

Recent Amendments to Kentucky Business Entity Laws

By Thomas E. Rutledge

The 2007 amendments to Kentucky's various business entity statutes serve primarily to reconcile and clarify the various acts. The effective date of most provisions of H.B. 334 was June 26, 2007.

The Contingency of the 2002 Amendments to the Business Corporation Act

In anticipation of the deletion of sections 190, 191, 192, 193, 194, 195, 198, 200, 202, 203, 205, 207, and 208 of the Kentucky Constitution, amendments to KRS §§ 271B.6-210, 271B.6-230, 271B.7-040, 271B.7-280, and 271B.8-080 were proposed to and approved by the 2002 General Assembly, each contingent upon the amendment of the Kentucky Constitution. Unfortunately, these provisions became trapped in something of a time warp. Senate Bill 121, containing the 2002 KyBCA amendments, stated that these provisions would be effective if that series of thirteen provisions of the Kentucky Constitution were deleted by the voters. However, it was not until later in the session that the two chambers reached agreement on the proposed amendments to the Kentucky Constitution. By that time, the proposal had been

modified, and the voters were not asked to delete sections 195 or 205 of the Kentucky Constitution, two sections that had been listed in section 22 of S.B. 121. In the end, the voters did approve the amendment of the Kentucky Constitution through the deletion of the eleven provisions. In response to this discrepancy, the Reviser of the Statutes determined there to exist a "contingency" with respect to whether these statutory provisions had been amended.¹

A new and non-codified section provides that the amendments to KRS §§ 271B.6-210, 271B.6-230, 271B.7-040, 271B.7-280, and 271B.8-080 as set forth in 2002 SB 121 were effective as of the amendment of the Kentucky Constitution by the voters in 2002.²

Names of Business Entities

The single largest group of amendments made in 2007 deal with business entity names. One significant problem has been inconsistent standards for name distinguishability. The various acts have been made consistent by adding to each act a defined term "name of record with the Secretary of State,"³ being a real,⁴ fictitious, reserved, registered or assumed name of an entity, and requiring that distinguishability be determined against each "name of record with the Secretary of State."⁵

Reserved names have been made renewable for additional periods of 120 days,⁶ and a registered name may be cancelled prior to its expiration.⁷

Statements in the KyBCA, the KyLLCA, the Nonprofit Corporation Act and elsewhere to the effect that the chapter in question does not govern "fictitious" names have been revised to properly refer to "assumed" names.⁸

The provision in the PSC Act permitting a PSC to use a name containing the name of a shareholder even if that name is not distinguishable has been eliminated.⁹ The limitation on the use of "cooperative" in a business entity name has been clarified.¹⁰ Similar additions have been made with respect to the use of "rural electric cooperative" in a business entity name.¹¹

The Kentucky Revised Uniform Partnership Act (2006) and the Kentucky Uniform Limited Partnership Act (2006)

The repeal of Kentucky's old partnership and limited partnership acts has itself been repealed,¹² and those old laws will mostly remain on the books. Those provisions of KyRULPA addressing the qualification of foreign limited partnerships to transact business¹³ have been repealed,¹⁴ and the provisions of the LLP amendments to KyUPA allowing foreign LLPs to qualify¹⁵ have been likewise repealed.¹⁶ From January 1, 2008, all foreign limited partnerships seeking to qualify to transact business in Kentucky must comply with the requirements of KyULPA,¹⁷ and foreign LLPs seeking to qualify to transact business must comply with the requirements of KyRUPA.¹⁸

The Business Trust Act

The Business Trust Act has been significantly expanded to address names,¹⁹ registered office and agent,²⁰ foreign qualification,²¹ annual reports,²² and the internal affairs doctrine.²³

Inspection Rights

Notwithstanding having received a certificate of authority, the law of the jurisdiction of incorporation governs the



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“internal affairs” of a foreign corporation.²⁴ Language has been added to several acts to make express that the right of inspection against a foreign business entity will be determined by reference to the laws of the jurisdiction of organization of that foreign business entity.²⁵ The LLC Act now expressly permits a written operating agreement to impose reasonable limitations upon a member’s use of the LLC’s records and information.²⁶

Preserving Limited Liability Subsequent to Dissolution

In *Forleo v. American Products of Kentucky, Inc.*,²⁷ the Kentucky Court of Appeals held that corporate shareholders may be personally liable for debts and obligations of a corporation incurred after administrative dissolution.

In the *Forleo* case, a corporation was administratively dissolved. However, notwithstanding that dissolution, the shareholders, who were also the officers and directors of the corporation, continued to carry on an active business. Certain suppliers were not paid, and those suppliers brought suit against the corporation and its shareholders seeking payment. The Court held that the shareholders were personally liable on the debt to the supplier. Thereafter, the administrative dissolution of the corporation was cured and the corporation was reinstated. On the basis that the cure related back to the original administrative dissolution, the shareholders sought to have set aside the judgment against them. The Court of Appeals, while acknowledging that the cure of the administrative dissolution did relate back to the original dissolution, still held that the actions undertaken during the period of administrative dissolution, because they were outside the scope of those necessary or appropriate for the winding up and termination of the corporation, were not protected by the limited liability shield. Rather, because the corporation had acted outside of its legal authorization, the shareholders would be liable upon those debts. This ruling is subject to a number of criticisms, and in consequence amendments have been made to the KyBCA as well as other acts of preclude this result in the future.²⁸

The Notice Effect of the Articles of Organization

As originally enacted, the KyLLCA did not address the notice effect of the Articles of Organization.²⁹ However, the notice effect of the member- or manager-manager election in the articles of organization is implied.³⁰ Under the amended act, the articles of organization are notice of the formation of the LLC, of the information set forth in response to the mandatory requirements of KRS § 275.025(1), including whether it is member- or manager-managed, whether it is a professional LLC, and whether it is a non-profit LLC.³¹ Other statements made in the articles do not, by filing, give notice. Still, one acting as an agent for an LLC must properly identify that principal in order to avoid personal liability on the obligations undertaken on its behalf.³²

Modification of Rules for Dissolution of LLCs, Succession in Single Member LLCs

The modification of KRS § 275.285(2) serves to (a) require that the departure from the default rule be in a written operating agreement and (b) provide a default rule of unanimous (as contrasted with majority-in-interest) approval of the members to voluntarily dissolve an LLC. Requiring unanimity among the members to voluntarily dissolve the LLC (unless they have elected a lower threshold in the operating agreement) has benefits when determining appropriate discounts for federal estate and gift taxation.³³

An LLC must have at least one member.³⁴ Under the amended act, upon the dissociation of the last member, the LLC will not be dissolved if:

- a succession mechanism set forth in a written operating agreement is satisfied; or
- the successor-in-interest of the last remaining member determines to continue the LLC.³⁵

Durational Limits of Corporation and LLCs

A corporation, upon reaching the maximum duration set forth in its articles of incorporation, is treated as having been administratively dissolved.³⁶ Under the amended KyBCA, the Secretary of State will notify the corporation of the adminis-

trative dissolution,³⁷ and the corporation is afforded a sixty-day window within which to amend its articles of incorporation to extend or delete the period of duration.³⁸ The extension or deletion of the period of duration will relate back and will cure the administrative dissolution. After the sixty day period the corporation may not amend its articles and must proceed to wind-up and dissolve.

The KyLLCA did not address any mechanism for cure of the consequences of an LLC having reached its date of dissolution.³⁹ Under the revised act, reaching the end of an LLC’s duration is treated as an administrative dissolution with notice and cure similar to that now in place for corporations.⁴⁰

Dissenters’ Rights in LLC

Dissenters rights do not exist at common law.⁴¹ Several states provide for corporate-style dissenters rights in their LLC Acts; Kentucky does not. Amendments to the KyLLCA expressly provide that absent a provision giving members dissenter’s rights, members have no such rights.⁴²

Pledges of LLC Interest

An addition to the KyLLCA serves to preempt KRS §§ 355.9-406 and 355.9-408, which may be interpreted to preempt limitations upon pledges of LLC membership interests contained in a written operating agreement.⁴³

Not-for-Profit LLCs

An entirely new series of provisions applies to non-profit LLCs, defined as those formed for a non-profit purpose,⁴⁴ with that definition coming from the non-profit corporation act. Although, in the course of its initial drafting, it was not contemplated that an LLC could be formed for a non-profit purpose, the KyLLCA does not contain an express requirement of a for-profit purpose.⁴⁵ In *Mercy Regional Emergency Medical System, LLC v. John Y. Brown, III* it was held that an LLC need not have a for-profit purpose.⁴⁶ Still, a non-profit LLC was not subject to the substantive limitations imposed upon non-profit corporations. With these additions, a non-profit LLC will be subject to a variety of limitations equivalent to those to which non-profit

corporations are subject. Under these provisions, a non-profit LLC may not:

- issue membership interests;
- issue dividends or distribute its income to its members or managers;
- make loans to its members or managers;
- merge other than with a non-profit LLC; or
- distribute its assets other than as provided by statute.⁴⁷

These amendments:

- acknowledge that LLCs may be organized for non-profit purposes, while requiring that such non-profit LLCs be subject to special requirements;
- add definitions of a “non-profit limited liability company” and “non-profit purpose” to the table of definitions used in the KyLLCA, which definitions have been adopted from the KyNPCA;
- require non-profit LLCs to set forth their non-profit purpose in the articles of organization and prevent subsequent deletion of that statement of purpose; and
- recite the limitations upon distributions by non-profit LLCs.⁴⁸

Conversions

A new series of provisions permit a business corporation to convert into a LLC. The approval of a conversion requires the consent of a majority of the board of directors and a majority of the shareholders and, if there is class voting, a majority of each class.⁴⁹ Dissenter rights will apply in the event of a conversion of a corporation into an LLC.⁵⁰ No provision permits an LLC to convert into a corporation, and this provision allowing the conversion into an LLC is limited to business, and does not include non-profit, corporations. The LLC resulting from the conversion is the same entity that existed before the conversion.⁵¹

The provision addressing the conversion of either a general or a limited partnership into an LLC have been simplified by providing for the automatic cancellation of LLP elections and certificates of limited partnership as part of the conversion.⁵² Certificates of assumed name of the predecessor entity need not be cancelled as they may now become assumed names of the successor LLC.⁵³ The

effect of a conversion has been made more specific,⁵⁴ and it is provided that upon the conversion a written operating agreement becomes binding upon each member in the new LLC.⁵⁵

KyULPA provides that a LLC may convert into a limited partnership.⁵⁶ The statute has been revised to delete a confusing reference to an effective date of conversion,⁵⁷ with that date now determined exclusively from the effective date of the certificate of limited partnership.⁵⁸ The LLC Act has been supplemented to require the unanimous approval of all members for a conversion.⁵⁹

Changing Orders

The changing order provisions under KyRUPA, KyULPA and the KyLLCA have been amended to provide parallelism between those acts.⁶⁰

Amendments to Annual Reports

Various of the annual report provisions have now been amended to expressly allow the amendment of the information set forth in the last filed annual report.⁶¹

Other Changes to the Business Corporation Act

Amendments to KRS § 271B.1-200 expressly allow the reference to facts extrinsic to the articles of incorporation, and this flexibility extends to various plans and articles of merger.⁶²

In most circumstances shares of stock owned by a corporate subsidiary are not voted; this provision has been expanded beyond corporate subsidiaries to any entity controlled by the corporation.⁶³ In the adoption, modification or deletion of a super quorum or voting requirement, it must be approved by the higher of the existing or the proposed requirements.⁶⁴

Adopting the principle set forth in MBCA § 7.47, already implicit in KRS § 271B.15-050(3), an addition has been made to the derivative action statute making clear that where a derivative action is brought on behalf of a foreign corporation, it is the law of the jurisdiction of incorporation that governs the suit.⁶⁵

It has been made express that the list of activities that do not constitute “transacting business” does not determine whether a foreign corporation is subject to service of process, taxation or other

regulation.⁶⁶ A new section directs that corporations notify the Secretary of State of changes of the principle office address by means of a distinct filing and not by means of amending either the articles of incorporation or the annual report.⁶⁷ KRS § 271B.8-570 has been revised to include LLC managers, to utilize the defined term “entity” and to render the language gender neutral.

Beginning January 1, 2008, a corporation, having been administratively dissolved, will be required to submit with its application for reinstatement a certificate from the Division of Unemployment Insurance “reciting that all employee contributions, interest, penalties, and service capacity upgrade fund assessments have been paid.”⁶⁸

Other Changes to the Limited Liability Company Act

A new subsection has been added to KRS § 275.100 to confirm that an LLC is a legal entity.⁶⁹ Language has been added to address in greater detail the time of formation of an LLC and the conclusiveness of the filing of the articles of organization.⁷⁰ A series of amendments to the LLC Act authorize an LLC to engage in a share exchange with a corporation pursuant to which the LLC acquires the shares of the corporation.⁷¹ A provision newly added to the KyLLCA directs that a sale of all or substantially all of the assets of the LLC may be done on the terms and conditions approved by a majority-in-interest of the members.⁷²

Departures from the default rule of KRS § 275.170, addressing the standard of culpability applicable to members and managers of an LLC, must be in a written operating agreement.

The provision addressing how managers vote has been amended to make clear that, except as provided in the articles of organization or in a written operating agreement, managers vote on a per-capita basis and decisions are made by a simple majority.⁷³ A new provision directs that membership interests under the control of the manager subject to the conflict of interest do not vote on the approval of the transaction.⁷⁴ At the same time the rather ambiguous language allowing the approval of a conflicted transaction by one-half of the number of “other persons participating

in the business or affairs of the [LLC]" has been deleted.

An interest in an LLC has previously been issued by an LLC upon the making of or the undertaking of an obligation to make a contribution to the LLC.⁷⁵ A pair of new provisions allow the issuance of a membership interest without requiring a contribution or an obligation to make a contribution⁷⁶ and as well permit a member who does not have a membership interest.⁷⁷

An important new subsection has been added to the provision setting forth limitations on distributions.⁷⁸ Prior to this provision, the limitations upon "distributions" were applicable to compensatory payments made by the LLC to its members.

Confirming the common law of agency, the act has been supplemented to note that one who acts on behalf of an LLC without actual authority to do so, even within their apparent agency authority,⁷⁹ shall be liable on all liabilities so created.⁸⁰

The LLC Act lists dentistry as a professional service that may be rendered through a professional LLC.⁸¹ KRS § 313.240 permitted dentists to practice through professional service corporations, but did not address professional LLCs. As amended, KRS § 313.240 expressly permits dentists to practice through professional LLCs, and as well for the first time expressly authorizes dentists to practice through partnerships.

Other Changes in the Professional Service Corporation Act

KRS § 274.087, addressing the merger of a professional service corporation, has been repealed.⁸² The merger of a PSC will be governed by the merger provisions of the KyBCA⁸³ and if a corporation surviving the merger is rendering a professional service it must comply with the PSC Act. With this amendment a PSC may also merge with an LLC and otherwise partake in organic transactions as can any business corporation.

The deletion from the listing of "qualified persons"⁸⁴ of a "registered limited liability partnership" does not mean that an LLP may not be a shareholder in a PSC. Rather the deletion was to eliminate a redundancy. As every LLP is a partnership,⁸⁵ there is no need to separately list that sub-category.

Other Changes

KRS § 14.105, which addresses the ability of the Secretary of State's office to accept electronic signatures, has been expanded as to the acts for which electronic signatures may be accepted.⁸⁶

Conclusion

The 2007 amendments to the business entity acts in no way complete the task of rationalizing all of Kentucky's various business entity laws. There continue to exist nonsensical distinctions that need to be addressed and there exist as well numerous distinctions and open questions regarding the application of non-business entity statutes to new forms of business entities. Still, with the 2007 amendments to the various business entity acts, Kentucky law is more rational and consistent than it was.

ENDNOTES

1. See also Cynthia W. Young, *Modernizing Kentucky's Corporate Laws*, 67 BENCH AND BAR 12 (May 2003).
2. 2007 Acts, ch. 137, § 179.
3. See KRS §§ 271B.1-400(16); 275.015(17); 362.401(9); 272.010(1); 273.161(14); 379.310(15); and 386.370(3). Accord KRS §§ 362.1-101(9); 362.2-102(15).
4. "Real name" is a new defined term and is determined by reference to the assumed name statute. See KRS §§ 271B.1-400(21); 272.010(1)(h); 273.161(15); 275.015(17); 362.401(14); 379.310(16); and 386.370(3).
5. See KRS §§ 271B.4-010(2); 271B.4-030(1); 271B.15-060(2); 362.403(3); 272.131(4); 272.390(5); 275.100(2); 275.410(2); 273.177(2); 273.179(1); 279.340(2); 293.364(2); 272.010; 273.161(14); and 386.382(1). Accord KRS §§ 362.1-114(1); 362.2-108(4).
6. See KRS §§ 271B.4-020(1); 275.105(1); 362.404(2); 362.1-115(1); 362.2-109(1); and 273.178(1).
7. See KRS §§ 271B.4-020(3); 275.105(3); 273.178(3); and 362.405(3).
8. See KRS §§ 271B.4-010(5); 273.177(5); 275.100(5); 279.030(5);

and 279.340(6). Accord KRS §§ 272.131(7); 272.390(8); 362.1-114(4); and 362.2-108(6).

9. See KRS § 274.077(3) (before deletion by 2007 Acts, ch. 137, § 91).
10. KRS § 272.050. See also KRS § 272.010(1)(g) (new defined term for "entity").
11. KRS § 279.060.
12. See 2007 Acts, ch. 137, § 180. See also KRS § 446.010(2).
13. KRS §§ 362.495 through 362.509.
14. See 2007 Acts, ch. 137, § 181.
15. See KRS § 362.585; 362.595(4).
16. See 2007 Acts, ch. 137, § 181 (repealing KRS §§ 362.585 and 362.595(4)).
17. See KRS §§ 362.2-901 through 362.2-910.
18. See KRS §§ 362.1-1101 through 362.1-1105.
19. KRS §§ 386.382; 386.4432.
20. KRS §§ 386.384; 386.386; 386.288; 386.4434; and 386.4436.
21. KRS §§ 386.4422; 386.4426; 386.4428; 386.4430; 386.4442; 386.4444; 386.4446; and 386.4448.
22. KRS § 386.392.
23. KRS § 386.4420.
24. KRS § 271B.15-050(3). See also KRS §§ 275.405(3); 362.495; 362.2-901; and 386.4420(1)(a).
25. KRS §§ 271B.15-050(3); 275.380(1)(a); 362.495; and 362.2-901(1).
26. KRS § 275.185(5). See also KRS §§ 362.2-110(2)(d); 362.2-304(7); and 271B.16-040(4).
27. 2006 WL 2788429 (Ky. App. Sept. 29, 2006).
28. See KRS §§ 271B.14-050(2)(i); 275.300(3)(i); 362.1-802(3); and 362.2-803(5).
29. Contrast KRS § 271B.18-050. See also KRS §§ 362.429; 362.2-103.
30. See KRS § 275.135.
31. KRS § 275.025(7).
32. See, e.g., RESTATEMENT (THIRD) OF AGENCY § 6.03.
33. The KyLLCA originally provided a default rule of unanimous approval for the voluntary dissolution of an LLC. See 1994 Acts, ch. 389, § 57, codified at 275.285(2). In 1998 this default rule was reduced to majority-in-interest. See 1998 Acts, ch. 341, § 38.
34. KRS § 275.015(8).

35. KRS § 275.285.
36. KRS § 271B.14-200(4).
37. KRS § 271B.14-210.
38. KRS § 271B.14-220(5).
39. KRS § 275.285 recites that upon reaching that date the LLC “shall be dissolved and its affairs wound up.”
40. KRS § 275.295(1)(d).
41. *See, e.g.*, 12B WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5906.10 (2000 Perm. Ed.) (“The appraisal remedy is entirely the product of statute.”).
42. *See* KRS §§ 275.030(6); 275.175(4); 275.345(3); 275.350(4); and 275.247(2). A new defined term “dissent” has been added at KRS § 275.015(6).
43. KRS § 275.255(4).
44. *See* KRS §§ 275.015(18), (19).
45. *See* KRS § 275.005. *Contrast* KRS § 362.1-201(1).
46. Civ. Action No. 98-CI-01357, Franklin Circuit Ct. (Feb. 16, 1999).
47. *See* KRS §§ 275.520; 275.525; and 275.530. *Accord* KRS §§ 273.237; 273.241; and 273.277.
48. KRS §§ 275.015(18); 275.015(19); 275.530; and 275.525.
49. KRS § 275.376. *See also* KRS §§ 271B.11-030; 271B.12-030. This provision was patterned on KRS § 271B.11-030.
50. KRS § 271B.13-020(1)(d).
51. KRS § 275.377. *Accord* KRS §§ 275.375(1); 362.1-904(1); and 362.2-1105(1).
52. KRS § 275.370.
53. KRS § 365.015(8).
54. KRS § 365.375(2)(a)-(c).
55. KRS § 365.375(2)(d).
56. KRS §§ 362.2-1102 through 362.2-1105.
57. KRS § 362.2-1104(1)(c), deleted by 2007 Acts, ch. 137, § 161. KRS § 362.2-1104 has been supplemented to make more clear that it applies only to an LLC into an LP conversion.
58. KRS § 362.2-1104(2). *See also* KRS § 362.2-120.
59. KRS § 275.372(2). *See also* KRS § 362.2-1102(4).
60. KRS §§ 275.260; 362.1-504; and 362.2-703. The charging order provisions of KyUPA (KRS § 362.285) and KyRULPA (KRS § 362.481) have not been revised.
61. *See* KRS §§ 271B.16-220(5); 275.190(5); 362.1-121(5); 362.2-210(5); 273.3671(5); and 386.392(5).
62. KRS §§ 271B.1-200; 271B.6-010(4). Similar revisions have not been made in the LLC and limited partnership acts in that there has been no call for similar additions to the various model and uniform acts and because in that contractual realm there likely already exists the flexibility to so reference extrinsic facts.
63. KRS § 271B.7-210(2).
64. KRS § 271B.7-270(2).
65. KRS § 271B.7-400(6).
66. KRS § 271B.15-010(3). *Accord* KRS §§ 275.385(3); 362.2-903(2) (as amended by 2007 Acts, ch. 137, § 159); and 386.4442.
67. KRS § 271B.5-025. There is a \$10.00 fee for this filing. *See* KRS § 271B.1-220(1)(i). A similar change has been made with respect to non-profit corporations. KRS § 273.1842. *See also* KRS § 273.2521(e). *Accord* KRS § 275.040; 362.2-115. *See also* KRS § 271B.1-210(1)(g).
68. KRS § 271B.14-220(1)(e). No similar revision was made in the other business entity acts. *Contrast* KRS §§ 275.295(3)(a); 362.1-122(5); and 362.2-810(1).
69. KRS § 275.100(2). *Accord* KRS §§ 362.1-201(a); 362.2-104(1).
70. KRS § 275.020(2), (3). *Accord* KRS § 271B.2-030(2). While counsel, in issuing opinions on the formation of LLCs, will find comfort in these new provisions, attention needs to be paid to other aspects of the KyLLCA such as the definition of an LLC (KRS § 275.015(8)) and its requirement that an LLC have at least one member.
71. *See* KRS §§ 275.500; 275.505; 275.510; and 275.515.
72. KRS § 275.247(1). *Accord* KRS § 275.350(1)(requiring majority-interest approval for a merger).
73. KRS § 275.175(1).
74. KRS § 275.170(2). *Accord* KRS § 271B.8-310(4).
75. KRS § 275.195, now recodified at KRS § 275.195(1).
76. KRS § 275.195(2).
77. KRS § 275.195(3).
78. KRS § 275.225(7). *Accord* KRS § 362.2-508(8).
79. *See* KRS § 275.135.
80. KRS § 275.095. *See also* RESTATEMENT (THIRD) OF AGENCY § 6.10.
81. KRS § 275.015(20).
82. *See* 2007 Acts, ch. 137, § 181.
83. *See* KRS § 274.015(2).
84. KRS § 274.005(4).
85. *See* KRS §§ 362.555(1); 362.1-201(2).
86. KRS § 14.105(1).