

Concurrent Session

Consumer: Representing Small Business Clients

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Representing the Small Business Debtor: Problems, Issues, Solutions

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I. Document/Issue Checklist for the Small Business Client Interview

Representing small business clients can be rewarding, but it is also a challenge. Many small business owners are not sophisticated and their document and file organization and retention may be rudimentary at best. They may not have a clear understanding of what type of entity (if any) they operate under; they may have commingled personal and entity assets; may have violated loan covenants; or may be using corporate funds to pay personal debts and vice versa. Separating the personal issues from the business issues can be time consuming, but understanding these issues is key to being able to advise the client(s) appropriately. The following categories of documents will assist you in this task.

1. **Organizational Documents:** Articles of incorporation, by-laws, membership or partnership agreement, shareholder agreements, stock certificates, corporate minute book, list of equity holders, etc. These documents help determine:

- ▶ What is the corporate structure (or is there one at all)?
- ▶ Was the entity formed properly to begin with (or is it *ultra vires*)?
- ▶ How/when was the entity created (purchased from someone else – is there a carry back note, covenants not to compete, restrictions on sale, rights of first refusal upon sale, etc.)?
- ▶ Is the entity still in good standing (may create personal liability; entity may not be eligible to file bankruptcy)?
- ▶ Were corporate formalities followed (can corporate creditors pierce the corporate veil)?
- ▶ Who are the equity holders (check for conflicts of interests)?
- ▶ How is the equity interest owned (tenancy by entirety? JTWROS?, by a trust? etc.)
- ▶ Who is authorized to act on behalf of the entity (helping you determine who you represent and what he/she/they are actually authorized to do)?
- ▶ What corporate formalities (shareholder vote, director vote, percentages of vote, etc.) are necessary to liquidate, sell assets, file bankruptcy and/or wind up the corporate affairs?
- ▶ Who can authorize the filing of a bankruptcy for the entity (is it your client or are other consents/votes necessary)?
- ▶ What state law governs (laws for what steps are necessary to liquidate or sell assets as well as fiduciary duties of officer/directors/shareholders and the liquidating trustee vary by state)?
- ▶ Are there buy out, put, rights of first refusal or similar provisions (that might be enforceable against a Chapter 7 Trustee or the equity interests)?

TIP: Be sure to ask WHO created the entity – self created, lawyer or accountant? – these other parties may have retained original documents.

2. **Loan Documents:** notes, security agreements, mortgages or deeds of trust, subordination agreements, factoring agreements, personal guaranties, financial statements, UCC-1s, etc. These documents determine:

- ▶ Who is borrower?
- ▶ Who is/are the secured lenders? (conflict of interest?)
- ▶ What assets of the business are subject to a lien or security interest?
- ▶ Are there assets that are unencumbered (may be able to be sold)?
- ▶ Are any of the assets double-pledged (potential bank fraud issues)?
- ▶ What are the interest rates/payments terms?
- ▶ When do the loans mature (how much time do we have)?
- ▶ What are the events of default?
- ▶ What is the notice/cure provision (how much time does the client have before

foreclosure begins)?

- ▶ Are the debts cross-collateralized or cross-defaulted?
- ▶ Who has personally guaranteed the debt?
- ▶ Is the personal liability capped or limited?
- ▶ Did the client pledge personal assets such as a home or life insurance policy (in addition to the business assets) to guarantee the loan?
- ▶ Is there an SBA guarantee (need to schedule in the event of bankruptcy)?
- ▶ Has the client violated any non-monetary covenants (particularly in the case of the SBA or federally insured depository banks, for which there may be criminal ramifications)?
- ▶ Are any of the personal or corporate financial statements inaccurate (potential criminal liability and nondischargeability)?
- ▶ Is the business “out of trust” – having sold assets without paying the lender (potential criminal liability and nondischargeability)?

TIP: Ask the client to bring the ENTIRE loan closing file. If they say they can’t find it, have them call the lender and say they are meeting with their financial advisor (YOU) and need a copy faxed or emailed.

3. **Real Estate Leases:** All leases and subleases of the business premises. These documents determine:

- ▶ Who is the lessee?
- ▶ Did the client execute the lease in a noncorporate capacity (such as to create an argument there is personal liability even in no personal guaranty)?
- ▶ Who is the landlord? (is there a conflict of interest, make sure is given notice)?
- ▶ Are there landlord liens?
- ▶ Is there a personal guarantee?
- ▶ Is there a security deposit and how much (may be an asset)?
- ▶ Is the lease assignable or may there be a sublease (potential to sublet unused space to create cash flow)?
- ▶ How many years’ liability on the remaining lease terms?
- ▶ Is there an option to purchase (if favorable, may be a valuable asset)
- ▶ What trade fixtures or improvements belong to the landlord (as opposed to the secured lender)?
- ▶ Is there a subordination to the interests of the secured lender (this will help avoid fights on who gets the trade fixtures and leasehold improvements)?
- ▶ What are the default provisions (how quickly can the landlord evict)?
- ▶ Is the lease below market (may be a valuable asset that can be assumed or assigned – a potential reason to file bankruptcy to preserve)?
- ▶ Has the lease already been terminated?

4. **Personal Property Leases/Executory Contracts:** leased vehicles, leased equipment, software or IP licenses, franchise agreements, distributorship agreements, credit card processing machines, copier leases, collective bargaining or union contracts, etc. These

documents determine:

- ▶ Who is the lessee (the debtor in a personal capacity or an entity)?
- ▶ Who are the lessors (check for conflicts, make sure all are given notice)?
- ▶ Is the debtor a lessor (may not be able to reject the lease)?
- ▶ Is the lease or contract assignable?
- ▶ Is there an option to purchase?
- ▶ What are the leased items (to ensure they are properly returned)?
- ▶ Is the lease a true lease or disguised financing (such that it may be restructured in bankruptcy or may be subject to a secured lender's lien)?
- ▶ Is there a personal guarantee?
- ▶ Are there any covenants/restrictions (in the event of a franchise shut down, are there obligations to cease using proprietary items, covenants not to compete, etc.)?
- ▶ Are there union obligations?

5. **Two Years' Business & Personal Tax Returns (at least), Accounting Information:**

Tax returns, K-1s, etc. These help determine:

- ▶ Does the company have an accountant (accountant will be necessary to file all appropriate final returns in the event of a liquidation or shut down)?
- ▶ Is the accountant familiar with the business (a good accountant can help negotiate with taxing authorities, lenders, creditors and develop cash flow projections and other reports to help analyze the viability of the business)?
- ▶ Has the accountant been paid (need to plan to find money to pay the accountant as part of the shut down)?
- ▶ Has the business filed all required returns (Forms 1040, 940, 941, etc.) (if returns are past due, may affect timing of filing bankruptcy)?
- ▶ Are there tax refunds that haven't been received yet (are an asset; may be subject to a lender's lien after shutdown and therefore may have to be turned over – affects timing)?
- ▶ Are the returns filed consistently with the organization documents (i.e., is a partnership correctly filing partnership returns)?
- ▶ How is the business taxed (a pass-through entity, such as a limited liability company or subchapter S corporation, such that losses show up on the individual owner's tax return – may create a big tax refund for a chapter 7 trustee! – a C corporation – forgiveness of debt captured in the corporation)?
- ▶ Will there be other tax advantages or disadvantages if assets are liquidated or foreclosed (recapture, capital gain or loss)?
- ▶ What assets does the corporation own (if depreciated or deducted, then the individual debtor likely can't argue the assets are owned individually without the risk of tax/bank/bankruptcy fraud)?
- ▶ Are there criminal tax evasion issues that a bankruptcy might elevate to the IRS' attention (true employees treated like subcontractors, failure to treat business payment of personal expenses as income on personal returns, failure to disclose business income, under-reporting of business income)?

6. **Company Financials:** Accounts Payable, Accounts Receivables, Profit & Loss, Financial Statements, Cash Flow Projections, Balance Sheets, Inventory Reports, Borrowing Base Reports:

- ▶ Who are the vendors/suppliers/customers (check for conflicts, make sure all are given notice)?
- ▶ Does the principal owe the company money (an asset that could be attachable by creditors or property of a bankruptcy estate or may be subject to a lender's lien)?
- ▶ Does the company owe the principal money (maybe able to recharacterize payroll as loan repayment to reduce payroll tax liability, maybe able to transfer out unencumbered assets as loan repayment)?
- ▶ What assets are shown on the balance sheet (to compare to inventory lists or lists given to a secured lender)?
- ▶ Are the Borrowing Base Reports correct (false written financial statements could subject the principal to a complaint to determine dischargeability under § 523(a)(2))?
- ▶ Is the business problem a simple failure to collect A/R (would aggressive collection save the business)?
- ▶ Do the financials seem out of whack (possible employee embezzlement)?
- ▶ Is it clear based on cash flow that the company business model just doesn't work or is there some other business problem that could be fixed?
- ▶ Or is there a failure to keep adequate financial records (might be able to fixed with a referral to a good accountant)?
- ▶ Is the company financing itself off the government tit by not paying its payroll or other taxes (companies going deeper in the hole every month on such taxes generally should be shut down as soon as possible)?

7. **Credit Card Information:** Personal and business credit cards, card member agreements, applications, credit report (www.annualcreditreport.com):

- ▶ Is the credit card truly a corporate card or is it in the individual's name (you could shut the business down and not have to worry about putting the individual in bankruptcy)?
- ▶ If the debt is all personal and not technically owed by the entity, could the entity survive if the owner restructures the credit card debt in a Chapter 13?
- ▶ If the credit card debt is both personal and corporate, meaning with a Chapter 13 the business will not be protected from creditor collection efforts, then is the business still viable?
- ▶ Has the business been paying the owner's personal credit cards that were used for personal purposes (should be reported as income on the individual's tax returns and a fraudulent conveyance if the company files bankruptcy)?

8. **Insurance Policies/Bonds:** Directors & Officers ("D&O" - also called "errors & omissions"), "key man" life insurance on owners, auto insurance, premises liability,

casualty policies, workers compensation policies, employee loss/dishonesty, etc.

- ▶ Is there cash value in life insurance policy (may be used as an asset to negotiate with creditors)?
- ▶ Is there a sales tax or other bond posted with the State (may be an asset)?
- ▶ Is the business operating without essential insurance such as liability/casualty/work comp and in possible violation of state law (insurance should be obtained immediately for any business that wants to keep operating)?
- ▶ Is there employee loss/dishonesty policy (may be able to make a claim and save the business)?
- ▶ If the business files bankruptcy, will the officer and directors be carried by the D&O in the event a trustee sues them?

9. **Retirement Plans:** Company 401(k), defined benefit or contribution pension plans, etc.

- ▶ Is there a company retirement plan of some sort (there are various ERISA responsibilities for terminating company plans in the event of a business shutdown)
- ▶ Is there a third party administrator (“TPA”) (the TPA will need to be paid in order to get its assistance in shutting down the plan)?
- ▶ Was the plan self-directed (watch for inappropriate transactions between the principal and the plan – there are tax, Department of Labor civil penalties and possible criminal consequences to such transactions, in addition to the fact it may invalidate the exempt status of the plan under applicable state law)?

10. **Taxing Authority Information:** Tax warrants, tax levies, correspondence with any tax authority:

- ▶ Are there past due tax liabilities?
- ▶ Is there personal liability for corporate taxes?
- ▶ Are there tax liens filed or threatened?
- ▶ When were the tax liens filed (after 45 days, the IRS comes ahead of lenders with respect to A/R)?
- ▶ What taxing authorities will need to be notified in the event of shut down by the filing of final returns (to make sure the taxing authorities don’t continue to assess liability)?

TIP: There are many taxes besides income and property taxes. Don’t overlook municipal and county taxes, plus state and federal custom and duties tax, excise tax, fuel taxes, etc.

11. **Lawsuits, Threatened Litigation, Administrative Proceedings, Environmental Issues, Settlements:** All lawsuit petitions, complaints, counterclaims, demand letters, work compensation proceeding, class actions, labor proceedings, EEOC proceedings, environmental proceedings, other regulatory proceedings, reservation of rights letters

from insurers:

- ▶ Is the business a plaintiff or defendant in any litigation?
- ▶ If a defendant, are there counterclaims (that might constitute an asset)?
- ▶ What litigation is threatened (is there a potential of a class action – all parties need notice)?
- ▶ Is insurance paying to defend?
- ▶ Will insurance cover any judgments for damages?
- ▶ Is it the type of proceeding that a bankruptcy filing will stay (or it is regulatory or criminal)?
- ▶ Do the company’s lawyers have company documents in their possession?
- ▶ What governmental regulatory agencies would have to be notified in the event of a closing or bankruptcy?
- ▶ Have there been lawsuit settlements in the previous two years (need to be disclosed on the SOFA and may be a reason to file a bankruptcy to recover as a preference the settlement money so it can go to pay tax liability, for example)?

12. **Employees:** list of employees, former employees terminated within the previous two years, salary and benefit information, employee contracts:

- ▶ How many employees are there (remember WARN Act and other notice requirements for shut down of business)?
- ▶ Who are the employees (check for conflicts)?
- ▶ Are there potential employee discrimination or other related claims that could be brought (need to list in a bankruptcy)?
- ▶ Are there past due wages (owner has potential personal liability)?
- ▶ What is the salary and benefit structure (is keeping the employees feasible as part of a reorganization or restructure)?
- ▶ Are there notice provisions in employee contracts?
- ▶ Are there family members employed (consider impact of shutting down the business and the fact the whole family will become unemployed overnight)?

13. **Insider Transactions/Officer/Owner Loans/Compensation & Dividends/Stock Redemptions:** 12 months’ history of all amounts paid to owners in any form:

- ▶ Is the owner paying him/herself a salary (it is not a very good business if you aren’t getting paid)?
- ▶ If a salary is being paid, is it over market (may not be approved by the court in a Chapter 11; a Chapter 7 trustee may sue to recover as a fraudulent conveyance – two year look back)?
- ▶ Is there an individual actually “looting” the company by paying a huge salary (who is your client)?
- ▶ Are there loan repayments to owners/officers/directors (potential one year look back for insider preferences)?
- ▶ Were dividends paid while the entity was insolvent (in violation of applicable

state corporate law and can be recovered)?

TIP: These transactions must be disclosed in the SOFA.

14. **Utilities:** List of all utilities and semi-utilities such as mobile phone service, cable; monthly obligations to utilities, threats of shut off, etc:
- ▶ How much does it cost on a monthly basis to pay utilities (if insufficient cash flow, another indicator the business may not be able to be saved)?
 - ▶ Are there utility security deposits (a potential asset)?
 - ▶ Are the utilities past due (is shut down imminent – need to find money to pay)?
 - ▶ Would a shut down of the utilities pose a threat of harm to the public health and safety of the employees or others (such as an apartment complex that provides water to the tenants)?
15. **Other Transfers:** Bills of sale, asset purchase agreements, other documents of sale from transactions in the past two (or four) years:
- ▶ Have assets been sold?
 - ▶ Were any of the assets sold subject to a lien?
 - ▶ Were corporate formalities followed?
 - ▶ Were the sales for fair market value?
 - ▶ What was the disposition of the proceeds?
16. **Bank Accounts:** One year's business and personal bank account statements:
- ▶ Where are the business and personal checking accounts (at a secured lender's institution – possible immediate right of set off)?
 - ▶ Are the business and personal accounts commingled (possible tax problems, bank fraud, piercing of corporate veil)?

II. General Considerations for Determining When an Individual is Liable for Corporate Debt

1. **By Contract:** *written* personal guaranty, assumption of debt, etc.
- ▶ *Statute of Frauds, K.S.A 33-106* (“No action shall be brought whereby to charge a party upon any special promise to answer for the debt, default or miscarriage of another person ... unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing and signed by the party to be charged therewith, or some other person thereunto by him or her lawfully authorized in writing”)
 - ▶ *General Statute of Frauds R.S. Mo. § 432.010* (“ No action shall be brought ...upon any special promise to answer for any debt or damages out of his own estate, or to charge any person upon any special promise to answer for the debt, default or miscarriage of another

person ... unless the agreement upon which the action shall be brought, or some memorandum or note thereof, shall be in writing and signed by the party to be charged therewith, or some other person by him thereto lawfully authorized ...)

► ***Credit Agreement Statute of Frauds, R.S.Mo. § 432.045***

1. For the purposes of this section, the term "credit agreement" means an agreement to lend or forbear repayment of money, to otherwise extend credit, or to make any other financial accommodation.

2. A debtor may not maintain an action upon or a defense to a credit agreement unless the credit agreement is in writing, provides for the payment of interest or for other consideration, and sets forth the relevant terms and conditions, except this subsection shall not preempt other specific statutes that authorize additional protection for consumer credit used in personal, family or household purposes and the limitations on credit agreements in subsection 3 of this section.

3. (1) If a written credit agreement has been signed by a debtor, subsection 2 of this section shall not apply to any credit agreement between such debtor and creditor unless such written credit agreement contains the following language in boldface ten point type: "Oral agreements or commitments to loan money, extend credit or to forbear from enforcing repayment of a debt including promises to extend or renew such debt are not enforceable. To protect you (borrower(s)) and us (creditor) from misunderstanding or disappointment, any agreements we reach covering such matters are contained in this writing, which is the complete and exclusive statement of the agreement between us, except as we may later agree in writing to modify it."

(2) The provisions of this section shall not apply to credit agreements for personal, family, or household purposes when there is already a written contract governing the transaction, and the debtor and creditor orally agree to defer one or more loan payments or make other credit agreement modifications and such deferrals or modifications are limited in duration to not more than ninety days.

4. Nothing contained in this section shall affect the enforceability by a creditor of any promissory note, guaranty, security agreement, deed of trust, mortgage, or other instrument, agreement, or document evidencing or creating an obligation for the payment of money or other financial accommodation, lien, or security interest.

► *But see Baron v. Lerman, 719 S.W.2d 72 (Mo.App. 1986)* A promise need not be reduced to writing under the provisions of this section dealing with promises to answer for the obligation of another person, if main purpose of such promise is to serve the interests of the promisor rather than such other person)

2. **By Statute:** trust fund taxes, PACA, WARN Act, wage statutes, etc. (see below)
3. **By Form Of Entity:** partnership or general partner in limited partnership
4. **By Other Operation of Law:** successor liability doctrines, piercing of corporate veil or alter ego, tortious participation in wrongful corporate act, fraud

► *Stratton v. Garvey International, Inc., 9 Kan. App. 2d 254 (Kan. Ct. App. 1984)*

(generally, where one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor, except: (1) where the purchaser expressly or impliedly agrees to assume such debts; (2) where the transaction amounts to a consolidation or merger of the corporation; (3) where the purchasing corporation is merely a continuation of the selling corporation; or (4) where the transaction is entered into fraudulently in order to escape liability for such debts.)

5. **By Default Judgment or Court Order**

III. Possible Solutions for the Small Business Debtor

1. Do Nothing (explain judgments, foreclosures, bank set off rights, etc.)?
2. Work Out (negotiate with creditors)?
3. Investors or venture capital?
4. Sale of all or part of business (stock or assets)?
5. Friendly foreclosure with lender?
6. Agreed to Receivership?
7. Chapter 11?
8. Collapse of entity, transfer of assets to individuals, and restructure in Chapter 13?
9. Corporate Chapter 7?
10. Business Shut down without formal dissolution (typically but not always followed by personal Chapter 7 – see steps below)
11. Corporate Dissolutions (filing articles of dissolution in accordance with applicable corporate law)

IV. Cynthia's "Mom & Pop Shutdown Kit" For the Small Business

1. Review all pertinent documents, including whether entity is in good standing
2. Determine whether the business should be reorganized or shutdown
3. Make sure the shareholder/owner/member is not in a divorce proceeding (business is a marital asset - consult the divorce lawyer first)
4. If the determination is made to shut down, consider all applicable shut down methods (sale of all or substantially all assets, simple cease of operations, settlement with creditors, corporate dissolution, corporate bankruptcy, voluntary receivership) and determine which path to take
5. Confirm the decision in writing
6. Refer client to accountant for determination of tax consequences of sale, shutdown, transfer of assets, foreclosure of assets

TIP: Also consider whether the shut down will create a substantial loss; in a pass through entity such as an LLC or subchapter S corporation, the loss may generate a substantial personal tax refund; this may impact the timing of the bankruptcy filing for the individual owner

7. Have accountant prepare any past due returns

8. Determine the value of remaining business assets
9. Determine which of those assets are subject to any lien (secured lender, taxing authority, landlord, judgment lien)
10. Determine the extent and amount of the business debts
11. Determine which debts the owner may be personally responsible for
12. Determine if unencumbered assets should be sold for fair market value to pay personally responsible debt
13. Determine if certain assets should be transferred out to the owner through loan repayment or fair market value

TIP: You must follow state law requirements regarding how assets are transferred, i.e., bill of sale, transfer of title, etc. See *In re Roedemeier*, 2006 Bankr. LEXIS 1132 (Bankr. D. Kan., Aug. 16, 2007) (Somers, J.) (where a bankruptcy debtor was the sole shareholder of a corporation which forfeited its articles of incorporation, under K.S.A. 17-6807 the forfeiture did not dissolve the corporation, and thus the corporation's dental equipment did not revert to the debtor and the debtor was precluded from claiming an exemption in the equipment).

14. Discuss risk of creditors filing an involuntary petition
15. Determine what corporate formalities (who may authorize, etc.) are necessary to shut down
16. Determine a shut down date

TIP: It is normally better to shut down at the end of a week, month, quarter, year, etc. - since it will have to be reported for tax and other purposes and is easier to remember, account, file final returns and reports, etc., at the end of a reporting period

17. Remove personal property items that the owners brought to the business premises that are not assets of the business and/or subject to any lien
18. Make back up copies of records/information that the individual owners may need to protect themselves (all employee files, tax information, etc. – remember that taxing entities and work comp insurers can audit for up to 5 years)
19. Open another business account if the business account is with the secured lender (to make sure there is no acceleration and setoff)
20. Determine law firm retainer to be paid out of business assets
21. Determine accountant retainer to be paid out of business assets
22. Determine if special counsel retainer should be paid (regulatory, corporate, etc.)
23. Pay employees through the last day of work and advise to cash their checks immediately
24. Make a written inventory of all business assets

TIP: Ask the accountant for how detailed the inventory will need to be; this impacts the information necessary to file the final return and determine the

loss

25. Make a video inventory; lock premises
26. Notify utilities of a date of shut down (typically 3 to 7 days, to give lender and landlord an opportunity to put utilities in own name)
27. Notify the secured lender and provide copy of written inventory, the keys, when the shut off date with utilities will be and who the landlord is
28. Notify the landlord of same
29. Negotiate/prepare/execute voluntary surrender of assets to secured lender
30. Negotiate/prepare/execute termination of possession to landlord
31. Notify the utilities of shut off date
32. Notify insurance agent or insurers
33. Have accountant file the final returns
34. File any personal bankruptcy of owners and notify **all** business and personal creditors, regardless of whether there is personal liability

TIP: This is the client's opportunity to get a fresh start so extreme care should be taken to list anyone who could later sue. Former disgruntled employees, disgruntled customers should all be listed. Quiz the client about whether there are also potential tort claims (slip and falls, etc.) as well. For some businesses for which there is a high risk of customers or clients coming out of the woodwork and suing down the road, such as home builders/remodelers or lawyers and doctors, consider listing all customers/clients who have transacted business with the debtor within the applicable state statute of limitations.

35. If not filing the bankruptcy, have owner send letter to vendors/suppliers/customers indicating business is shut down
36. Keep corporate shell alive for a minimum of 3 years (less likelihood of a vendor/supplier/customer suing the owner individually – paying the minimal fee to renew the corporate charter is like cheap tail coverage)
37. Make sure if the business is an entity that the registered agent has not resigned, or change registered agent
38. Warn the client to send you any lawsuits in the future (to avoid a default judgment that creates personal liability)
39. Sit back and wait for applicable statute of limitations to pass before closing the file.

V. Selected Non Bankruptcy Statutes Applicable to Small Business Reorganizations/ Liquidations/Shutdowns:

A lawyer attempting to help the small business client must be familiar with:

Applicable State Law:

- ▶ Article 9 Lender Remedies
- ▶ Article 2 Personal Property Lease Remedies
- ▶ Deed of Trust/Mortgage Foreclosure Remedies
- ▶ Forcible Detainer/Eviction
- ▶ Civil Procedure and Collection Generally
- ▶ Corporate/Partnership/LLC governance
- ▶ Tax Assessment and Collection
- ▶ Employment and wage laws

- ▶ Special considerations:
 - if dealing with franchisees, any statutory obligations
 - if dealing with P.C.s/medical: any Board of Healing Arts requirements
 - if dealing with law firm shutdowns, ethical requirements for disposing of client files
 - if dealing with regulated businesses, any regulatory requirements
 - if dealing with not for profit businesses, any applicable requirements

Applicable Federal Law:

- ▶ ***HIPPA, 29 U.S.C. §§ 1181*** (certain duties imposed on sale or storage of private medical information)

- ▶ ***WARN Act, 29 U.S.C. §§ 2101, et seq.*** (companies with more than 100 employees have duty to warn employees in advance of shut down or owners face personal liability for wages)

- ▶ ***Federal Priority Statute, 31 U.S.C. § 3173*** (federal government obligations take priority over certain other payments or distributions when entity insolvent)

- ▶ ***IRS 45-day rule, 26 U.S.C. § 6323*** (when and under what circumstances IRS lien has priority over previously granted liens)

- ▶ ***Perishable Agricultural Commodities Act of 1930 (“PACA”), 7 U.S.C. §§ 499a, et seq.*** (perishable commodities and proceeds held in trust for the supplier; personal liability for failure to pay supplier)

VI. Selected Applicable Kansas Statutes and Case Authorities

- ▶ ***Bank Setoff Rights, K.S.A. 9-1206*** (“Any bank shall have the right to set off any obligation or claim which it has, when the same is matured against any depositor”).

- ▶ ***Partnership Dissolutions, K.S.A. 56a-801, et seq.***
- ▶ ***Corporate Sale of Assets, K.S.A. 17-6801*** (corporate assets may be sold, with vote by majority of outstanding stock, approved by board of directors, upon such terms and conditions deemed expedient and for the best interests of the corporation)
- ▶ ***Corporate Dissolution and Deadlock Procedure, K.S.A. 17-6804*** (majority of directors and shareholder approval; procedure for dissolving when there are two equal stockholders who disagree)
- ▶ ***Payment of Fees, K.S.A. 17-6806*** (“No corporation shall be dissolved under this act until all corporate fees due to or assessable by the state have been paid by the corporation”)
- ▶ ***Continuation of Corporation For Purposes of Windup, K.S.A. 17-6807*** (all dissolved or terminated corporations shall be continued for a term of 3 years to wind up corporate affairs)
- ▶ ***Payment of Corporate Debts & Distribution to Stockholders, K.S.A. 17-6810***

The directors or, if appointed by the district court, the receivers of a dissolved corporation, after payment of all allowances, expenses and costs, and the satisfaction of all special and general liens upon the funds of the corporation to the extent of their lawful priority, shall pay the other debts due from the corporation, if the funds in their hands shall be sufficient therefor, and if not, they shall distribute the same ratably among all the creditors who shall prove their debts in the manner that shall be directed by an order or decree of the court for that purpose. If there shall be any balance remaining after the payment of the debts and necessary expenses, they shall distribute and pay the same to and among those who shall be justly entitled thereto, as having been stockholders of the corporation or their legal representatives.

- ▶ ***Revocation or Forfeiture of Articles of Incorporation, K.S.A. 17-6812***

(a) The district court shall have jurisdiction to revoke or forfeit the articles of incorporation of any corporation for abuse, misuse or nonuse of its corporate powers, privileges or franchises. The attorney general, upon his own motion or upon the relation of a proper party, shall proceed for this purpose by commencing a quo warranto action in the district court of the county in which the registered office of the corporation is located.

(b) The district court shall have power, by appointment of receivers or otherwise, to administer and wind up the affairs of any corporation whose articles of incorporation shall be revoked or forfeited by any court under any section of this act or otherwise, and to make such orders and decrees with respect thereto as shall be just and equitable respecting its affairs and assets and the rights of its stockholders and creditors.

(c) No proceeding shall be instituted under this section for nonuse of any corporation's powers, privileges or franchises during the first two (2) years after its incorporation.

- ▶ ***Dissolution or forfeiture of articles of incorporation by court decree or judgment; filing of decree or judgment, K.S.A. 17-6813***

- ▶ ***Actions against Officers/Directors/Stockholders for Debts of Corporation, K.S.A. 17-7101***
 - (a) When the officers, directors or stockholders of any corporation shall be liable by the provisions of this act to pay the debts of the corporation, or any part thereof, any person to whom they are liable may have an action against any one or more of them. The petition in any such action shall state the claim against the corporation and the ground on which the plaintiff expects to charge the defendants personally.

 - (b) No suit shall be brought against any officer, director or stockholder for any debt of a corporation of which he is an officer, director or stockholder, until judgment be obtained therefor against the corporation and execution thereon returned unsatisfied
 - ▶ ***Speer v. Dighton Grain, Inc.***, 229 K. 272, 280, 286, 287, 624 P.2d 952 (1981) (creditor of insolvent corporation can not maintain personal action on own behalf against directors or officers who breach duty by negligent mismanagement)

 - ▶ ***Carson v. Davidson***, 248 K. 543, 549, 808 P.2d 1377 (1991) (The trust fund doctrine is viable in Kansas; under the trust fund doctrine the assets of a dissolved corporation are a trust fund against which the corporate creditors have a claim superior to that of the stockholders, and creditors have the right to follow such assets into the hands of stockholders who hold assets as though the stockholders were trustees)

 - ▶ ***Kansas Com. on Civil Rights v. Service Envelope Co.***, 233 Kan. 20 (Kan. 1983) (The general rule as to tort liability of corporate officers is that director or officer of a corporation does not incur personal liability for its torts merely by reason of his official character. If, however, an officer commits or participates in the commission of a tort, whether it is also by or for the corporation, he is liable to third persons injured thereby, and it does not matter what liability attaches to the corporation for the tort. An officer or agent of a corporation who violates a duty owed to third persons is liable to such persons)

- ▶ ***Limited Liability Dissolutions, K.S.A. 17-76,118 et seq.***
 - ▶ ***In re Greeson***, 2009 Bankr. LEXIS 1732 (Bankr. D. Kan. June 2, 2009) (Nugent, J.) (where individuals dissolved LLC and transferred assets to themselves and filed chapter 13, assets determined to be property of the bankruptcy estate, except for titled vehicle; rejecting secured lender's argument that the assets should be deemed held in trust for the LLC creditors)

- ▶ ***Personal Liability for Willful Non-payment of Wages, K.S.A. 44-315*** (filing bankruptcy is an exception).
 - ▶ ***State ex rel. McCain v. Erdman***, 4 K.A.2d 375, 376, 377, 607 P.2d 78 (sole officer of corporation who knowingly permits violation of wage payment laws is personally liable for unpaid wages and damages)

- ▶ *Bulk Transfer Law, K.S.A. 84-6-101, et seq.*[Repealed], effective July 1, 1992.

VII. Selected Applicable Missouri Statutes and Case Authorities

- ▶ *Employer/Corporate Officer Liability For Withheld Sales Tax, R.S. Mo § 143.241*
- ▶ *Withholding of Tax Money In Case of Sale of Business, R.S. Mo. § 144.150*
- ▶ *Violations in collecting, penalty. R.S. Mo. § 144.157*
- ▶ *Failure to Withhold, Report, Pay A Misdemeanor, R.S. Mo. § 144.510* (“Any person, officer, agent or employee of any firm, corporation, association, joint adventure, estate, trust, receiver or syndicate violating any of the provisions of sections 144.010 to 144.510 shall be deemed guilty of a misdemeanor, and, where punishment is not otherwise provided for herein, shall be punished for such”)
- ▶ *Thirty Days’ Notice of Reduction of Wages, R.S. Mo. § 290.100* (“Any ... corporation doing business in this state, and desiring to reduce the wages of its employees, or any of them, shall give to the employees to be affected thereby thirty days' notice thereof. Such notice may be given by posting a written or printed handbill, specifying the class of employees whose wages are to be reduced and the amount of the reduction, in a conspicuous place in or about the shops, station, office, depot or other place where said employees may be at work, or by mailing each employee a copy of said notice or handbill, and such company or corporation violating any of the provisions of this section shall forfeit and pay each party affected thereby the sum of fifty dollars, to be recovered by civil action in the name of the injured party, with costs, before any court of competent jurisdiction”)
- ▶ *Payment of Dividends, R.S. Mo. § 351.220.1* (“No dividend shall be declared or paid at a time when the net assets of the corporation are less than its stated capital or when the payment thereof would reduce the net assets of the corporation below its stated capital...”)
- ▶ *Limitation of Shareholder’s Obligation to Corporation or Creditors, R.S. Mo. 351.275.1* (“A holder of or subscriber to shares of a corporation shall be under no obligation to the corporation or its creditors with respect to such shares other than the obligation to pay to the corporation the full consideration for which said shares were issued or to be issued...”)
- ▶ *When Execution May Be Levied Against Shareholders, R.S. Mo. § 351.280*

If any execution shall have been issued against any corporation, and there cannot be found any property or effects whereon to levy the same, then such execution may be issued against any of the shareholders to the extent of the amount of the unpaid balance of such shares by him or her owned;

provided, always, that no execution shall issue against any shareholder except upon an order of the court in which the action, suit or other proceedings shall have been brought or instituted, made upon motion in open court, after sufficient notice, in writing, to the person sought to be charged; and, upon such motion, such court may order execution to issue accordingly; and provided further, that no shareholder shall be individually liable in any amount over and above the amount of shares owned.

▶ ***Liability of Directors, R.S. Mo. § 351.345***

In addition to any other liabilities imposed by law upon directors of a corporation, the directors of a corporation who shall knowingly declare and pay any dividend except as permitted by and in accordance with the provisions of sections 351.210 and 351.220, and except, with respect to liquidating dividends, as permitted by, and in accordance with the provisions of this chapter in connection with reduction of stated capital or with dissolution, shall be jointly and severally liable for all the debts of the corporation then existing, and for all that shall be thereafter contracted as long as they shall respectively continue in office; provided, that the amount for which they shall be liable shall not exceed the amount of such dividend, and that if any of the directors shall be absent at the time of making the dividend, or shall object thereto, and shall file their objection, in writing, with the secretary of the corporation, they shall be exempted from said liability; and further provided that a director shall be fully protected in relying in good faith upon the books of account of the corporation or statements prepared by any of its officials as to the value and amount of the assets, liabilities and earnings of the corporation, or any other facts pertinent to the existence and amount of surplus or other funds from which dividends might properly be declared and paid.

- ▶ ***Bodine Aluminum Co. v. Mitauer***, 776 S.W.2d 485, (Mo. Ct. App. 1989)
 (While an officer or director of a corporation may avoid personal liability after a corporation's charter has been forfeited by filing an affidavit stating that the conditions giving rise to the forfeiture have been remedied, that remedy is not available when a personal judgment has been obtained against a statutory trustee prior to rescission of a forfeiture; thus, statutory trustees, who neither sought nor obtained rescission of the forfeiture of a corporation's charter, were personally liable for a judgment obtained against the corporation in an action on an account)

▶ ***Dissolution by Board of Directors and Shareholders, R.S. Mo. § 351.464***

1. A corporation's board of directors may propose dissolution for submission to the shareholders.
2. For a proposal to dissolve to be adopted:
 - (1) The board of directors must recommend dissolution to the shareholders unless the board of directors determines that because of conflict of interest or other special circumstances it should make no recommendation and communicates the basis for its determination to the shareholders; and
 - (2) The shareholders entitled to vote must approve the proposal to dissolve as provided in subsection 5 of this section.
3. The board of directors may condition its submission of the proposal for dissolution on any basis.
4. The corporation shall notify each shareholder, whether or not entitled to vote, of the proposed shareholders' meeting in accordance with section 351.230. The notice must also state that the

purpose, or one of the purposes, of the meeting is to consider dissolving the corporation.

5. Unless the articles of incorporation or the board of directors, acting pursuant to subsection 3 of this section, require a greater vote, including a vote by any class of stock or any series of any class, the proposal to dissolve to be adopted must be approved by at least two-thirds of the votes entitled to be cast on that proposal.

- ▶ ***Dissolution by consent of all shareholders R.S. Mo. § 351.466*** (A corporation may be dissolved by the written consent of the holders of record of all of its outstanding shares entitled to vote on dissolution)

- ▶ ***Effect of Corporate Dissolution, R.S. Mo. § 351.476.***

1. A dissolved corporation continues its corporate existence but may not carry on any business except that appropriate to wind up and liquidate its business and affairs...

2. Dissolution of a corporation does not:

(1) Transfer title to the corporation's property;

(2) Prevent transfer of its shares or securities, although the authorization to dissolve may provide for closing the corporation's share transfer records;

(3) Subject its directors or officers to standards of conduct different from those applicable to directors and officers of a corporation which has not been dissolved; ***provided that any such officer or director who conducts business on behalf of the corporation except as provided in this section shall be personally liable for any obligation so incurred;***

(4) Change quorum or voting requirements for its board of directors or shareholders; change provisions for selection, resignation, or removal of its directors or officers or both; or change provisions for amending its bylaws;

(5) Prevent commencement of a proceeding by or against the corporation in its corporate name;

(6) Abate or suspend a proceeding pending by or against the corporation on the effective date of dissolution;

(7) Terminate the authority of the registered agent of the corporation; or

(8) Make available for use by others its corporate name for a period of one year from the effective date of its dissolution.

- ▶ ***Drummond Co. v. St. Louis Coke & Foundry Supply Co.***, 181 S.W.3d 99 (Mo. Ct. App. 2005) (Directed verdict in favor of the corporate director on the creditor's suit that the director breached a fiduciary duty to the creditor to stop the diversion of corporate funds was affirmed because there was no evidence that the director committed an intentional or fraudulent act, when the creditor failed to make a submissible case on its claim of breach of a fiduciary duty on the part of the director; there was no evidence that the director committed any acts of active malfeasance, nor did the evidence establish any common law liability or duty)

- ▶ ***Procedure and Effect of Administrative Dissolution, R.S. Mo. §§ 351.486.3*** ("A

corporation administratively dissolved continues its corporate existence but may not carry on any business except that necessary to wind up and liquidate its business and affairs under section 351.476 and notify claimants under sections 351.478 and 351.482, ***and any officer or director who conducts business on behalf of a corporation so dissolved except as provided in this section shall be personally liable for any obligation so incurred***")

- ▶ ***Partner's Liability, R.S. Mo. 358.150*** ("all partners are liable jointly and severally for everything chargeable to the partnership pursuant to sections 358.130 and 358.140, and for all other debts and obligations of the partnership")
- ▶ ***Title Loan Liability, R.S. Mo. 367.512.2*** ("Any borrower who obtains a title loan under false pretenses by hiding or not disclosing the existence of a valid prior lien or security interest affecting the titled personal property shall be personally liable to the title lender for the full amount stated in the title loan agreement")