for the small home-based businesses.

We have heard three arguments over the years. One is that the SOS wanted to remove the exemption for corporations and LLCs to level the playing field. However, this language puts back onto a playing field those small one-person corporations with an exemption that is already in statute for home-based businesses.

Chair Segerblom:
How would you obtain the exemption? Would it be check the box on the Internet?

Mr. Taylor:
The format is to demonstrate the income and make a sworn statement.

Chair Segerblom:
For example, I live in California and I contact you to file a Nevada corporation. I use my home in California as the place of business and sign statements stating I only make $27,000. Can the SOS's Office do anything about it?

Mr. Taylor:
I am not suggesting we should have nothing to do about it. I am suggesting that there should be some provision or penalty, if there is not one already, for filing a false statement. The SOS's Office should have the ability to investigate if it has probable cause to believe that someone has filed a false statement. We are not protecting wrongdoers. I am protecting smaller companies.

Senator Jones:
Do counties that regulate home-based businesses have the same criteria for getting a county or city business license?

Mr. Taylor:
Some do and some do not. There is no consistent application for that throughout the State.

Senator Jones:
Therefore, we could have a circumstance in which home-based businesses do not have to register with the State but still have to get county business licenses.

Mr. Taylor:
The issue is that they still have to register with the SOS's Office as corporations or LLCs, pay the appropriate fees and register statements showing that they are exempt. It does not give any less information; it actually gives a bit more information than what they would file with a business license application.

The other concern is that, because it is based off the net profit of a company, clients may pay themselves large salaries in order to bring themselves below the $27,000 cap. I would suggest to you that: one, they increase their payroll taxes significantly in order to avoid the $200 fee, which escapes logic; and two, the State will be in a better position if they pay the payroll taxes rather than pay the $200 business license fee.

Chair Segerblom:
Was there a decrease in registrations after the regulations were adopted?

Mr. Taylor:
We have seen declines in filing numbers, both in renewals and new filings, but more important, in the overall numbers of corporations and LLCs. There are

probably a number of factors involved in this decline. One of them is smaller businesses choosing a more affordable jurisdiction for them to start a business or to incorporate their dream. We have seen businesses move from Nevada, especially small home-based businesses, to states like Wyoming where there is a more affordable fee structure.

Chair Segerblom:
Are you testifying that registrations in Nevada have gone down, while in Wyoming they have gone up in the past 2 years?

Mr. Taylor:
I have not checked Wyoming's filings, but overall filings in Nevada have gone down a few percentage points.

Randi Thompson (Director, National Federation of Independent Business):
I have submitted written testimony in support of S.B. 331 (Exhibit I).

Robert W. Marshall:
I have been trying to make money on home-based businesses and so far, I have been unsuccessful. When I received my annual renewals for my LLCs and limited partnerships last fall, I was very surprised to learn that the exemption which is still in statute no longer applied. I have one corporation, two LLCs and one limited partnership. I received a letter from the SOS's Office (Exhibit J) which I would like to put into evidence. It was apparent to me that a regulation had overridden the statute.

Nothing in NRS 76.020, subsection 2, paragraph (c) states that the home-based business exemption is limited to a natural person. The statute uses natural person in various instances. However, this section does not say natural person. It says a person, and we have already heard the statutory definition. I do not understand how a statute could be modified by a regulation.

I have four small businesses, which we run out of our house, and we support this legislation.

Senator Hutchison:
Mr. Taylor, you are incorporated and involved in helping people incorporate businesses. You have seen a drop-off. We all know the economy has been bad for various reasons. Can you please explain why this fee has had an adverse

effect on the number of new corporations in Nevada, particularly with small businesses?

Mr. Taylor:
Most of the evidence I have is anecdotal from my relationships with other registered agents. They have seen individual numbers drop off, especially those registered agents catering to small upstart businesses. It costs more to form corporations and LLCs in Nevada. There was some relief for those new businesses before they obtained a commercial location. They were able to receive a break on their fees.

For example, I had started a consulting firm in 2007 while I was working for another registered agent firm with the dream of going out on my own. I ran it out of my home. I worked on the weekends and did individual consulting work, but it was not until last year that we acquired a commercial location and therefore no longer qualified for the home-based exemption. However, to pay an extra $1,000 over the years while I was working for someone else and pursuing my dream would have been a drastic financial impact.

Chair Segerblom:
Mr. Anderson, will you start with explaining how this was dropped accidentally out of the law and how we had to bring it back? How much money is Nevada making because of the added fees?

Mr. Anderson:
This is a policy matter. It was a policy matter when S.B. No. 8 of the 20th Special Session came before the Legislature, as were A.B. No. 78 of the 76th Session and the provisions of the Adopted Regulation of the Secretary of State, LCB File No. R080-11 approved by the Legislative Commission in March 2012.

That bill and that regulation clarified the 2003 law. The intent was that this applied to sole proprietors working out of their homes and not to every corporation registered with the Secretary of State's Office.

Senate Bill 331 is a major shift because it reverses the intent of S.B. No. 8 of the 20th Special Session and the provisions of the Adopted Regulation of the Secretary of State, LCB File No. R080-11 approved in March 2012. As written, the bill expands to whom the home-based exemption applies or how businesses

may interpret it. It offers the exemption to any business operating out of the home of a natural person who is a shareholder, director, officer, member and so forth. It is possible that, practically if not legally, the home-based business exemption could be taken by virtually anyone, which was the way it was going when we were looking at this in 2011.

Chair Segerblom:
Would you explain that history of how they were covered and then somehow were eliminated?

Mr. Anderson:
When we took over the State business licensing in 2009, we had until October 1, 2009, to get that in place. We rushed to get our systems up to speed and we made some determinations that would allow home-based businesses and corporations to apply for and obtain a State business license. At that time, we had no idea how many people would take advantage or abuse this until we started seeing a rise in claims for exemptions. For example, in fiscal year 2011, 23 percent of all business entities claimed a home-based business exemption. In the last quarter of that fiscal year, 25 percent were claiming the exemption.

Chair Segerblom:
What is the annual fee if you are not exempt?

Mr. Anderson:
If you are not exempt, the annual fee is $200 for the State business license.

Chair Segerblom:
You said 25 percent of business entities claimed the exemption. How many business entities are there?

Mr. Anderson:
We have approximately 285,000 business entities. At its peak in 2011, there were 287,000 business entities. There has been a decline of about 1 percent since we started looking at this and moving forward with the regulations.

There may be arguments about flight to Wyoming and some businesses have not renewed their licenses. Some registered agents may be seeing numbers

decline; however, some of our larger registered agents had more business entities at the end of fiscal year 2012 than in prior years.

Chair Segerblom:
That is 75,000 businesses at $200 each.

Mr. Anderson:
That is $15 million per year, which is $30 million over the biennium. We do not have the resources to investigate every home-based business exemption. The majority of these home-based business exemptions are coming from entities that have no Nevada nexus. They are coming in to take advantage of our State law. However, they do not have a physical presence in this State other than having a registered agent. We also had a gamut of businesses not necessarily represented by a registered agent. These were just people claiming these exemptions on their own.

Chair Segerblom:
How would you investigate 75,000 businesses claiming they are home-based businesses eligible for this exemption?

Mr. Anderson:
I do not know if I can answer that question. Nevada is unique as is Wyoming and Delaware. There are many entities coming from out of state to take advantage of Nevada law.

We have no way of knowing other than they have declared that they meet the requirements for a home-based business exemption. They can check the box or put a 003 in the box on the list, sign it and we accept it.

Senator Jones:
I want to protect home-based businesses in Nevada. I do not care to protect home-based businesses from paying Nevada taxes. When business owners are located in other states, can we create a framework which would require them to have their home-based businesses operate out of homes in Nevada?

Mr. Anderson:
There is a possibility that we could do that. However, with the limited amount of information we collect at the SOS's Office, there is really no way of knowing

if businesses are really in Nevada because their registered agent addresses are their addresses in Nevada.

Senator Jones:
When they request exemptions, could we require them to assert, under penalty of perjury, that they operate their home-based businesses out of homes in Nevada?

Mr. Anderson:
Yes and no. Nevada law states that if there is no place of business in this State, the business address is the registered agent's address. It becomes a muddled mess. We could ask for that, but we may not have the ability to actually verify that information.

Senator Jones:
I understand that aspect of it, but we could at least put in some protection so that out-of-state businesses pay Nevada taxes.

Senator Ford:
I support home-based businesses. I have a cottage industry law in work session now. However, there are clearly two sides to every story, and you just gave the second side. That $15 million is a lot of money.

You said something that struck me, and I need to know if I understood this correctly. Did you say that legislative intent from 2003 indicates that we only intended this statute to apply to natural persons?

Mr. Anderson:
Our interpretation of legislative history is that it did not apply to corporations and other entities, only to sole proprietors doing business strictly out of their homes.

Chair Segerblom:
That is the way it was from 2003 to 2009. When the SOS took over business licensing in 2009, it put a form on its Website where a corporation could check the box, and all of these corporations immediately started checking the box. That was a mistake on the SOS's part.

Mr. Anderson:
That is correct. When we took this over from the Department of Taxation, 155,000 entities should have been paying State business license fees but were not. We took over the licensing in order to tie the annual renewal to the annual filing of the list of officers. Therefore, rather than being proactive with just filing with the Department of Taxation, businesses have to make claims for exemptions on the annual lists that they have to file to remain active in this State.

We became more efficient, but we also became less efficient because we allowed this to occur. The Adopted Regulation of the Secretary of State, LCB File No. R080-11 and A.B. No. 78 of the 76th Session were attempts to correct that error, and we have done so. We are collecting $65 million a year in business license revenue. If we were to go back to where we were in 2011, we would reduce that by $15 million, if not more, per year.

Nicole J. Lamboley (Chief Deputy, Office of the Secretary of State):
When the Department of Taxation created the issuance of the State business license in 2003, the Nevada Tax Commission adopted regulations clarifying that the exemption applied only to natural persons. We attempted to codify the action taken by the Commission in 2003-2004 through A.B. No. 78 of the 76th Session and then by adopting the regulation.

The discussion occurred in the 20th Special Session when addressing the revenue package adopted by the Legislature. The legislative testimony will show that this was to apply to direct sellers—the people who conduct home-based businesses like the Mary Kay seller or those who sell Pampered Chef.

Mr. Anderson:
Here is information that the Committee would find interesting regarding the abuse of the home-based business exemption. The examples I gave about the bowling alley, the resort, the casino property and the mining property were just the tip of the iceberg. Those things made us aware.

We had one registered agent with 99 percent of the 500 represented entities, most of which were in China, claiming the home-based business exemption. The registered agent was also claiming the home-based business exemption. Another resident agent was charging customers for the State business license, claiming the exemption and then pocketing the excess fees. Several other

registered agents provided their represented entities with a residential agent address to list as their Nevada address in order to claim the home-based business exemption. Another used the address of a hotel, stating that was where the businesses were being conducted in order for their entities to claim the home-based business exemption. Another entity claimed the home-based business exemption for 118 of 124 active entities, and once the Adopted Regulation of the Secretary of State, LCB File No. R080-11 passed, the entity began claiming the film company exemption in place of the home-based business exemption. All of these entities were shell entities that had no active business in this State.

Other registered agents have instructed their customers to list their home addresses and claim the exemption because the SOS cannot verify that information.

There were a couple of major commercial registered agents with over 70 percent of their represented entities claiming home-based business exemptions. We saw this snowballing in 2010. From the time we started seeing this rise in exemptions through 2011, it was clear to us that there was no way we could enforce that. Businesses were merely adding an 003 code to their annual lists and claiming the exemption. There was not a whole lot we could do about it.

Those are just a few of the examples behind the impetus for the clarification of the intent of the original law through the regulation, and that was appropriate.

Chair Segerblom:
Were you present when the Legislative Commission's Subcommittee to Review Regulations adopted the regulation? Could you explain that history?

Mr. Anderson:
There was contention at the original Legislative Commission meeting. The regulation was pulled back, and then it was brought back to the Legislative Commission's Subcommittee to Review Regulations to pass. The Subcommittee was assigned to review this so that the whole Legislative Commission did not have to meet. There was contention, but it did ultimately pass.

Chair Segerblom:
Did Senator Steven A. Horsford make the motion?

Mr. Anderson:
Yes, he did.

Senator Roberson:
This Committee and this Legislature can do whatever it chooses to do regarding this legislation. I can live with that result. My larger concern is the process of why we are here today and how this came to be.

I listened to Mr. Anderson's testimony. I hope you will follow up with him to look at the legislative history from 2003 because I disagree with him on his interpretation of that legislative history. I have reviewed all of the committee hearing minutes from the 76th Session, and I chose one just now because we are talking about the terms "natural person" versus "person." The argument was made by Mr. Anderson that the intent was to mean a natural person in this context and not the broader definition of a person.

Scott Scherer, who represented the Nevada Registered Agent Association 2 years ago, touched on the point that NRS 76.020, subsection 1, paragraph (a), specifically refers to any person except a natural person. The language in the statute draws the distinction between a person and a natural person. They are two different things. Otherwise, paragraph (a) would be meaningless. On many occasions, the Nevada Supreme Court stated that we should not interpret statutes in a way that would render any language meaningless.

The SOS's Office knew it had a problem. The SOS's Office wanted to generate more revenue but knew the law said what it said. That is why the SOS brought A.B. No. 78 of the 76th Session to change the law and could not get it done through this body. Therefore, the SOS's Office subverted the legislative process and went the regulatory route to change the law effectively. That process was inappropriate. Regardless of whether you think the home-based business exemption should be limited to natural persons or to the broader definition of persons is not the point I am trying to make. You all can debate that. I am concerned about the legislative process and an Executive Branch agency subverting that process to get a desired result.

Chair Segerblom:
The Legislative Commission passed this.

Senator Roberson:
No, the Legislative Commission did not pass it. It had to be sent from the Subcommittee to the Legislative Commission. It failed both times. It was then sent back to the Subcommittee. It was a five-member Subcommittee, three Democrats and two Republicans, who made this decision, after 63 Legislators did not agree as a body to put this into law. Therefore, five people on a Subcommittee made this determination in the interim. I do not think that was good process. Please consider those.

Senator Ford:
I do not disagree with natural person versus person. I am a lawyer just as you are and I understand that we should say what we mean. Whether you disagree with the list of history in the testimony or not, what about the precedent that was set based on the testimony we just heard about the Nevada Tax Commission instituting regulations that limited it to natural persons based on the belief that from 2003 it was only intended to apply to natural persons.

Senator Roberson:
We are talking about an Executive Branch agency interpreting the law that this body, this branch of government passed. You can agree or disagree with the interpretation. We have five fine attorneys on this panel. You can read statutory language and make your own interpretation or determination of what that means. Bureaucrats in the Department of Taxation went through a regulatory process. Perhaps it was result-driven, perhaps not, but they wanted to interpret that language in the way they saw fit. That is what happened.

I do not give a lot of credence to that. The Legislature should be determining statutory interpretation to the extent practicable. We have seven intelligent people on this Committee. You can look at the definitions and the language in the statutes and make your own determination. The important point for me is the Legislature should be making this decision.

Senator Jones:
I was not here in the 76th Session and I was not part of the interim; therefore, I am not going to get into whether it was the right or the wrong decision. I want to make sure we get the policy correct. I have some concerns with many of the inappropriate exemptions apparently being taken by out-of-state businesses.

Are you willing to work on something that really gets at the home-based businesses as opposed to bowling alleys in Arkansas or elsewhere?

Senator Roberson:
Senator Jones, that is an excellent point, and I appreciate your previous comment. It would be a good idea to look at home-based businesses located in Nevada. I am open to that modification.

Getting back to the examples I have heard repeatedly about the bowling alley, the casino and the mining company, there may or may not have been a company in each of those categories that claimed that. However, when they did that, they did it under penalty of perjury. People will always break the law, but why should we punish the smallest of businesses because of some wrongdoers. That is a question for this Committee to determine.

Chair Segerblom:
We will close the hearing on S.B. 331 and open the hearing on S.B. 355.

SENATE BILL 355: Revises provisions governing unclaimed property. (BDR 10-826)

Senator Michael Roberson (Senatorial District No. 20):
Senate Bill 355 seeks to reform Nevada's unclaimed property law by excluding business-to-business transactions, providing a reasonable limitation period for unclaimed property to escheat and barring contingent fee audits. These reforms will help to make Nevada an ideal location for businesses to incorporate and as such, will help us to grow our way to prosperity.

Increasingly, large businesses are looking at states' unclaimed property laws and weighing their options as to where to incorporate. Delaware, long reputed to be a friendly state in which to incorporate, has begun to absorb a lot of criticism based upon its unclaimed property law. The Council on State Taxation (COST) grades Delaware an F in this regard. I have submitted testimony from the COST (Exhibit K). Recently, *The Wall Street Journal* ran an exposé of Delaware's law and described in detail how its unclaimed property law could force large corporations to consider incorporating elsewhere.

According to the Legislative Counsel's Digest for S.B. 355 in Nevada,

> Existing law establishes the powers, duties and liabilities of the State and other persons concerning certain property which is abandoned and unclaimed by its owner—and that is in chapter 120A of NRS. Under existing law, a holder of property that is presumed to be abandoned by its owner must pay or deliver the property to the State Treasurer, acting as the Administrator of Unclaimed Property. [(NRS 120A.560, 120A.570)] Existing law requires the Administrator to deposit any money received as abandoned property and the proceeds of the sale of abandoned property in the Abandoned Property Trust Account. The first $7.6 million of the balance remaining in the Account at the end of a fiscal year is transferred to the Millennium Scholarship Trust Fund. The remaining balance is transferred to the State General Fund, subject to any valid claims. [(NRS 120A.620)]
>
> Sections 2 and 3 of this bill exempt from the provisions of existing law governing unclaimed property: [(1)] certain payments or credits due to a business association from another business association; and [(2)] property the value of which is less than $50. Thus, under sections 2 and 3, such property is not required to be paid or delivered to the Administrator if it is abandoned and unclaimed by its owner.
>
> Section 5 of this bill provides that if the Administrator enters into a contract with a person to examine the records of another person to determine whether that person has complied with existing law governing unclaimed property, the compensation paid to the contractor must not be contingent on the value of any property that should have been reported, paid or delivered to the Administrator as abandoned property.
>
> Existing law prohibits the Administrator from maintaining an action to enforce the duty of a holder of abandoned property to report, deliver or pay the property to the Administrator more than 7 years after the holder specifically identified the property in a report filed with the Administrator or gave express notice to the Administrator of a dispute governing [*sic*] the property. Section 4 of this bill

> revises this statute of limitations to provide that an action with respect to a duty of a holder must be commenced not later than 4 years after the duty arose.
>
> Existing law requires a holder of abandoned property to maintain records concerning the information included in a report of abandoned property filed with the Administrator for a certain number of years after the holder files the report. Section 6 of this bill requires such records to be maintained for a certain number of years after the property is presumed to be abandoned rather than after the filing of a report with the Administrator.

Senate Bill 355 will improve Nevada's unclaimed property laws and administration. The COST supports S.B. 355 and states that these changes are important toward reforming Nevada's unclaimed property laws. Nevada could obtain an A grade by implementing the three major improvements contained in S.B. 355 and surge ahead as a more attractive state for business to incorporate.

Senator Hutchison:
Are there many business-to-business transactions of abandoned property where the State makes a claim on that property? Has that become a problem?

Senator Roberson:
Yes, surprisingly so. I did not realize this until recently and that prompted me to bring this bill. However, looking at Delaware goings-on, Delaware expects to bring in approximately $566.5 million for the fiscal year in June. Last year, that state returned $18.9 million of unclaimed property to its owners and booked almost $320 million in revenue from the liquidated property. There are 300 audits underway in Delaware. The State resolves approximately 50 audits per year. To many of these companies, this is a money grab. They are seriously looking at incorporating in other places. Many of these companies are involved in audits for many years. This is big money.

Senator Hutchison:
We will make Nevada much more attractive in terms of this legislation as it relates to Delaware. We will be far ahead of them, and that has become problematic in Delaware. This is a good piece of legislation, and I support it.

Senator Kihuen:
Senator Roberson, what other states are we competing against besides Delaware?

Senator Roberson:
Wyoming is one. In general, regarding incorporating companies, the ones you hear about most prominently are Delaware and Wyoming. It is interesting that all the bills you have heard today address this issue about Nevada being competitive with other states as far as economic development, business entity formation and incorporation. We are always looking at Delaware and Wyoming. The unclaimed property law is one area in which we can really shine compared to Delaware.

John P. Sande III (International Game Technology):
Approximately 4 or 5 years ago, International Game Technology (IGT) went through an audit. The company had no problem with the State Treasurer but had a problem with the auditor who was subject to a contingent fee. According to IGT, the auditor did minimal work and created a large list of potential unclaimed property issues that IGT had to address.

International Game Technology spent over $250,000 of employee hours responding to this audit that lasted 2 years. It was the most labor-intensive audit to which IGT had ever been subject; and the total amount it paid was $2,300.

We also support going from 7 years to 4 years to commence a civil action.

Senator Hutchison:
Audits occur when there is a claim or a belief of abandoned property in the accounts of hotels, casinos or other businesses. You said these audits are burdensome because a contingent feature drives them and someone is looking for some quick money.

Is it correct that audits are triggered because there is contention over unclaimed property in the accounts of businesses, or is it a periodic requirement under the law?

Mr. Sande:
It is just periodic. Many large businesses in this State are audited from time to time.

International Game Technology is not concerned about being audited. The contingent fee was the problem plus the fact that it was the most labor-intensive audit to which they had ever been subject.

Senator Ford:
The situation you just described sounds lopsided. How frequently does it happen that a contingent-based audit results in such lopsided results?

Mr. Sande:
I can only speak for IGT. The major problem for IGT was spending $250,000 worth of time and having someone delve into all of the company's records instead of a normal audit where a certain number of issues are reviewed and a determination is made as to whether there is a problem.

Senator Ford:
Senator Roberson, I would be interested in knowing whether we are addressing a real problem or whether we are only addressing one instance of a bad contingent fee circumstance going awry.

Senator Roberson:
My point of bringing this bill is not simply to address a problem in this State, but to give our State a competitive advantage over a state like Delaware. This issue is becoming increasingly important to large corporations when they are deciding where to domicile.

Delaware goes back to 1981 audits, and if companies do not have records back that far, Delaware will estimate the amount it deems it is owed and add interest and penalties to that legacy amount. The COST grades Delaware an F and Nevada a C. With this bill, we become an A. That is another tool to incentivize companies to look to Nevada.

Senator Ford:
I agree with improving our standing. However, I want to be certain that we do not continue to hamstring or handicap our administrative agencies. We already do not give them enough money. Administrative agencies need to hire auditors

on a contingent basis. As long as we do not have fraud or other pervasive problems, I would rather not take another route, unless we can give the agencies the funds they need to pay investigators who can do what is needed regarding these audits.

Senator Brower:
I am aware of this problem, but I had not focused on the contingent fee aspect of it. This is a very interesting issue. Contingent fees might work in the private sector particularly in personal injury cases; however, there is potential for abuse in the government context. We see government, including our own State, hiring lawyers on a contingent fee basis to sue companies. This type of litigation creates all kinds of perverse incentives. We see it again in these audits. I am going to digest this fully as we consider this bill; however, you have raised some troubling issues.

Ms. Thompson:
I had not planned to testify today on this bill, but I am reminded of a situation I had with a small business owner not too long ago. She had purchased a hair salon from a previous owner. That owner had outstanding gift certificates. She was paid for those gift certificates knowing that she would have to honor them while they were still active. This was before the Legislature enacted a law that gift certificates cannot have an expiration date. When she bought this business, she assumed those gift certificates. She had a customer complain because she would not honor a gift certificate. This had nothing to do with the former owner, but the person filed a complaint with the State Treasurer, which started an investigation into what were the unclaimed properties. Not only did the new owner have to work many hours with the State Treasurer's Office, but the Office threatened to fine her on all of the past gift certificates going back 7 years even though she did not own the business at that time.

Therefore, this affects small businesses as well. People do not redeem gift certificates or they try to use them later. I did not want Mr. Sande to be alone in saying it is not just a big business issue; it is also a small business issue.

The statute of limitations is also a concern, especially for so many businesses that are sold quickly.

Senator Brower:
Randi, you lost me and maybe I am just not familiar with this. How is the State involved in a private small business gift certificate plan?

Ms. Thompson:
I hope State Treasurer Kate Marshall will elaborate on it. However, from what I understand, if someone buys a gift certificate but never uses it, technically, that is unclaimed property. I do not understand why we have this, but that gift certificate becomes unclaimed property. That person could go the Website and say I have an unused gift certificate. That is the unclaimed property challenge for small businesses.

Senator Kihuen:
Senator Brower, I cosponsored the bill addressing gift certificates, A.B. No. 279 of the 74th Session that passed in 2007. The money reverts to the State to be used for education. Our ideal scenario was to have no expiration dates on gift certificates but unfortunately, there are still businesses that have expiration dates on their gift certificates. I would like to have the gift certificate for the rest of my life if I wanted to, but unfortunately, businesses do not allow it.

In the 74th Session, the Retail Association of Nevada opposed the bill. There was an agreement that 60 percent of the money would go back to the State and 40 percent would go back to the business. The initial intent of the bill was for 100 percent of the money to go back to the State.

That is my money. If I paid $100 and the gift card expires or if I give it to my brother and he does not use it, my brother should get that money back, or I should get it back. If I do not get it back, the State should because that money has already been invested in the business.

I do not know how much money has been collected. The State Treasurer and I worked on the bill in the 74th Session, and it has brought thousands of dollars to the State. Part of the stipulation on that bill was the money was not to go back just to the State but it was to be invested in education.

Senator Brower:
I am still struggling with the concept of the State government getting involved in these private transactions.

Carole Vilardo (President, Nevada Taxpayers Association):
I have had conversations with COST as recently as yesterday. I would definitely support not doing contingent fee audits. I appreciate your comments, Senator Ford; unfortunately, this is the body with the ability to provide the funds for audits.

Contingent fee audits have proved to be a disaster for a business. The auditors try to find revenue from that business they believe was not paid. It may not be justified, but that business will spend a lot of money to prove that it is not in the wrong. We have not agreed with contingent fee audits in the past and do not agree now. We would like to see it removed from this bill.

The other thing that would bring consistency to various statutes is the 4-year provision used for tax purposes and by the Controller's Office for providing liens. In tax, auditors go back 3 years in a 5-year period, which effectively makes it a 4-year period. If fraud is found, then they go back 7 years. That is a point of consistency that might be beneficial. I have not spoken to Senator Roberson about the potential of doing something like that. That might be a way to alleviate your concerns, but it at least brings us into some conformity with what the business community expects and for which it has to keep records.

Those are reasons we would support S.B. 355. I spoke with COST's general counsel and discussed where states are going. It is unfortunate, but too many times what a state does has nothing to do with a policy issue; it has to do with pure revenue. It does not always make sense. This is an opportunity to deal with policy.

Senator Ford:
I am not opposed to the 4-year period. Do you know how many other states use this? You stated Delaware goes back 30 years. What are other states doing in this regard? How does our 7 years compare?

Senator Roberson:
I am happy to follow up with you and get more information on other states.

Kate Marshall, State Treasurer:
Ms. Vilardo mentioned that this was purely a revenue issue. If S.B. 355 were to pass, it would negatively affect the people and the small businesses of Nevada.

As State Treasurer, my task is to serve as the administrator of the Unclaimed Property Division; therefore, we had to identify a fiscal note for this bill for the State. The fiscal note does identify the harm that would occur to the people or small businesses. However, if this bill passes, the reduction in revenue to the State is approximately $35 million annually. That is something to consider seriously. This Legislature takes balanced budget requirements very seriously. If there were a reduction in revenue of $35 million, you would have to either cut programs or find revenue elsewhere.

Senator Roberson mentioned the former Governor Kenny Guinn's Millennium Scholarship annual transfer of $7.6 million from unclaimed property to that scholarship. Of course, if we had to reduce revenue by $35 million annually, we would not be able to make that transfer. We would have to find that money elsewhere or not fund the Millennium Scholarship. It would affect the solvency of the scholarship quite significantly.

Senator Kihuen:
How much money are we using for the Millennium Scholarship out of the current unclaimed property?

State Treasurer Marshall:
By statute, it is $7.6 million annually. It was suspended for a short time during the financial crisis. We estimate that approximately $30 million a year from unclaimed property goes to the State. Therefore, if we had a reduction of $35 million, the simple math would tell you that we would not be able to transfer $7.6 million to the Millennium Scholarship.

Senator Kihuen:
We would have to find that money elsewhere in the budget.

State Treasurer Marshall:
Yes, you would be faced with that decision.

You asked how much money we had given from gift cards because of your bill. Last year, $360,000 went to education. That is not part of this fiscal note.

Senator Kihuen:
Is this from A.B. No. 279 of the 74th Session?

State Treasurer Marshall:
Yes. It was a Nevada bill, but we were enacting federal law.

Senator Ford:
I would like to hear your comments on the 7-year period being cut to 4 years. I also want to know how removing the contingent fee potential would affect your operations regarding audits on unclaimed property.

State Treasurer Marshall:
Unclaimed abandoned property is any financial asset left inactive by the owner, such as savings accounts, checking accounts, uncashed money orders, certified checks, insurance funds, payroll checks, stocks, bonds and business-to-business transactions such as when your campaign has unclaimed property left over and I come to do my budget hearing and hand it back to you. In addition, we also receive safe deposit contents from banks on behalf of lost customers.

Typically, most accounts become unclaimed when there is no owner contact with a company for approximately 3 years. Different types of unclaimed property have different time periods associated with them. However, what happens is the owner forgets the account exists, the business changes its accountant, the person moves, there is no forwarding address or stocks split. In some cases, the owner dies and the heirs have no knowledge of the fund.

What is important to understand from the beginning is that the Uniform Unclaimed Property Act is a consumer protection act. When we talk about these businesses having this money, they are the debtors. The owner is the small business or person to whom that property belongs. These entities that ask for further safeguards from having to turn over the money are asking you to safeguard the debtor at the expense of the owner. You should realize that structure.

The purpose of these state laws across the Country that require abandoned property to be escheated or transferred to the state is so the owners never lose the rights to their property. We have people coming back 20 years later realizing that they have property. We are trying to get the owner what they are owed.

In 1965, the U.S. Supreme Court ruled in *Texas v. New Jersey*, 379 U.S. 674 (1965) that the company that holds the property is the debtor and the owner is the creditor. Therefore, safeguarding unclaimed property is a manner of

protecting the owner's rights. We are tasked with standing in the place of that owner until we can locate him or her.

To go back to Ms. Vilardo's statements, I take very seriously getting property back to the owner. We have one of the highest rates in the Country of returning property to their owners. That was not true when I came into the Office. We return approximately 38 percent, surpassing many states. Most states are in the low 30 percent. When I came into the Office, Nevada was in the low 20 percent in terms of finding owners. We spend considerable effort trying to find owners. That is our No. 1 mandate with respect to unclaimed property.

Every year, we get unclaimed property from debtors and we try to locate those owners. At the end of the fiscal year, we remit to the General Fund the property that has not been claimed by the owners. That does not mean that it is now the State's. The owner can always come back. The State gets to use it in the interim, but once we find the owner, we always return it.

In the last 2 fiscal years, my office has set all-time records for transfers to the General Fund, $97 million in fiscal year (FY) 2012 and $83 million in FY 2011. If you remember, those were very hard times for this State in terms of its budget. That might have been considered great help to the Legislature then.

This amount is being reduced to approximately $30 million a year because Citibank moved its corporate headquarters to North Dakota. Citibank is a bank with offices worldwide, and it returned many funds to us.

What do we do to find the owner so we can take the money that the debtor gives us and return it to the owner? We have a Senior Services program where we literally go out to senior centers. We look through the unclaimed property database for those senior citizens who are living on fixed incomes. We have collaborated with HopeLink of Southern Nevada to identify senior citizens for their money. A lot of their money is $50 and under. It makes a huge difference to people who are living hand-to-mouth. When they get that $50, then they can pay that electric bill.

Under Operation Claim It!, we contacted over 2,000 owners and beneficiaries of U.S. savings bonds in order to return them. These were all Nevadans.

When I came into office, only about 14 counties received a publication of unclaimed property lists. Now all 17 counties receive publications. We publish the names and addresses of those identified as rightful owners in 19 publications in Nevada, making sure they reach into the far corners of Nevada.

We also upgraded the Website to search on anything. For example, if you searched on Brower, you would not have to search on Senator Brower; all of the Browers would come up and then Senator Brower could decide if any of those Browers were his or someone to whom he was related.

I want to make sure that you understand, in terms of the statute of limitations, you could enact a 4-year statute of limitations. That would not mean companies could get rid of their data or documents after 4 years because other states have a 7-year statute of limitations. Other states audit businesses in this State. The unclaimed property laws are national. The states would keep their information for other states, like Delaware, and not for Nevada. Nevada does not get to have the information, but Arizona, Utah, Arkansas, everybody else does. It seems odd. Do not forget you must keep your federal taxes for 7 years.

Regarding the contingent fee, I know that IGT spoke about the company's experience 4 years ago. I will acknowledge it was arduous for all parties and I appreciate Mr. Sande's comments that IGT thought the State Treasurer's Office was helpful. We actually put someone in the business as a contact IGT people could call and talk to at any time if they had any questions.

Employees of the company that did that audit did such a poor job that I refused to let them do audits of any businesses in Nevada for Nevada. However, we contracted with the company to do audits outside of Nevada. This year, I changed that further and we no longer do business with that firm at all because I am concerned that its employees are heavy-handed and not doing things in an appropriate way. Therefore, to answer Senator Ford's question, yes, that was a single instance and not a pattern of practice.

I want to make sure you understand that a lot of the information Senator Roberson gave was about Delaware, not Nevada.

Senator Kihuen:
Section 3 of the bill states, "the provisions of this chapter do not apply to any property the value of which is less than $50." Approximately how much of the money that you receive on the unclaimed property is less than $50?

State Treasurer Marshall:
Over 50 percent is less than $50.

Senator Ford:
When you mentioned that, I recalled a fact that the check I just received was for $29.19 for property left in Texas from Allstate. I would not have received that if this provision were in there. You are doing a good job of reaching out to people who have lost property.

The contingent fee question was what happens if you can no longer operate under a contingent fee basis.

State Treasurer Marshall:
It will cost the State significantly.

Steve G. George (Chief of Staff, Office of the State Treasurer):
In terms of section 2 on page 2 of the bill, the business-to-business exemption, no such exemption is included in the Uniform Unclaimed Property Act. There are national uniform laws in many different areas and unclaimed property is one of those. A similar exemption was before the 2009 Session for consideration in S.B. No. 167 of the 75th Session. Then the Senate Committee on Judiciary Chair Terry Care requested the comments of the Uniform Law Commissioners about the proposed exemption. The Commission provided the following guidance, all of which applies equally to this bill,

> To provide a deviation from the Uniform Unclaimed Property Act may result in a nonuniform adoption. The proposed amendment for the exemption of business-to-business transactions is neither uniform nor national in scope. The Uniform Law Commission discourages the adoption of amendments that encourage a nonuniform adoption.

In the U.S. Supreme Court decision in *Texas v. New Jersey,* the Court stated that holders are the debtors, not owners of the unclaimed property. In our fiscal

note, we stated how this proposed business-to-business exemption would have adversely affected Nevada over the past few years. For FY 2010 through FY 2013, we estimate the State General Fund would have lost more than $100 million in transfers from the abandoned property trust fund. Our fiscal note states that cost per fiscal year to the State and its citizens for this exemption alone are $15 million per year. That would be $15 million the State would have to obtain from somewhere else.

This does not account for the loss of property owed to small businesses and individual rightful owners or heirs. In FY 2013 to date, nearly 5,000 businesses have reported unclaimed property with an average amount of $8,489 being reported. Additionally, in FY 2013 alone, claim payments of $26 million have been paid to all claimants, with $12.7 million paid to Nevada businesses or 48 percent of all claims paid.

It is important to note that although a forgotten credit of $1,000 with a national holder might not affect that holder, the $1,000 credit to a small business may mean the difference of a fully funded payroll or extending the life cycle of that business.

Senate Bill 355 as proposed would eliminate the highly successful Voluntary Disclosure Agreement (VDA) program initiated by the State Treasurer's Office in 2011. The VDA program provides a noncompliant Nevada business with the opportunity to conform to reporting requirements as outlined in NRS 120A without interest and penalties being assessed. Nearly 100 percent of all VDA recoveries are business-to-business related. That is the point of it. Therefore, we estimate the loss of $1.3 million to the State General Fund if the language in S.B. 355 had been in effect since FY 2012.

Section 3 of S.B. 355 on page 2 calls for property valued at less than $50 not be reported to the State. This would include all aggregate property reported, meaning reported en masse by holders. This would include safekeeping items as outlined previously by the State Treasurer. Compared to total receipts for the unclaimed property program, all items less than $50 comprises 55 percent of all items reported when safekeeping and securities are included. In fact, in just the last 4 fiscal years, more than $442 million worth of property, each with a value of $50 or less, has been reported to the State, meaning the rightful owners or heirs would have lost their ability to ever claim those funds.

Further, more than 146,000 claims during that same time had at least one property valued at less than $50. Our fiscal note points out that would be a $15 million loss to the State, not to mention the tens of thousands of Nevada small business owners and individual Nevadans who would not have been reunited with their rightful money.

Section 5 changes the way audits are compensated from a contingent basis to a flat fee. No state in the Country conducts audits on an hourly basis as opposed to contingent fees for out-of-state national audit firms. The state of Ohio did that a few years ago. We testified on this in 2009. They found they were spending three times as much money on conducting the audits than what the audits actually recovered.

When our staff conducts audits, we do not charge anything for the audit even if they find something. When the State contracts with professional national audit firms, they are paid 12 percent of the contingent fees. We only use these firms to conduct large company audits. That would be a $250 million or greater business. We will also use them to do multistate audits out of state because we cannot send our staff to Michigan to do an audit.

The audits performed by national audit firms working on behalf of the State recover approximately $3 million in a year. That money is either returned to the rightful owners, the heirs or transferred to the State General Fund. Over the last 10 fiscal years, these national audit firms have performed 4,300 audits and recovered $17 million.

If the audit company charged the State a flat fee, which is typically $300 per hour, the unclaimed property laws might need to be changed to require a business to pay that fee instead of the State. It takes about 1,900 hours to complete a large company audit. At a rate of $300 per hour, that would be about $576,000 per audit firm or $2.3 million per year. If the provisions of section 5 were passed, the State or the businesses would have to pay to conduct the audits instead of a contingent fee.

It is important to note that we had the same flat fee argument in the 75th Session. Many of the audits conducted by the out-of-state firms find nothing. Therefore, nothing comes to the audit firms; they do not have a 12 percent fee that they collect, and nothing comes to the State. However, if

we were to charge it on an hourly level, that fee would exist no matter what the findings.

Senator Hammond:
Going back to finding unclaimed funds, I am sure you have done several cost-benefit analyses. What is the cost to the taxpayer to find that money?

Mr. George:
It costs the taxpayer nothing because the General Fund does not pay any of the fees. The staff is paid through findings. All of our materials, everything is paid through findings. There is no cost to the General Fund. That is one of the fiscal notes attached to this bill. If we took this away instead of having that money, it would cost the State approximately $1.2 million to fund our staffing and equipment.

Senator Hammond:
You pay your staff from the findings that you discover.

Mr. George:
Correct. That is how the staff is paid.

The other two fiscal notes come from notifying business of these changes, which would cost approximately $80,000 per year; and the unclaimed property staff's salaries and supplies, which would cost $1.2 million per year. Therefore, our total fiscal note is $35 million per year.

Senator Hutchison:
The policy question is not whether we use contingent or hourly based attorneys. There is nothing wrong with hourly based attorneys or private attorneys in general. The policy question is if there is a problem using private counsel or private collection firms to do the bidding of a government agency with state government pressure behind that effort.

Could you take all of the audit functions in-house? It is a government function, and you do not want to deal with the perverse incentives and abuses that can occur with an outside, private audit company. What personnel would be required to do that in-house?

State Treasurer Marshall:
You have to realize that we receive $3 million from out-of-state audits. If we were to do those on an hourly basis, it would cost us about $2.3 million. Are you are asking whether we would hire staff who would go around the Country and audit?

Senator Hutchison:
What would it take you to perform all of the audit functions? Is it going to take two or three more auditors?

State Treasurer Marshall:
Mr. George can tell you what it would take us to do audits in the State. We will have to get back to you on doing audits out of state because we did not look at that. That would be an addition.

The pay structure for auditors in this State is such that it is very difficult to get an auditor who is a certified public accountant or has significant auditing background, if any. Because we do not pay auditor rates, most of the time we hire auditors who do not know how to audit and we train them.

Mr. George:
In a large company, for which we use outside firms, audits take about 1,900 hours on average. We would need many more auditors just to perform them in-State. The auditor would be at that company for many hours.

An out-of-state audit involves a company that is incorporated in another state but also has holdings in this State, and there are people to whom it owes unclaimed property. That is what multistate audits do. If we were to do out-of-state audits, we would have to have a Nevada auditor live in the other state for a year to complete that audit. That would be incredibly expensive. In the last 10 years, we have done about 4,300 of those types of audits. Therefore, 4,300 times is a lot of money.

Senator Hutchison:
You are saying that as a practical matter, it is impossible, given your budget constraints, to hire enough people; that becomes a policy question for us. If the Legislature wants to apply this policy level, you will need more money in your office. The State must understand that we will pay for our government in a different way from what we are doing now. We will not use

contingency-based or collection firms any longer because of the perverse interests and relationships that may create. As a policy committee, we have to decide to pay more money for that. We can decide what the true dollar cost of government. That is a policy question.

State Treasurer Marshall:
If you did not fully fund an audit program, the practical effect is that you would be safeguarding debtors at the expense of owners, senior citizens, your constituents and small businesses.

Senator Hutchison:
We have to decide whether to fully fund a government function, which we do all of the time. There is always a victim. When we do not fund government, people will not get services to a level they think they should.

The policy question is do we use contingency-based professionals in this State. If we do not, then we have to pay more money for your Office, the Attorney General's Office and other offices to do their jobs. We can agree on that.

State Treasurer Marshall:
Alternatively, you are safeguarding debtors at the expense of owners.

Senator Hutchison:
In this situation, we may be doing that, just as we have to make 1,000 other choices whenever we have funding decisions in State government. That is a policy question. However, we cannot say we are not helping grandma; we have to follow a policy that we may not want to follow. We have to decide the best policy to make, implement it and then pay for it.

State Treasurer Marshall:
You would have to decide that policy discussion within the confines of U.S. Supreme Court law.

Senator Hutchison:
I agree that we need to follow the U.S. Supreme Court. That does not apply in terms of the policy debate I am discussing.

Senator Brower:
What troubles me about this discussion and this bill is that they reveal the issues we often hear that perhaps we are doing something in the wrong way and that it is a bad policy. However, if we change it, fix it and correct it, we have a budget hit of X or Y. We see that in the complimentary meal tax debate. We have seen that in the Incline Village property tax litigation.

A few of us in this room realize that we need to adequately fund government and also rest assured that we are working hard to make sure we have the revenues. It is just not good enough to say we cannot change the way we do business, even when we assume or agree that we are doing it in the wrong way, because there is a budget impact. We have to get the policy correct first and then determine how to fix the revenue loss if there is one.

Let me focus on the contingent fee issue. I have been the chief auditor of a billion-dollar federal government agency. I understand that no one likes to be audited. I have been the bad guy. I have been the signer of audit reports and recommendations. The idea of giving government auditors a financial incentive is scary. It is not unlike the government saying that we do not really have the resources to prosecute all of the crimes that are occurring, so let us hire private lawyers and pay them based on every conviction plea deal. In fact, let us give them a bonus depending on how big a sentence they can get on defendants. We would all agree that would be crazy. That would create a perverse incentive of which no government should be part. This is not that different. I understand there is a potential budget impact, but to give private sector actors the power of the government and pay them based upon what they find is troubling.

State Treasurer Marshall:
The State Treasurer's Office will leave the policy making to your body. That is what you do well. One of the things that the Legislature also considers when it makes policy decisions is not making a policy decision based on one bad instance and changing the entire law. We see this many times when we have this kind of automatic extreme reaction to a single bad instance. When you change the entire law, it has incredible negative ramifications for your constituents, your small businesses and the owners of those properties, and you begin to safeguard debtors which is an amazing policy decision to make but it is yours to make.

Mr. George:
Senator Brower, in the 75th Session the same contingent issue was part of that bill. The argument I made is the same one I have made to you. If contingent fees are something that businesses might take advantage of, what might they do if they were paid on an hourly fee instead? If they were paid $300 per hour, would that not give them the same disincentive to make sure the audit took much longer so they could charge more? Nationally, that is the reason everybody uses contingent fees because if you do not find anything, you will not continue that audit because it is not financially feasible for you to do so.

Senator Brower:
I understand that; that is why we are having this debate. That is helpful, but some functions of government are just so inherently governmental that we need to be careful about letting private actors perform those functions and have the financial incentive to perform them more aggressively than the government or the people would want them performed.

Senator Ford:
Kudos to you for getting rid of the firm that did what it did to IGT. That is part of the check and balance on these types of things.

Regarding the statute of limitations, I noticed that Nevada is in middle of the other states. The majority of states have no statute of limitations. Most of them are approximately 10 years, and we are at 7 years. The point is that we are already in the middle; only a few states have 5 years, but most of them do not have any. I want to make sure the Committee understands that.

Mr. George:
Actually, I did not address that.

Robert P. Krenkowitz:
Unclaimed property law, although you may say it has some flaws, is one of the best and most valuable consumer protection programs a state can have.

In your deliberations regarding policy, please keep one crucial fact in mind, the property involved is that of the consumer, the owner or the business entitled to the money. It is not the property of the holder. I get frustrated when I find that holders, who have been so used to pocketing this money for so many years, think they have a right to the money. They never had that right.

Unclaimed property law is not some Johnny-come-lately program. It derives from the medieval concepts of *bona vacantia*, which means property that belongs to no one but belongs to the sovereign, because under the law somebody must always own the property. Those concepts were part of the English common law that came to the United States. The laws have morphed into the concept of unclaimed property in which the state steps into the shoes of the rightful owner to protect and safeguard the rights of the owner and to prevent forfeiture.

The alternative to an unclaimed property law is to allow the holder to confiscate the money, to forfeit the money, and one great principle of equity in the law is that the law abhors forfeiture. Keep in mind that this money does not belong to the corporation holding it; does not belong to the bank in which it is deposited; does not belong to the department store that issued the gift certificate; and does not belong to American Express because they issued a traveler's check. That money belongs to a citizen, whether that citizen is a private individual, an incorporated individual or some other kind of business entity.

Senator Ford:
I received a check for $29 for money I forgot about 8 years ago. What about personal responsibility? I should have known about my own bank account. In that regard, maybe the money does escheat to the State based on the common laws about which you were speaking. How does that affect all of this?

Mr. Krenkowitz:
You may say that each individual has the responsibility to keep track of all of their information and assets. Practically speaking, people move around from place to place and leave accounts behind. More typically, what happens is that you had a security deposit with your utility company and you moved out of the house you lived in for 20 years. You have completely forgotten it because you never received statements about it.

There are instances of mistakes in the company's records. Ford is a common name. It could be inverted, it could be "Foed," and the company made a spelling mistake, or it makes a mistake in your address in the zip code or street address. Or, you may have died and you may not have told your beneficiary that you had this account somewhere.

You may have read about the controversy about using the Social Security Death Master File to locate insurance policy beneficiaries. There are ways of learning that a policy owner has died. However, the beneficiary knows nothing about it. That can go on for 30 years if nobody takes an affirmative action and steps forward to claim those properties. Therefore, the State Treasurer's Office has to do what it can to find Senator Ford, and when Senator Ford is found, it is his property. For him it was $29; in Michigan not too long ago, it was $3 million.

This is not the corporation's money; it is not the holder's money; this is the public's money. The purpose of unclaimed property law, as the U.S. Supreme Court has said, is that the property escapes seizure by would-be possessors and is used for the general good rather than the chance enrichment of particular individuals and organizations.

Much has been said about section 2 of S.B. 355 which deals with business-to-business transactions. You read part of the statement from the Uniform Law Commissioners that opposes that kind of an exemption (Exhibit L). We ought to make note of the next paragraph where the Commission states that the adoption of the business-to-business exemption undermines the sound public policies of Nevada's unclaimed property law. These laws protect owners and provide the use of these funds for the public good when rightful owners cannot be found.

The other aspect is, if you do adopt a business-to-business exemption, it is only good in one situation where a Delaware holder owes property to a Delaware citizen because of a transaction that occurred in Delaware. That is the only way it will have any kind of effect. You must recognize that in this area, more than one sovereign state can have sovereignty over a transaction. You have sovereignty over the people in Nevada. You have sovereignty over transactions in Nevada. However, when you have an out-of-state holder, you have no sovereignty over them. If the holder is in Ohio, you cannot take the property because of this provision. Ohio will take the property.

People are concerned about Delaware. If it is a Delaware corporation, Delaware will say Nevada cannot take that property under its law. Delaware is the sovereign and because it is the situs of the corporation, it can now take the property. Even if you conceptualize the situation where neither the state of the last known address nor the state of incorporation has this kind of an exemption, the transaction occurred in a state that did not. That state will say that it wants

to exercise its sovereignty. Delaware as the state of incorporation can. Nevada as the state of residence can. However, the transaction happened in New Jersey, so New Jersey will take possession of that property. The net effect of that kind of business-to-business exemption is that you only protect that limited situation.

When you have a business-to-business transaction, you are discriminating against people who ordinarily would be protected by the law. Why should small businesses be deprived of the opportunity that Senator Ford had to get his money back? Small businesses try to maintain their books, but errors happen. Why should they be cut off? They want the same protection, and just because a business is formed as a limited-liability company (LLC) to protect itself from certain other liabilities, why should the policy determination be that it is not entitled to any kind of protection?

Regarding the statute of limitations period, what is being done here is not just reducing the limitations period, it is reversing almost 50 years' worth of law. If you look at the statute, the limitation period runs when the State had notice. Now it is saying, no, I do not want to have to give you any notice. It runs when the duty arises even if I do not satisfy the duty. I suggest that you are letting yourselves in for mischief. You reward the holder who says, I will sit back and unless the state can find out by some other source or by some other magic, I will be free.

Senator Roberson:
I appreciate the lively and dramatic testimony of the opposition and your time in considering this bill. I hope it has given everyone an opportunity to think about an issue that we do not think much about.

I want to make clear that by this bill I am not out to harm the funding for the Millennium Scholarship in any way. I do not intend to protect debtors over owners, and I am not trying to hurt consumers. However, it does not hurt to look at ways to make Nevada more competitive and more business-friendly. Looking at excluding business-to-business transactions and considering the merits of government-sanctioned contingent agreements is of value.

The fiscal note put together by the State Treasurer's Office does not and cannot reflect the fiscal and economic benefits to Nevada because of making this State more business-friendly.

Senator Kihuen:
We will close the hearing on S.B. 355.

Chair Segerblom:
We will open the hearing on S.B. 307.

SENATE BILL 307: Revises provisions relating to trusts, estates and probate. (BDR 12-179)

Senator Ben Kieckhefer (Senatorial District No. 16):
The law governing trusts and estates in Nevada is excellent. It puts us in a fine and sound position to compete with other states for the creation of these types of documents and legal entities. I would submit that we need to continue to protect that position.

Russel B. Duckworth, CFA (Duckworth Capital Management, LLC):
I have noticed that we have a disparity in our law for creditor exemptions for retirement plans. Senate Bill 307 adds a new category of exemption for retirement benefits for military personnel. That is an excellent provision to add to our statute. It is similar to a provision that exempts, in their entirety, the retirement benefits paid out of the State pension plan. However, one thing I have noticed is a disparity in how retirement benefits are protected if you have an IRA or 401(k). Unlike government retirement benefits, it is not protected in its entirety. It is limited to $500,000. All citizens in Nevada deserve to have their retirement benefits protected in their entirety. My amendment (Exhibit M), removes the $500,000 cap from private retirement plans.

Specifically, it amends sections 26 and 27 of the bill by deleting the $500,000 cap to protect all property in an IRA, a 401(k) and so forth.

Chair Segerblom:
You are not concerned about the benefits from military retirement; you are concerned about removing the $500,000 cap.

Mr. Duckworth:
Yes.

Senator Jones:
I appreciate the sentiment. All of us want to protect our retirement benefits. However, having recently been through litigation involving this very provision, my concern is that it creates a perverse incentive for people to hide money in retirement accounts in order to evade creditors.

I recently had a circumstance in which the exact same thing occurred. Someone was hiding more than $4 million in accounts in order to evade creditors. That is the policy reason the limitation exists. Do you have any response to that?

Mr. Duckworth:
Someone fraudulently making transfers at the eleventh hour is addressed in the fraudulent transfers part of our statute. I am not sure what the policy rationale is for the limit. I have noticed a disparity. If you are taking $100,000 per year out of the state pension plan, that is completely exempt. Whereas, if you have a $5 million IRA account and you are invested at 2 percent to get the same certainty of payment, $100,000, you are not 100 percent exempt. Therefore, I am not sure what the difference is. It is not for last-minute transfers because that is addressed by fraudulent transfers.

This cap was last updated in 1997. Sometime before that, it was $100,000 and put into the law. It is inappropriate that one group of citizens is treated differently. In the case of the $5 million IRA, only the first $500,000 would be protected and therefore the $10,000 per year income is protected, whereas the state employee gets the full $100,000. That is inappropriate from a policy standpoint.

Senator Jones:
Have you looked at other states to see what their caps are?

Mr. Duckworth:
In my letter provided to the Committee (Exhibit N), 42 out of the 50 states provide unlimited protection. A few states provide exceptions for child support or spousal support. I would support those exceptions if you wanted to put those in the bill. Only eight states, such as Nevada, have a hard cap.

Senator Hutchison:
Mr. Duckworth, did you vet this with anyone?

Mr. Duckworth:
I am here on my own.

Senator Hutchison:
You might want to work with Senator Kieckhefer on this.

Senator Segerblom:
In the section 26 Notice of Execution on page 21, lines 29 and 30 of S.B. 307, annuity plans are included, but later excluded. Would this also limit annuity plans to $500,000?

Mr. Duckworth:
It addresses a different category of annuities not addressed in the exemptions. The $500,000 cap applies to that new provision.

Senator Segerblom:
However, under our existing law, are annuities exempt?

Mr. Duckworth:
The retirement annuity being added is implemented for a tax-exempt organization that often gets an IRS section 403 annuity retirement plan. Those exempt annuities you are talking about are through an insurance company. These are through a retirement plan.

Robert E. Armstrong:
In the context of family trust companies, I have been made aware of three provisions. First is the definition of interested person in section 3, which is a very useful provision. However, we have a similar provision in NRS 669A.070. This interested person provision regarding trusts expands the persons identified who are interested persons with regard to a trust proceeding. When we read that interested person provision in light of NRS 669A.255, it became apparent that the expansion of the definition would not mesh because we use a similar provision in the interested person provision in NRS 669A. A significant portion of the change that I am recommending in NRS 669A (Exhibit O) is instead of using the term "interested person," it should more appropriately be the "beneficiary" receiving these reports because in actuality, the person is receiving accountings from the family trust companies.

Chair Segerblom:
Do you want to eliminate that section?

Mr. Armstrong:
I would like to substitute the term "beneficiary" for "interested person" in the provision.

I would also like to add that if we do an accounting pursuant to NRS 165, that should be sufficient for the reporting obligation contained in the statutes. We try to give the family trust company an option of either doing the statutory requirement or providing the requirements already laid out in NRS 165.

The second issue is that this bill codifies fiduciary duties, for which, up to now, we have relied on common law. It is a useful exercise to identify these fiduciary duties, but I was concerned that these duties, in one fashion or another, have always existed in common law. Because of the specific language used in section 33 of S.B. 307, the statute should be applied prospectively as opposed to silent or retrospectively. If we knew this provision was coming down the pipe, we might have crafted many existing trusts drafted 20 or 30 years ago differently. It would be beneficial, especially in the family trust area, to make the application in section 33 apply prospectively instead of silent or retrospectively. It makes the law clearer once enacted.

Section 62 of the bill is a new section being introduced by the Nevada State Bar concerning the duty to disclose the existence of a trust and other matters related to trust administration. It is a useful provision, but I have drafted a number of trusts. Trusts will continue to be created under the same trust instrument, which has its own duties to disclose; however, this provision trumps that. With regard to family trust companies, I would like to make sure that the testator could draft a provision dealing with this duty to disclose through a properly crafted trust instrument.

Keith Lee (Sutton Place Limited):
We have been working with NRS 669A to create a business-friendly, separate chapter dealing with family trusts. These are closed family trusts. I concur with what Mr. Armstrong said. I would suggest we exempt NRS 669A trusts completely from the application of this bill. We are mixing apples and oranges. There is a reason why we have NRS 669A, and it is working.

Chair Segerblom:
We will close the hearing on S.B. 307 and open the hearing on S.B. 279.

SENATE BILL 279: Revises provisions relating to the Secretary of State. (BDR 7-461)

Senator Greg Brower (Senatorial District No. 15):
This is a simple, cleanup bill. During the interim, it came to my attention from district attorneys that at several places throughout the NRS, language that includes the word "instruct" rather than "refer" or some other word describes the relationship between the Secretary of State and the prosecutors around the State. The SOS's Office plays an important role in investigating criminal conduct. The prosecutors around the State, whether the district attorneys or the attorneys general, cannot be instructed by someone else.

Chair Segerblom:
Ms. Lamboley, do you agree?

Senator Brower:
The SOS is supportive of this bill. The intent is to clean up that language throughout the NRS.

Ms. Lamboley:
We spoke with Senator Brower in advance. We proposed similar language to remove "shall instruct" and change it to "may refer" in NRS 82. This bill extends it to a couple of provisions in Title 24, and we have no problem with it.

Chair Segerblom:
Do you agree that the SOS cannot order a district attorney to do anything?

Senator Brower:
The way I would describe that, in talking with district attorneys, is the SOS can so order, but it is not likely that order would be carried out. The practical reality is that the SOS's Office, the district attorneys and the attorneys general work closely on investigations and referrals are made often. When the prosecuting offices agree that the case should and can be prosecuted, those cases are prosecuted. It is simply just a matter of practice that one office cannot instruct the other office to do something. Everyone agrees on that.

Brett Kandt (Special Deputy Attorney General, Office of the Attorney General):
This bill would amend the existing statutes to reflect more accurately the way things operate in practice and to account for the fact that attorneys general and district attorneys are subject to certain ethical considerations and resource restraints when making litigation decisions.

Kristin Erickson (Nevada District Attorneys Association):
We also support S.B. 279.

Chair Segerblom:
We will close the hearing on S.B. 279.

SENATOR HUTCHISON MOVED TO DO PASS S.B. 279.

SENATOR FORD SECONDED THE MOTION.

THE MOTION CARRIED UNANIMOUSLY.

* * * * *

Chair Segerblom:
Having no more business to come before the Senate Committee on Judiciary, we are adjourned at 11:23 a.m.

RESPECTFULLY SUBMITTED:

_____
Suzanne Efford,
Committee Secretary

APPROVED BY:

_____
Senator Tick Segerblom, Chair

DATE:_____

EXHIBITS				
Bill	**Exhibit**		**Witness / Agency**	**Description**
	A	1		Agenda
	B	3		Attendance Roster
S.B. 441	C	7	Robert C. Kim	Memorandum
S.B. 441	D	1	Robert C. Kim	Proposed Amendments
S.B. 441	E	1	Albert Kovacs	Testimony
S.B. 441	F	17	Albert Kovacs	Delaware Supreme Court Chief Justice's Analysis of the Delaware LLC Act
S.B. 441	G	1	Robert C. Kim	Transitional Provision
S.B. 441	H	4	Robert C. Kim	Amendment
S.B. 331	I	2	Randi Thompson	Testimony
S.B. 331	J	1	Robert W. Marshall	Letter from Secretary of State
S.B. 355	K	3	Senator Michael Roberson	Letter from Council on State Taxation
S.B. 355	L	6	Robert P. Krenkowitz	Testimony
S.B. 307	M	2	Russel B. Duckworth	Amendment
S.B. 307	N	3	Russel B. Duckworth	Letter
S.B. 307	O	2	Robert E. Armstrong	Proposed Amendment