

H.B. 334: The 2007 Amendments to the Kentucky Business Entity Statutes

Thomas E. Rutledge
Stoll Keenon Ogden PLLC
Louisville, Kentucky

Representative Scott W. Brinkman



Objectives:

- Rationalize & Synchronize Similar Provisions of Business Entity Acts
- Clean Up
- Prepare for Further Progress



2002 Amendments to BCA

- Perceived conflict between 2002 S.B. 121 and 2002 S.B. 120
- The effectiveness of the 2002 amendments is confirmed as of 2002 (KRS §§ 271B.6-210; 271B.6-230; 271B.7-040; 271B.7-280 and 271B.8-080)



- Proper consideration for issuance of shares
- Unsecured promissory notes, services to be provided in the future are acceptable consideration
- Shares are “fully paid and non-assessable” as the note is issued or contract for services entered into
- Practice point-prevalue services and burn rate, detail consequences of failure to perform



- Cumulative voting for directors
 - Only if in the articles of incorporation
 - Not effective if only in the bylaws



Business Entity Names

- Distinguishability required from “Names of Record with the Secretary of State”
- Business and Nonprofit Corporations, LLCs, LPs, LLPs, Cooperatives and Associations, Business Trusts



- “Name of Record with the Secretary of State”
- Defined Term (*e.g.*, *KRS §§ 271B.1-400(16); 275.015(17)*)
 - Real
 - Reserved
 - Registered
 - Fictitious
 - Assumed



- Exception for distinguishability for PSC names is eliminated (KRS § 274.077(3))
- Reserved names may be renewed
- Registered names may be cancelled
- Limited availability of “Cooperative” clarified (KRS § 272.050)



Preservation of Uniform Partnership Act and Revised Uniform Limited Partnership Act

- With the exception of provisions on qualification of foreign LLPs and LPs, the Uniform Partnership Act and Revised Uniform Limited Partnership Act are not repealed
- KRS ch. 362 remains on the books



General Partnerships



Limited Partnerships

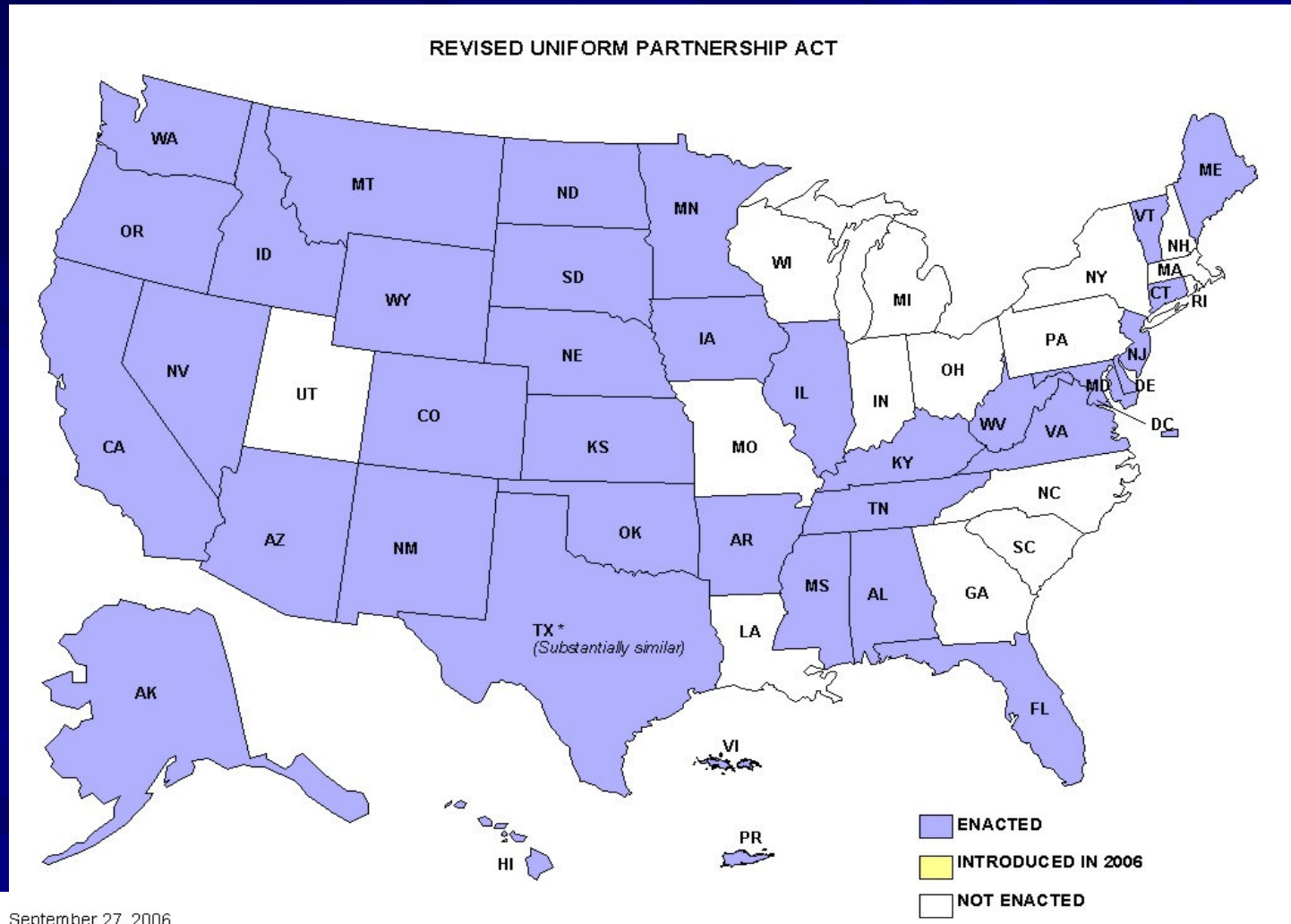


KyUPA LLPs vs. KyRUPA LLPs

- KyUPA – Partial Shield
 - KRS § 362.220(2)
- KyRUPA – Full Shield
 - KRS § 362.1-306(3)
- KyULPA – Full Shield LLLP
 - KRS § 362.2-404(3)



State Adoptions of RUPA

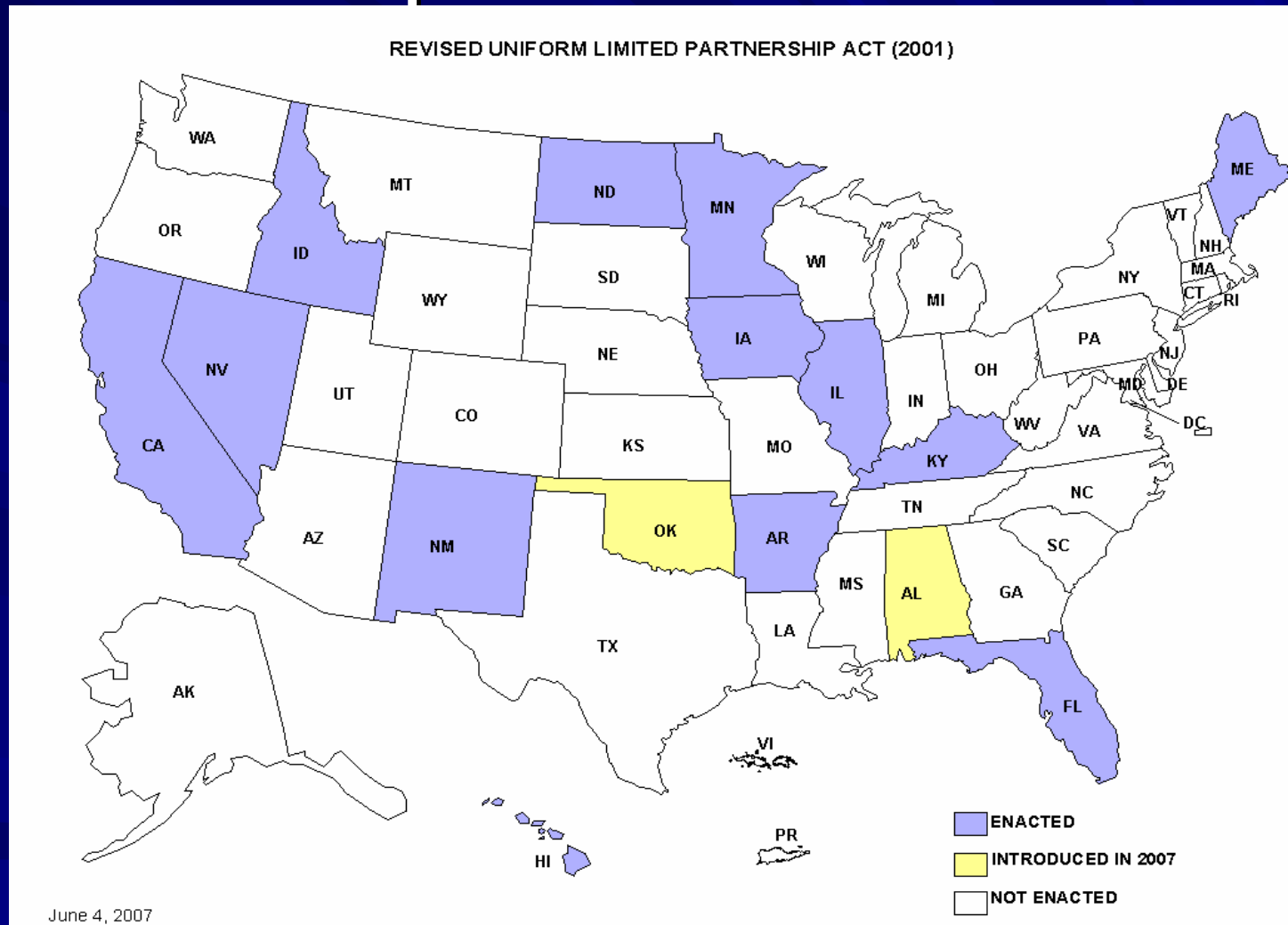


September 27, 2006



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State Adoptions of ULPA



Ethical Problems

- Who is the Client?
- Loyalty
- Zero sum issues



Qualification of Foreign LLPs and LPs

- Effective January 1, 2008, provisions of old laws for qualification of foreign LLPs and LPs are repealed
- On or before January 1, 2008, each foreign LLP or LP “transacting business” must qualify to transact under the Kentucky Revised Uniform Partnership Act (2006) or the Kentucky Uniform Limited Partnership Act (2006)



- There is no “grandfather clause” that will carry forward old foreign LLP or LP qualifications to the new laws
- *Contrast* KRS § 271B.17-020
- *See* FAQ on Secretary of State’s website



Increased NEGATIVE Consequences of Corporate Administrative Dissolution

- Effective July 1, 2008, new 271B.14-220(1)(e)
- Application for reinstatement to be accompanied by:
 - a certificate from the Division of Unemployment Insurance in the Department for Workforce Investment reciting that all employer contributions, interest, penalties, and service capacity upgrade fund assessments have been paid.



The Business Trust Act

- Neglected (at best)
- “Internal Revenue Code of 1954”



New BTA Provisions

- Name Distinguishability
- Registered Office/Agent for Service of Process
- Annual Reports
 - Beginning 2008
- Administrative Dissolution
- Foreign Qualification
 - Effective June 26, 2007



Foreign Business Entities

- Inspection rights are governed by the law of the jurisdiction of organization
 - *Sostarich v. Zirmed.com*
- Derivative actions are governed by the law of the jurisdiction of organization
 - *e.g.*, demand futility, security for corporation's expenses



Dissolution of LLCs

- We have again a unanimity requirement for voluntary dissolution
 - 1994 – Unanimous
 - 1998 – Majority-in-Interest
 - 2007 – Unanimous
- Departure from that rule must be in a written operating agreement
- No grandfather clause



Succession in SMLLCs

- Succession mechanism in written operating agreement
- Successor to last member may elect themselves a member
 - “Wandering between two worlds, one dead, the other powerless to be born”



Dissenter Rights in LLCs

- They do not exist unless set forth in:
 - Articles of Organization
 - Operating Agreement
 - Plan of Merger, Conversion or Asset Sale
- Drafting complexities
 - Timing of reciprocal obligations
 - Burden of initiating suit
 - Burden of proof



Signaling Effect of Form of Organization

- Not all things to all people
- Different outcomes are not the fault of failures in the law
- Internal - Dissenter Rights, Action for Accounting, Derivative Actions, Succession to Ownership and Participation Inspection Rights
- External - Charging order, UCC filings (LLC v. LLP), Apparent Agency Authority



Pledges of LLC Interests

- LLC interests excepted from UCC §§ 9-406 and 9-408 (KRS § 275.255(4))
- Consistent with KRS §§ 362.1-502(7); 362.2-702(8)
- Operating agreement limits on pledges should now be enforced



Not-for-Profit LLCs

- *Mercy Regional Emergency Medical System, LLC*
- Limitations on articles, mergers, issuance of interests, personal gain



Conversions

- Business corporation into LLC
- Unanimous approval for LLC to LP conversion

{Kentucky does not have domestications}



Conversion Statutes

- General partnership into limited partnership
(KRS §§ 362.1-902; 362.2-1102(1))
- Limited partnership into general partnership
(KRS §§ 362.1-903; 362.2-1102(2))
- General partnership into LLC (KRS § 275.370)
- Limited partnership into LLC (KRS §§ 362.2-1102(3); 275.372)
- LLC into limited partnership (KRS § 362.2-1102(4))
- Corporation into LLC
(KRS §§ 271B.12-030; 275.376 (new sections to be codified))
- Corporation into not-for-profit corporation
(KRS §§ 271B.10-010(3); 273.382)



Conversions You Cannot Do

- LLC into corporation
- KyUPA general partnership into LP
- Non-profit corporation into business corporation



Charging Orders

- Charging order provisions of the LLC Act, the Kentucky Revised Uniform Partnership Act (2006) and the Kentucky Uniform Limited Partnership Act (2006) written to be consistent
- Kentucky Uniform Partnership Act (1914) and Kentucky Revised Uniform Limited Partnership Act (1985) are not conformed



Charging Order

- Similar to a garnishment
- Does not transfer or assign the ownership interest absent foreclosure
- Never conveys right to participate in management (even in foreclosure)
- Taxation of distributions
 - Asset Protection



Manager Voting in LLCs

- Managers vote per capita, not by majority-in-interest (1998 drafting oversight)
- Majority controls
- Detail in operating agreement



Conflict of Interest Transactions

- Membership interests of manager do not vote on approving conflict of interest transaction
- Shares of corporation owned by a subsidiary in any form
 - KRS § 271B.7-210(2)



Compensatory Payments and “Distributions”

- LLC Act amended to exempt reasonable compensation from limitations on distributions
- Consistent with Kentucky Uniform Limited Partnership Act (2006); KRS § 362.2-508(8)



Limited Liability

- Amendments make it clear that shareholder's limited liability not lost in dissolution
 - *Forleo* decision (*Discret. Rev. Denied*)
 - Agency law issues
- In LLC, personal liability for agent acting outside scope of actual authority
 - Contrast statutory apparent authority; KRS § 275.135



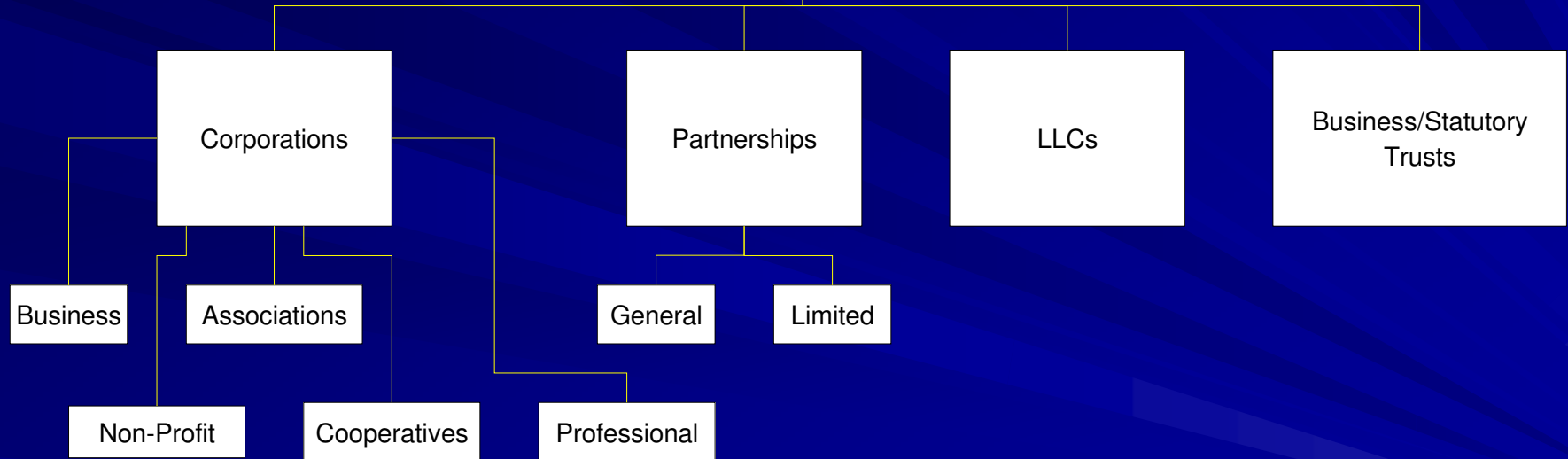
Future Projects

- Model Nonprofit Corporation Act
- Uniform Statutory Trust Act
- Uniform Cooperative Act
- Continuing efforts at rationalization
- Uniform Business Organization Code



Unified Business Entity Code

Common "Hub" Provisions
(e.g., Name, Registered Agent,
Requirements for documents to be filed
with the SOS, Foreign Qualification)



Implementation of KyRUPA & KyULPA

- The Kentucky Revised Uniform Partnership Act (2006); KRS ch. 362.1 (“KyRUPA”)
- The Kentucky Uniform Limited Partnership Act (2006); KRS ch. 362.2 (“KyULPA”)



Becoming a Partnership Subject to KyRUPA

- Formed on or after July 12, 2006; or
- Elects to be governed by KyRUPA; or
- Files a KyRUPA statement



Formed On or After July 12, 2006

- Old Partnership formed under KyUPA has 5 partners
- One partner dies on July 13, 2006; her estate is paid the value of her interest
- Four remaining partners continue the Partnership
- Resulting Partnership is formed after July 12, 2006 and is governed by KyRUPA



File a KyRUPA Statement

- Partnership, formed prior to July 12, 2006, owns Whiteacre
- In sale of Whiteacre, buyer's title insurance company requests Partnership to file a Statement of Partnership Authority confirming authority of Partner Bob to sign sales contract and deed
- Partnership is now governed by KyRUPA



Be Careful

(true life example)

- A, KyUPA LLP, files Statement of Merger of B, KyUPA Partnership, into A
- A, having filed a KyRUPA statement, is now governed by KyRUPA
- A has not filed a KyRUPA Statement of Qualification

Ergo, A is no longer an LLP



The Check-the-Box Regulations

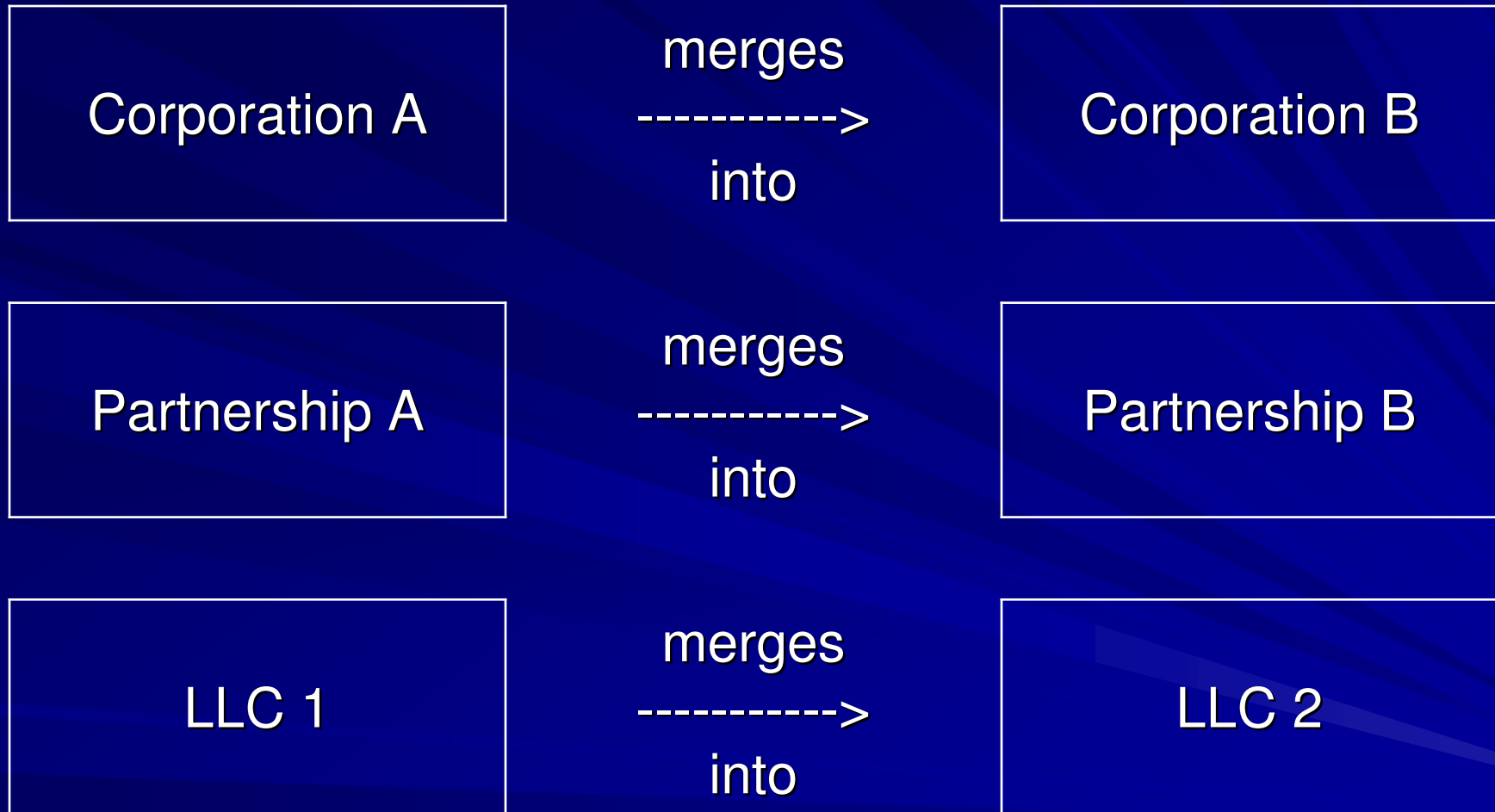
- Recently upheld by 6th (*Littriello*) and 2nd (*McNamee*) Circuits
- Single member of “disregarded entity” LLC is personally liable for employment taxes



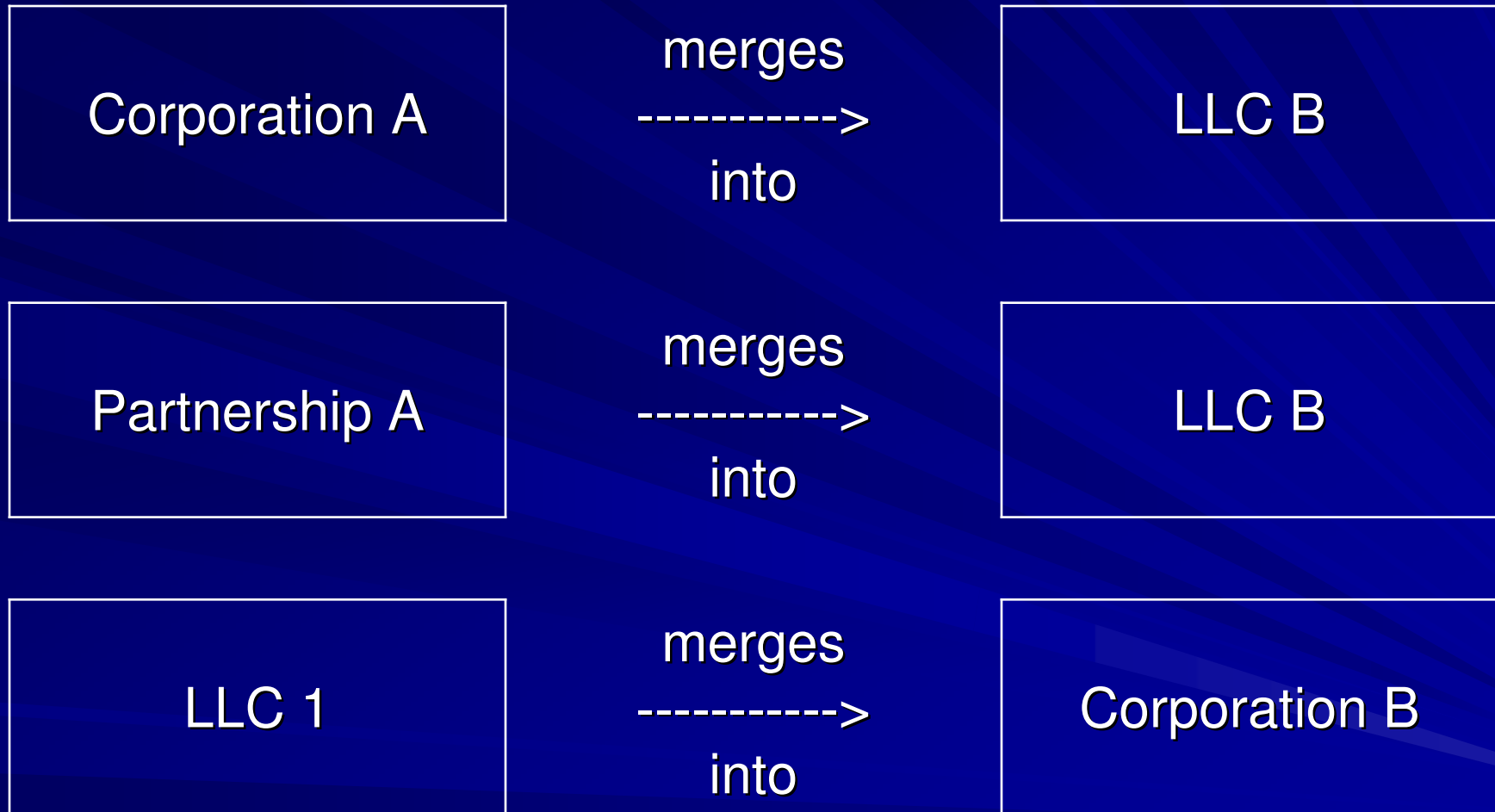
Mergers & Conversions



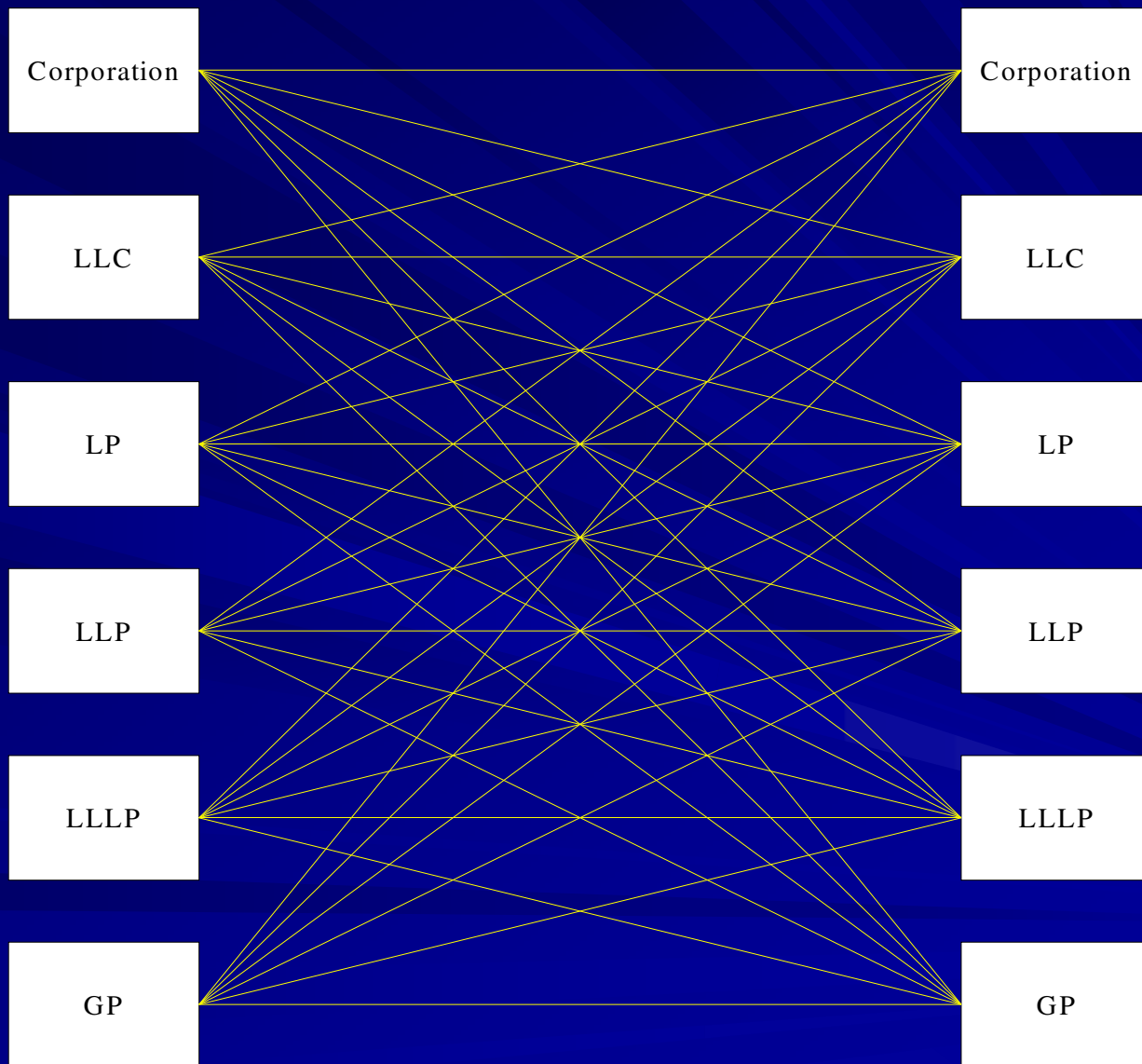
The intra-entity transaction



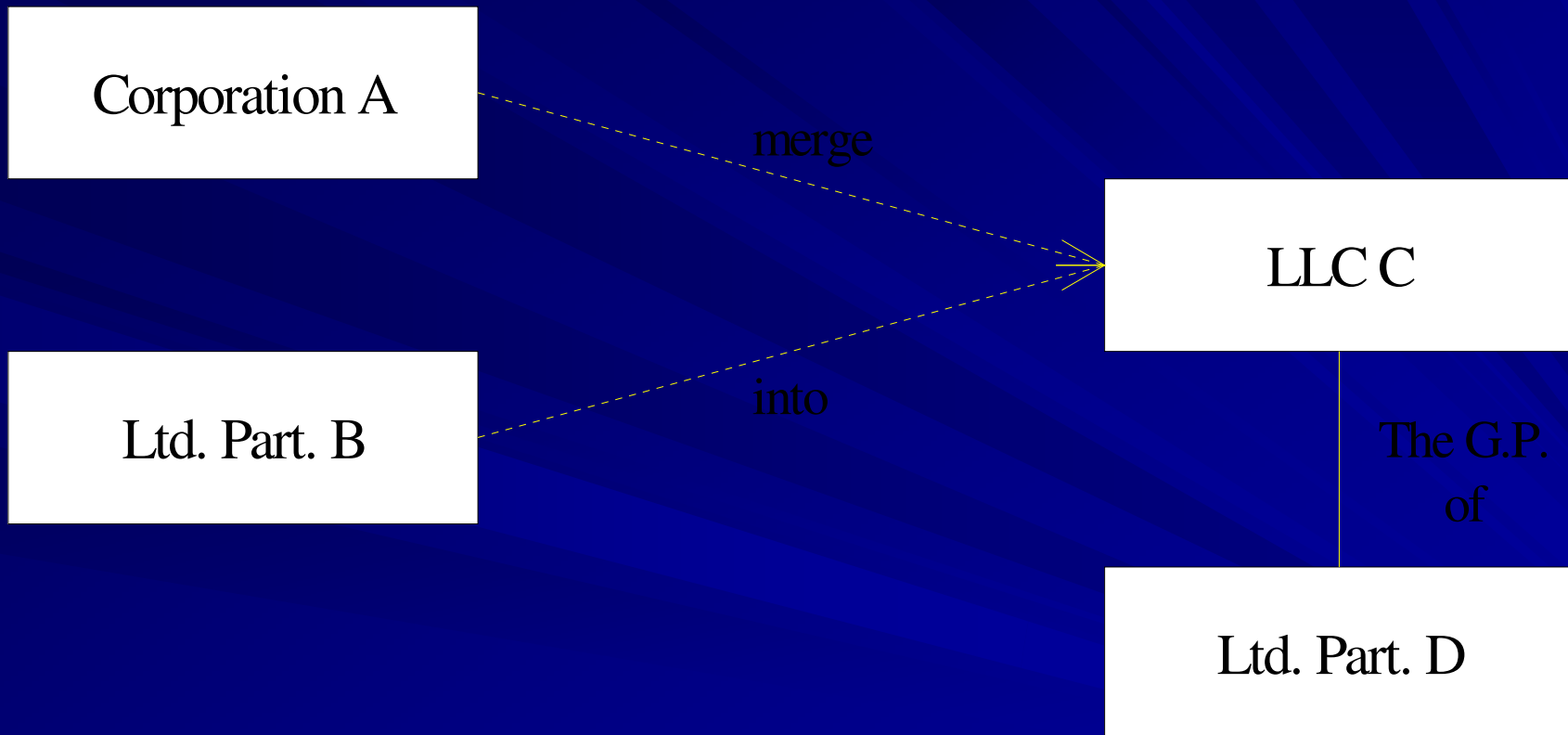
The inter-entity transaction



Possible Bi-Lateral Mergers



Non-Bilateral Merger



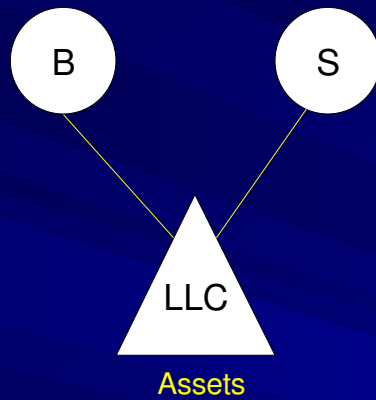
- The tax issues involved in organic transactions, even only intra-entity, are legion. Inter-entity transactions are an even higher level of complexity. A few points to keep in mind:
 - Be careful of not mixing state law and tax law concepts. For state law your LLC → LLC merger is a merger. But each LLC is taxed as a partnership. Ergo, Code § 368, which addresses tax free mergers between corporations, does not apply.
 - Do not assume that state (or local) tax law will conform to federal tax treatment.
 - Watch out for phantom income in transactions involving S-corps and entities taxed under Subchapter K.
 - Disregarded entities are disregarded for income tax, but not all, purposes. *E.g.*, REV. RUL. 2004-88, 2004-32 IRB 165.
 - Break down every step of the deemed transaction that is taking place and analyze it under the applicable Code provisions.



- Yes, the deemed transaction. Just because state law says you go from A to B does not mean the tax law means you go from A to B. Sometimes it diverts you to C, or G, or 1/X. For example, there are three models for the merger of two entities taxed as partnerships: assets over, assets up and interest over.



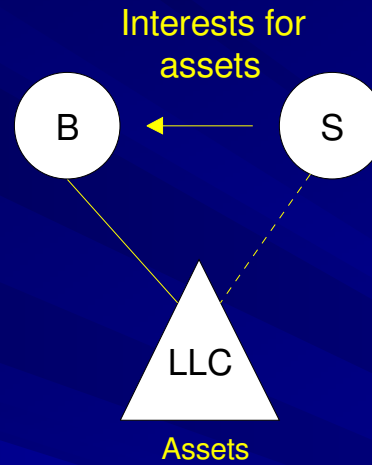
Rev. Rul. 99-6, Scenario One: B purchases S's interest in LLC



B and S are members of a two-member LLC.

B wishes to buy S's interest in the LLC.

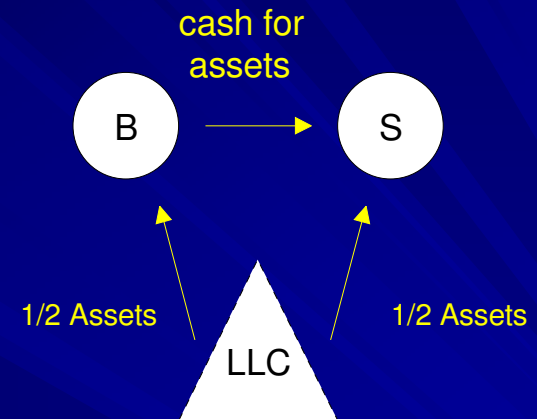
Treatment of S



B transfers cash for S's interest in the LLC.

S will treat the transaction as a sale of its interest.

Treatment of B

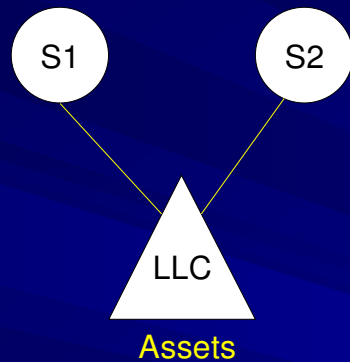


B will treat the transaction as if the LLC first liquidated, with both B and S receiving their proportionate share of assets.

B then treats the transaction as a purchase of S's share of the assets.



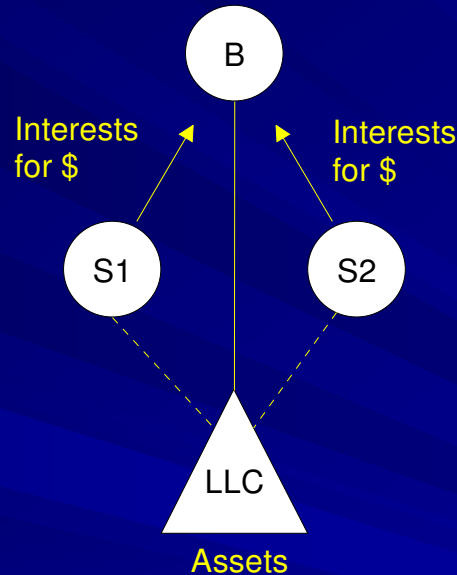
Rev. Rul. 99-6, Scenario Two: Current members of an LLC sell 100% of their interests



S1 and S2 are the current members of an LLC.

Both would like to sell their interests to a third-party purchaser.

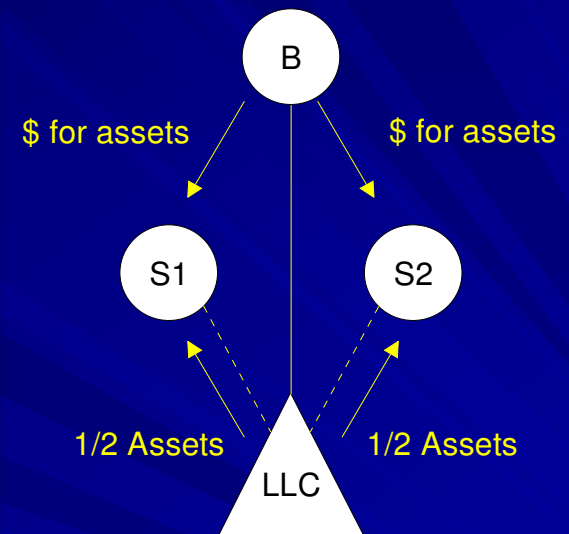
Treatment of S1 and S2



B purchases the interests for cash.

S1 and S2 are treated as selling their interests.

Treatment of B



B will treat the transaction as if the LLC had liquidated, and S1 and S2 received liquidating distributions of their proportionate shares of assets.

B then purchases assets from S1 and S2.



Office of Foreign Asset
Management (“OFAC”)
&
The Specially Designated
Nationals (“SDN”) List



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From the OFAC Website

OFAC publishes a list of individuals and companies owned or controlled by, or acting for or on behalf of, targeted countries. It also lists individuals, groups, and entities, such as terrorists and narcotics traffickers designated under programs that are not country-specific.

Collectively, such individuals and companies are called “Specially Designated Nationals” or “SDNs.”

Their assets are blocked and U.S. persons are generally prohibited from dealing with them.



- Possible expansion of S.B. 681
 - Senators Levin, Coleman & Obama
- April 26, 2006 Press Release from Senate Committee on Homeland Security



- Conflict checks
- Confirm your client is not doing business with them
- Representations and warranties

