MINUTES OF THE SUBCOMMITTEE OF THE SENATE COMMITTEE ON JUDICIARY

Seventy-Eighth Session
March 31, 2015

The subcommittee of the Senate Committee on Judiciary was called to order by Chair Greg Brower at 1:03 p.m. on Tuesday, March 31, 2015, in Room 2134 of the Legislative Building, Carson City, Nevada. The meeting was videoconferenced to Room 4412E 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.

SUBCOMMITTEE MEMBERS PRESENT:

Senator Greg Brower, Chair
Senator Becky Harris, Vice Chair
Senator Michael Roberson
Senator Scott Hammond
Senator Ruben J. Kihuen
Senator Tick Segerblom
Senator Aaron D. Ford

GUEST LEGISLATORS PRESENT:

Senator Mark Lipparelli, Senatorial District No. 6

STAFF MEMBERS PRESENT:

Patrick Guinan, Policy Analyst
Nick Anthony, Counsel
Lynette Jones, Committee Secretary

OTHERS PRESENT:

Mandy Shavinsky, Real Property Law Section, State Bar of Nevada
Jim Wadhams, Las Vegas Metro Chamber of Commerce
E. Norman Veasey, Las Vegas Metro Chamber of Commerce
Steve Morris, Morris Law Group
Kurt Franke, Nevada Justice Association

Chair Brower:
I will open the subcommittee hearing on Senate Bill (S.B.) 389.

SENATE BILL 389: Revises provisions relating to condominium hotels. (BDR 10-76)

Senator Aaron D. Ford (Senatorial District No. 11):
I will present S.B. 389. This bill makes conforming changes to *Nevada Revised* Statutes (NRS) 116B which is known as the Condominium Hotel Act. In 2011, the Real Property Law Section of the State Bar of Nevada proposed S.B. No. 204 of the 76th Session, which made the same changes to NRS 116, the Uniform Common-Interest Ownership Act.

Senate Bill 389 includes technical fixes identified by the Real Property Section since NRS 116B was enacted in 2007. The majority of the changes enacted in S.B. No. 204 of the 76th Session were made to conform NRS 116 to the 2008 amendments to the Uniform Common-Interest Ownership Act (UCIOA). As enacted in 1991, NRS 116 was based on the 1982 enactment of UCIOA.

Mandy Shavinsky (Real Property Law Section, State Bar of Nevada):
We are in support of S.B. 389. The Common-Interest Community (CIC) Committee of the Real Property Law Section, State Bar of Nevada, met on several occasions in 2012 to consider changes to NRS 116B. These changes are based on applicable provisions of the 2008 UCIOA amendments and changes made to NRS 116 during the 2007 Session.

Participants on the CIC Committee of the Real Property Law Section include Michael Buckley, Karen Dennison and me. I submitted a document that provides an explanation of the proposed amendments to S.B. 389 (Exhibit C). The proposed amendments incorporate the applicable provisions of the 2008 draft of UCIOA and S.B. 204 of the 76th Session. In addition, the CIC Committee discovered a number of minor changes to the law that did not come to light until after NRS 116B was enacted. These changes include moving provisions of the law into the sections that address the same topic. None of the proposed changes are policy-driven, and the members of the Real Property Law Section do not believe the changes will be controversial.

Changes listed in sections 7 and 26 of the bill are not based on the 2008 UCIOA amendments or S.B. No. 204 of the 76th Session. I bring these

sections to your attention because I noticed the highlighting of these sections on pages 2 and 4 of my document, Exhibit C, did not appear until after the document was recopied.

Chair Brower:
I reviewed the changes, and they appear to be in order. I will close the hearing on S.B. 389 and open the hearing on S.B. 329.

SENATE BILL 329: Revises provisions relating to partnerships. (BDR 7-784)

Senator Mark Lipparelli (Senatorial District No. 6):
I will present S.B. 329. The bill is designed to address the notion of an announced partnership versus one that is more formal.

Jim Wadhams (Las Vegas Metro Chamber of Commerce):
We support S.B. 329. This is a business bill that deals with the integrity of businesses and their corporate structures. This is important in Nevada as we climb out of recession and encourage further development and diversification of the economy.

Nevada has recognized the value businesses place on the certainty of law developed in Delaware. This certainty encourages businesses to incorporate Delaware law and its court decisions due to the depth and clarity of statute and judicial holdings. An interim study was conducted by the Legislative Commission's Subcommittee to Encourage Corporations and Other Business Entities to Organize and Conduct Business in This State. The study recognized the need to emulate Delaware law in the State. Three members of the Subcommittee still serve in this body today: Senator David R. Parks, Senator Mark A. Manendo and Chair Brower. The study report titled "Encouraging Corporations and Other Business Entities to Organize and Conduct Business in Nevada" was produced and presented at the 2001 Legislative Session.

The essence of S.B. 329 can be found in sections 3 and 6. I will explain the purpose of these sections and why we support the bill. *Nevada Revised Statutes* 87 deals with partnerships generally, and sections 3 and 6 of the bill deal with the doctrine of partnership law referred to as partnership by estoppel or partnership by conduct. Partners are responsible for each other's acts and

debts. Sections 3 and 6 refer to persons who should be treated as if they are partners.

A 2014 Nevada Supreme Court Case, *In re Cay Clubs,* 130 Nev. Adv. Op. 92, 340 P.3d 563 (2014), addressed this issue and found two businesses acting together to create a development entity would be treated as if they were partners. This prompts us to amend law.

Section 3 makes it clear if two businesses come together and engage in a single-purpose project, they may not be treated as partners if they take the next step and form a separate business entity. There is a reference to Title 7 of NRS which has various sections on corporate formation from traditional corporations to limited-liability companies. It is our belief this change will allow businesses to engage in development projects in a manner that allows the businesses to control their liability and manage it within the project.

Under Title 7 of NRS, businesses can use a variety of corporate forms available to limit entity asset liability. Persons forming an entity cannot be treated as partners if separate entities are formed for the purpose of the business. They would be considered stockholders or members depending upon the type of entity they form. Senate Bill 329 does not create new rights for immunity. I encourage the Committee's support.

Chair Brower:
Nevada is known as the Delaware of the West. If you have information on how we can continue those efforts, we would appreciate hearing it.

E. Norman Veasey (Las Vegas Metro Chamber of Commerce):
I am a former Chief Justice of the Delaware Supreme Court. I encourage Nevada to do what it can to have incorporations like those formed in Delaware. We have done it for a century and it has worked well. We have not only kept our code up to date, but we had cases decided and continue to be decided. It is a rich body of law. I will start with three basic points that represent the backbone of Delaware law on this issue.

My first point is businesses need predictability and certainty. An earlier reference to certainty has been made, and this has been said in our opinions of Delaware law. We do not want nasty surprises, but they do happen. We want businesses to understand what we are doing in Delaware code and courts.

The second point is transactions are driven by contracts. When a person signs a contract, the person intends to be bound by it along with others who sign the contract.

The third point is when someone plans to enter into a contract but is not happy with the financial responsibility of the counterparty to the contract, that person has options. The person can get a third party to join on the contract or get a guarantor. This is the framework of the fundamental principal of Delaware law.

The primacy or sanctity of contracts is extremely important. Separate incorporations or a limited-liability company (LLC) should not be disregarded. Delaware law says it will not be disregarded unless there is fraud, manipulation or, in the case of subsidiary situations, the subsidiary is a sham or alter ego of the parent. The parent is not liable for the subsidiary simply because the parent owns the majority of stock or all stock.

This is important based on four points. It is common for corporations to use subsidiaries to transact with other businesses. They can take risks. Sometimes big risk can result in big reward, and sometimes risk results in great loss. Corporations limit risk by limiting exposure to the subsidiary's assets, just like when a person buys stock in a corporation. We would not expect a stockholder to be liable for the faults of the corporation regardless of whether it is General Motors or a mom-and-pop store.

My next point is the essential ingredient to business planning. Limited liability is an important investment because the investor knows what he or she is going to lose and when. Bad surprises by courts will drive businesses away. We are very sensitive about losing businesses and corporations in Delaware. We do not want to be nice to everyone, but we try to make our decisions straight down the middle. If you have a bad surprise in court, this will drive businesses away. Delaware honors the expectations of parties in contracts. The parties know whom they are dealing with, and they know the third party not tied to the contract will not be liable.

An alter-ego setting exists when a corporation is a sham or someone deals with or misleads someone else. If the corporation has what some call a separate mind of its own and it is not inequitable or a sham, this is a situation Delaware law and other states would honor. Nevada Supreme Court case *Truck Ins. Exchange v. Palmer J. Swanson, Inc.,* 124 Nev. 629 189 P.3d 656 (2008),

made a good decision on the alter-ego scenario. The Supreme Court determined the need to have complete identity of the subsidiary with the parent in order to create an alter ego. This will pierce the corporate veil and ensure they are indistinguishable.

Common expectations of businesses are that courts honor the certainty and sanctity of the contract and provide for the taking and limiting of risk. This is the fundamental cornerstone of commerce.

Chair Brower:
I read the *Cay Clubs* decision, and I understand what the Nevada Supreme Court was trying to do. The purpose of S.B. 329 is to prevent what we saw in the *Cay Clubs* case, which was a judicial finding of a partnership that did not exist because of a joint venture activity. The bill addresses the problem going forward.

Mr. Wadhams:
Yes. Sections 1 and 2 of the bill still apply, but any words about coming together to form a business avoid the implication of partnership. Section 3 addresses this and states, " ... so long as the business development is undertaken in furtherance of forming an entity in accordance with title 7 of NRS." There is a goal in mind for creating a specific purpose business entity.

Senator Harris:
The language in section 3, "furtherance of forming an entity" is broad. How far does one have to go in the furtherance of forming an entity? I have not read the *Cay Clubs* case, which would have given me a better perspective of the bill. Are you required to take steps and form an entity in order for this section to apply, or do you only need to work in good faith? Walk me through what you mean by "furtherance of forming an entity."

Mr. Wadhams:
As long as the words and phrases are being expressed in the process of creating the business entity, you are not in a partnership. It does reflect a process is underway, and it must reflect the intention to form a discrete business entity with a specific purpose.

Senator Harris:
There is no requirement that an entity must be formed?

Mr. Wadhams:
No. The language in S.B. 329 does not mandate that.

Senator Segerblom:
Are you saying if two entities want to do a business deal, refer to themselves as partners and take action or make an offer, it cannot later be described as a partnership?

Mr. Wadhams:
An example is you have an idea to have a marijuana dispensary, but you need someone with money to fund the idea. I have the funds and invest in the project and a third party hears that an LLC will be formed. The third party cannot treat us as partners because we are forming an LLC, which is needed to hold a dispensary license. This is the essence of the issue. The third party may think the project must be a good idea if a wealthy investor is behind the venture. This bill intends to protect us from going into the process. Once the process starts and people buy or negotiate a vendor deal with the project through an LLC, they cannot relate it back to the fact that we are forming a business together.

Senator Segerblom:
In your example, if you and I represent ourselves as partners during the course of negotiations, can another party rely on those representations?

Mr. Wadhams:
The language intends to provide protection as an entity is formed. In the marijuana dispensary scenario, forming an entity does not make us partners, we will be stockholders or members of an LLC.

Senator Segerblom:
During the process of negotiating a lease, we say we are partners in the business, and the third party acts upon the representation to his detriment. Later on, we form an LLC and the third party sues. We say we are now a corporation and the third party cannot sue based upon the fact we said we were partners.

Mr. Wadhams:
When coming together to form an LLC, the lease would be covered under the LLC and the landlord would recognize the LLC.

Senator Segerblom:
What if the LLC is never formed?

Mr. Wadhams:
If the LLC is never formed, then we did not perfect the lease. The fact we are in the process of forming an LLC does not make us partners.

Chair Brower:
The problem in the *Cay Clubs* case was two entities advertised as joint venturing or partnering on a project, but they were not a legal partnership. They did not hold themselves out as legal partners, and they did not represent to the third parties that a legal partnership was formed.

The Nevada Supreme Court found that the mere fact they described themselves as being in a joint venture or "partnering" led to partnership by estoppel. The point of S.B. 329 is to clarify doing such things and using words like "partnering" or "joint venturing" is not enough. The entities must actually hold themselves out in such a way as to make representations to third parties in a public manner so the third party believes there is a legal partnership.

This is the law, which appears to have been taken too far by the *Cay Clubs* case. This bill intends to clarify that merely using the words "partnering" and "joint venturing" is not enough. I am not clear on the final clause in the new language that says, " ... so long as the business development is undertaken in furtherance of forming an entity in accordance with title 7 of NRS." We need clarification on this language.

Mr. Wadhams:
I can supply the Committee information later or have Steve Morris provide information now.

Chair Brower:
Mr. Morris, explain to the Committee the facts of the *Cay Clubs* case and how the court interpreted law to reach the decision. Why do you believe this bill is necessary to avoid the same result in the future?

Steve Morris (Morris Law Group):
This bill does not overturn NRS 87, the Uniform Partnership Act under which *Cay Clubs* was decided. The case involved two people who came together and made an announcement they were partnering and going into business to develop a project. They formed an LLC to do that. The LLC, not the people who announced they were forming it, undertook efforts to promote the development of the project. The project failed, and investors were disappointed by the failure of the project. The investors said those who put together the LLC to promote the development should be held liable as partners.

This speaks to two things, one of which Mr. Veasey spoke about. The investor's claim is contrary to the contract and the contract principles that underlie the development. The people who were disappointed by the failure of the project did not loan money to those who said they were jointly coming together to form an entity to sponsor the project. They were people who dealt with the entity, the LLC that was formed by those who said they were going to join to develop the project.

I will use this example, Senator Harris. Suppose you and I made a joint announcement that we are going to build an addition to the Legislative Building and we are going together as partners to put an entity together. We create an entity called Morris and Harris, LLC, and we solicit funds for the project. The project comes up short and a vendor is disappointed that payment was not made. The vendor claims Morris and Harris, LLC, did not make payment as promised. The vendor believes Morris and Harris as individuals should pay because they said they were partners in creating the entity. This is the situation that S.B. 329 is designed to eliminate.

Chair Brower:
That example clarifies the reason for the last sentence in section 3.

Senator Harris:
I agree people use terms like "partnership" when they really mean they are forming a corporation or an LLC. What about the case in which a partnership is formed and working toward forming a business entity? The business entity is never formed and a third party has relied. Do we fall back on partnership theories of recovery at that point if an entity is never formed?

Mr. Morris:
This is what NRS 87 addresses now. If you say we are going to form this entity and you solicit money for that purpose but do not form the entity, you are liable as a common-law partner.

Kurt Franke (Nevada Justice Association):
We are opposed to S.B. 329 (Exhibit D). This is the exception that swallows the rule. The addition to statute makes other points of the statute moot because it relies upon a later evidence of subjective intent of a party to say he or she was doing it for the reason set forth in statute and cannot be held liable.

The partnership by estoppel rule says if a person is responsible for giving another the authority to enter into an agreement on your behalf, you are stuck with that agreement. You can allow people to walk around saying they are your partners going into an agreement on your behalf and then if the agreement does not turn out the way you like, you can say you are not subject to liability.

This would happen as a result of S.B. 329. The estoppel rule already has built-in protections. These protections include a partnership or person must know and allow the representation be made that this other person or entity is acting on behalf of the partnership; the person relying upon that apparent authority must act upon it reasonably; and the person relying must have a reasonable basis to believe the person had such authority.

As drafted, the bill has several issues that could cause problems with courts in the future and might exempt people from fraud. The bill talks about the sole purpose of business development without really providing a definition except in that last sentence. It talks about using the exact terms of partnering or joint venturing, although this may not be the case, so long as the business development is undertaken in furtherance of forming. The entity is not required to form; people can act and work together as partners toward forming an entity but never form the entity, and law still exempts them from liability.

Several points mistakenly came up during earlier testimony. The testifier said partners must ultimately form the entity. This was clarified later. Nothing in the bill requires the formation of the entity as long as there is movement toward the furtherance of forming an entity.

Mr. Veasey indicated businesses rely upon predictability and certainty. Business law represents half of my practice, and I enter into contracts on behalf of businesses all the time. This bill would undermine the predictability and certainty of the person you are dealing with. My clients talk to each other and talk to other businesses on a regular basis. If they represent themselves to be partners in a business and the partnership allows them to make that representation, this is generally good enough for them. This bill would require every such negotiation to require a review of the partnership agreement, every amendment or addition to the partnership agreement and every list of members to a current date before any business would be foolish enough to enter into an agreement with this exemption applied.

I want to clarify there was no judicial finding in *Cay Clubs* that a partnership existed. The court determined the decision would be made by the jury, and it overturned a summary judgment. It said the court could not make the decision, and it would be sent back to a citizen jury to decide based on the evidence of whether partnership by estoppel should apply. The statement of facts from the case said the validations are supported by some evidence. Cay Clubs inflated condominium value by advertising it would develop Las Vegas Cay Clubs as a luxury resort. Cay Clubs marketing materials represented it was in partnership with JDI Loans and JDI Realty, and the purchasers bought condominiums and engaged in other transactions on the belief the purported partnership provided resources and expertise. That is on the side of consumer protections. Those people had a right to rely, and the jury ultimately would decide if it was reasonable reliance.

Within the business-to-business context, S.B. 329 gives an out to someone who later testifies to his or her subjective intent. A person can claim the word "partnership" was casually used and becomes exempt from liability. The bill could be modified to accommodate these concerns.

Senator Lipparelli:
I am willing to work with those who oppose S.B. 329.

Chair Brower:
I will take a closer look at the *Cay Clubs* case, and we will proceed accordingly. I will close the hearing on S.B. 329 and adjourn the subcommittee meeting at 1:44 p.m.

RESPECTFULLY SUBMITTED:

_____
Lynette Jones,
Committee Secretary

APPROVED BY:

_____
Senator Greg Brower, Chair

DATE: _____

EXHIBIT SUMMARY				
Bill	**Exhibit**		**Witness or Agency**	**Description**
	A	1		Agenda
	B	4		Attendance Roster
S.B. 389	C	7	Real Property Law Section, State Bar of Nevada	Written Testimony
S.B. 329	D	2	Nevada Justice Association	Written Testimony in Opposition