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## Conversion and Mergers of Disparate Business Entities

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## CONVERSION AND MERGER OF DISPARATE BUSINESS ENTITIES

Robert C. Art\*

*Abstract:* Legislation permitting a business organized in one form, such as a corporation, to merge with a business of a different form, such as a limited liability company, is relatively recent, but reasonable and beneficial. A logical extension of this legislation is to permit a single business entity to convert its organizational form without involving a second entity. Recognition of these cross-entity transactions flows naturally from the expansion of organizational options in recent years, particularly the introduction of limited liability companies and limited liability partnerships. Conversion and merger of disparate entities are already available in a few states, with varying degrees of liberality, and are likely to become increasingly common. Both the Revised Uniform Partnership Act and the Model Business Corporation Act support the key principles behind conversion and merger. This Article examines the policies, principles, and drafting issues of cross-entity conversion and merger legislation. It focuses on Oregon's comprehensive statutory scheme and urges other states to emulate that approach.

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## I. INTRODUCTION

Why should merger of two corporations be authorized and facilitated by statute, while merger of a corporation with a limited liability company is cumbersome, complex, and expensive? Why should a general partnership be allowed to readily convert to a limited liability partnership, but not to a limited liability company? States increasingly are recognizing that only historical happenstance, not reasoned policy, accounts for such anomalies, and are updating their statutes to enhance

the opportunities for business entities and their counsel to alter their organizational form.<sup>1</sup>

This salutary development follows logically from the recent introduction of new forms of business organization, especially the limited liability company (LLC) and limited liability partnership (LLP), and from concepts incorporated in the Revised Uniform Partnership Act (RUPA).<sup>2</sup> Modern statutes both extend the range of permissible mergers to disparate entities (such as a corporation merging with a partnership), and authorize conversions from one form to another (a transformation not involving a second business).<sup>3</sup> These changes are variously known as cross-entity,<sup>4</sup> cross-species,<sup>5</sup> multi-entity,<sup>6</sup> or inter-entity<sup>7</sup> conversions and mergers. Oregon legislation effective in 2000 provides a particularly good model for other states to follow.<sup>8</sup>

Combining two business entities of unlike form has always been possible, but has been cumbersome, complex, and expensive, without policy justification. A corporation seeking to combine with an existing

1. See, e.g., Robert R. Keatinge, *Inter-Entity Mergers and Conversions and Other Changes Under SB 97-233*, COLO. LAW., Jan. 1998, at 43. Colorado, Delaware, Nevada, and Texas are among the states at the forefront of the trend toward authorization of mergers of disparate business entities and conversion of one form to another. Citations and further detail are provided *infra* notes 177-84.

2. REV. UNIF. PARTNERSHIP ACT (1994).

3. See, e.g., *infra* notes 177, 181, 195, 199-200 (citing statutes from Colorado, Delaware, Nevada, and Texas). Also, the Model Business Corporation Act was amended in 1999 to authorize mergers of corporations with "other entities" but the reform did not extend to conversions. MODEL BUS. CORP. ACT ANN. §§ 11.01-.02 (Supp. 1999); The Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Fundamental Changes*, 54 BUS. LAW. 685, 695-97 (1999) (indicating and explaining new cross-entity merger provisions, but making no provision for cross-entity conversion).

4. An article on Colorado's "inter-entity" mergers, for example, also refers to them as "cross-entity" mergers. Keatinge, *supra* note 1, at 44.

5. Paul L. Lion, III & Gerald G. Chacon, Jr., *Converting Partnerships and Corporations to Limited Liability Companies: Legal, Tax, and Practical Considerations*, in LIMITED LIABILITY COMPANIES: FORMATION, OPERATION, AND CONVERSION 216, 223 (Robert W. Wood ed., 1993).

6. For example, the Oregon State Bar committee that drafted Oregon's current legislation was known as the Task Force on Multi-Entity Conversion and Merger. The "multi" reference, however, emphasizes the number of entities (such as three corporations) that can merge, rather than the type (such as a corporation and a limited liability company (LLC)), which is the more significant innovation of the legislation.

7. See Keatinge, *supra* note 1 (as reflected in the article's title).

8. 1999 Or. Laws 362. The principal provisions of the legislation are codified in thirty-eight sections of OR. REV. STAT. chapters 60 (corporation), 62 (cooperative), 63 (LLC), 67 (partnership), and 70 (limited partnership) (1999). The Appendix to this Article provides a chart of citations by subject.

limited liability company, for example, could not merge because no statute authorized it, but could accomplish the same pragmatic results. As one possibility, the corporation could sell its assets to the LLC in exchange for LLC membership interests, then dissolve and issue the membership interests to its shareholders as a liquidating distribution. As a result, the two businesses become one, the corporation disappears, and the former shareholders become members of the surviving LLC—all of the characteristics of a cross-entity merger.<sup>9</sup> No apparent policy supported the law's failure to provide a more efficient, direct means.

Once cross-entity merger is accepted, authorization of cross-entity conversion is the next logical step. Otherwise, existing businesses are deprived of the flexibility and opportunities available to newly organized enterprises, and relegated to the traditional, burdensome means of altering their organizational form. A partnership or limited partnership wishing to become an LLC, for example, could dissolve and distribute its net assets (in cash or in kind) to partners, who could then organize a new LLC and contribute to it the former partnership assets in exchange for LLC membership interests.<sup>10</sup> Alternately, in a jurisdiction allowing cross-entity merger but not cross-entity conversion, the goal can be achieved in two steps. First, the partnership would organize an LLC, briefly holding all of the membership interests. Then the partnership would merge into the LLC, disappearing but leaving its former partners with membership interests in the surviving LLC.<sup>11</sup> No reason appears for the law not to authorize the direct, single-step option of conversion, involving only one entity and one document, to accomplish the same result.

Authorizing conversion and merger of disparate entities raises numerous issues, involving each of the constituencies within or affected by a business. Most importantly, rights of creditors and litigants must be protected, so that conversion and merger cannot be used to evade

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9. This approach and others are described in Mark D. Lubin, *Selected Aspects of the California Limited Liability Company Act*, in *THE BEST ENTITY FOR DOING THE DEAL*, 937 PLI/Corp. 343, 361–64 (1996); Lion & Chacon, *supra* note 5, at 216–22.

10. David C. Culpepper, *Limited Liability Companies*, in *ADVISING OREGON BUSINESSES* ch. 39A (1989 & Supp. 1997); Lion & Chacon, *supra* note 5, at 169, 218. A second method is for the partners to contribute their partnership interests to the LLC in exchange for LLC membership interests. The partnership then liquidates, distributing its assets to the LLC. A third alternative is for the partnership to exchange its assets for LLC membership interests and then liquidate, distributing the membership interests to the former partners. *Id.* at 216–21.

11. The proposed transaction is a variation of one suggestion by Lion & Chacon, *supra* note 5, at 213 (“Method 3”), 218 (chart IV), but substituting conversion for organizing a new entity.

existing obligations. Transfer of business property must be perfectly clear. The rights of owners must be preserved in the procedures to authorize the transactions and in the consequences of the transaction. Administrative procedures must allow the state to record and report on the current status of a business, without undue expense or complexity. Businesses that are organized in other states entail further issues of coordination, reciprocity, and choice of laws.

Several states have wrestled with these issues, producing alternate means of resolution.<sup>12</sup> Oregon has a particularly direct, comprehensive, and flexible set of statutes, effective in 2000, which other states should emulate.<sup>13</sup> The statutes authorize conversion or merger among any of the six business entity forms: corporation, professional corporation, cooperative, partnership (including general partnership and limited liability partnership), limited partnership, and limited liability company. Notably, the legislation allows conversion or merger of forms providing limited liability to owners (such as the corporation and LLC) into forms imposing personal liability on owners (such as the general partnership)—a policy and drafting decision that required particularly careful consideration.

This Article will outline the plethora of business organization alternatives presently available and the means by which business entities have traditionally been allowed to combine or to change organizational structure. It will describe the progress and alternative approaches used by states that have been leaders in enacting statutory provisions authorizing and facilitating mergers of disparate business entities and conversion of a business into a different organizational form. Finally, this Article will focus on Oregon's contribution to this field of law, a model that other states should follow.

## II. THE EXPANSION OF BUSINESS ORGANIZATION OPTIONS

The choices of business organization form for businesses has expanded over the past several years. Traditionally, Oregon, like other states,<sup>14</sup> offered the options (in addition to sole proprietorship) of

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12. For example, Colorado, Delaware, Nevada, and Texas allow cross-entity conversion and merger. See *infra* notes 177–82, 199–200, and accompanying text.

13. OR. REV. STAT. §§ 60.470–.497 (corporation), 60.605–.623 (cooperative), 63.467–.497 (LLC), 67.340–.365 (partnership), 70.500–.540 (limited partnership) (1999).

14. All fifty states provide for general partnerships, limited partnerships, and corporations. Dale A. Oesterle & Wayne M. Gazur, *What's in a Name?: An Argument for a Small Business "Limited*

corporation<sup>15</sup> (and the variations of professional corporation<sup>16</sup> and cooperative),<sup>17</sup> general partnership,<sup>18</sup> and limited partnership.<sup>19</sup> In general, the forms providing a shield from personal liability for business debts also entailed taxation at both the company and the owner levels.<sup>20</sup> More recent additions are the limited liability company<sup>21</sup> and limited liability partnership,<sup>22</sup> providing benefits both in terms of protection from liability and avoidance of company-level taxation.

A thorough presentation of the characteristics of each organizational form is complex, including myriad differences in individual states,<sup>23</sup> and is left to sources other than this Article.<sup>24</sup> However, mention of a few of

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*Liability Entity" Statute (With Three Subsets of Default Rules)*, 32 WAKE FOREST L. REV. 101, 102 n.12 (1997).

15. Oregon Business Corporation Act, 1987 Or. Laws 52 (codified at OR. REV. STAT. ch. 60 (1999)).

16. Oregon Professional Corporation Act, 1969 Or. Laws 592 (codified at OR. REV. STAT. ch. 58 (1999)).

17. The Oregon Cooperative Corporation Act, 1957 Or. Laws 716, is codified at OR. REV. STAT. ch. 62 (1999).

18. Oregon currently has two partnership acts. The older UNIFORM PARTNERSHIP LAW, codified at OR. REV. STAT. ch. 68 (1999) is based on the UNIFORM PARTNERSHIP ACT (UPA) (1914). The Oregon Revised Partnership Act, 1997 Or. Laws 775, and codified at OR. REV. STAT. ch. 67 (1999), is based on the REVISED UNIFORM PARTNERSHIP ACT (RUPA) (1994). The new act governs partnerships organized after January 1, 1998, all limited liability partnerships, and partnerships organized before 1998 that elect to be covered. The old act governs the rest, until January 1, 2003, when the new act will apply to all partnerships. 1997 Or. Laws 775, § 84 (codified at OR. REV. STAT. §§ 67.005 note, 68.010 note). See generally Michael D. Walker & Merritt S. Yoelin, *General Partnerships*, in ADVISING OREGON BUSINESSES ch. 3 (1989 & Supp. 1997).

19. Oregon's UNIFORM LIMITED PARTNERSHIP ACT, 1985 Or. Laws 677, codified at OR. REV. STAT. ch. 70 (1999), is based on the UNIFORM LIMITED PARTNERSHIP ACT. See generally James M. Kennedy & Turid L. Owren, *Limited Partnerships*, in ADVISING OREGON BUSINESSES ch. 6 (1989).

20. See *infra* notes 54–60 and accompanying text.

21. The Oregon Limited Liability Company Act, 1993 Or. Laws 173, is codified at OR. REV. STAT. ch. 63. See generally Culpepper, *supra* note 10.

22. Provisions governing limited liability partnerships (LLPs) are not in a separate chapter, as is each of the other forms of business entity. Instead, in 1997, the legislature appended a number of provisions applicable to LLPs, OR. REV. STAT. §§ 67.500–.770, to the general partnership act, OR. REV. STAT. ch. 67. 1997 Or. Laws 775.

23. A few examples will suggest the complexity of the comparison. An LLP has some tax advantages over an LLC in terms of wealth-transfer tax valuation and self-employment tax. In Florida, the corporate income tax applies to an LLC but not a limited partnership. Oesterle & Gazur, *supra* note 14, at 119 n.101. In Texas, the corporate franchise tax applies to an LLC but not a limited partnership. *Id.*

24. Sources comparing the characteristics of different entities include J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, *LIMITED LIABILITY COMPANIES: A STATE BY STATE GUIDE TO LAW AND PRACTICE* §§ 2.1–.23 (1994); Robert R. Keatinge, *Universal Business Organization Legislation: Will it Happen? Why and When*, 23 DEL. J. CORP. L. 29, 36–44 (1998); and Larry E. Ribstein, *The*

the most salient features will indicate some of the major reasons that businesses organized in one form may wish to convert or merge into another form.

### A. *The Traditional Entities: Corporation, Cooperative, Partnership, and Limited Partnership*

Prior to a key change in federal income tax regulations in 1988,<sup>25</sup> entrepreneurs organizing a business more complex than a sole proprietorship generally chose from a short list of well-established forms. To obtain protection from personal liability, they could organize a corporation, the professional corporation variant if they provided professional services, or a cooperative. Partnership, which exposes owners to full individual liability for business debts, was the default choice. Limited partnership, protecting some but not all owners, completed the traditional list of organizational options.

The corporate form was originally designed primarily for large enterprises, separating ownership from control, but was extended to small, closely held businesses and professionals. Corporations have centralized management, with a statutorily prescribed structure of directors elected by shareholders and officers appointed by directors.<sup>26</sup> Shareholders are deprived of agency power to bind the corporation, but are also protected from liability to creditors<sup>27</sup> except in the rare cases of "piercing the corporate veil."<sup>28</sup> Directors are subjected to the fiduciary duties of care and loyalty to shareholders, which cannot be waived, although most states permit exculpation from monetary liability for

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*New Choice of Entity for Entrepreneurs*, 26 CAP. U. L. REV. 325, 335-43 (1997). For an Oregon focus on the choice, see Nikki C. Hatton, *Selection of the Business Entity*, in ADVISING OREGON BUSINESSES ch. 1 (1989 & Supp. 1997).

25. In 1988, the Internal Revenue Service released the "check-the-box" regulations allowing non-corporate entities, such as limited liability companies, to select pass-through tax treatment. Rev. Rul. 88-76, 1988-2 C.B. 360. Until this key decision, the LLC had been an isolated form in Wyoming; after 1988 it rapidly spread throughout the country.

26. OR. REV. STAT. §§ 60.301, .307, .371 (1999); REV. MODEL BUS. CORP. ACT §§ 8.01, .03, .40 (1996).

27. OR. REV. STAT. § 60.151; REV. MODEL BUS. CORP. ACT § 6.22.

28. "Piercing the corporate veil" is a doctrine derived from case law rather than statute, imposing liabilities for corporate debts on shareholders, contrary to the usual rule of limited liability. Typical factors include fraud, gross under-capitalization, and evasion of existing obligations. *See, e.g.*, HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 146 (3d ed. 1983).

breach of the duty of care.<sup>29</sup> Those factors, plus the familiarity of the corporate form to investors, make corporations the typical business entity form for going public.

The professional corporation (PC), is simply a corporation organized for the purpose of practicing law, medicine, accounting, or a number of other professional services specified in the governing statute.<sup>30</sup> A few specialized provisions cover such matters as liabilities of employees, shareholders, and the corporation,<sup>31</sup> and the relationship of the PC to professional licensing agencies.<sup>32</sup> However, in all other matters, including conversion and merger, PCs are governed by the Business Corporation Act.<sup>33</sup>

Cooperative corporations (usually called cooperatives) are a distinctly different form, governed by a separate statute.<sup>34</sup> Cooperatives have "members" and may or may not have shares and shareholders.<sup>35</sup> Members commonly purchase supplies or market products through the cooperative, and receive net proceeds or other benefits in proportion to the volume of their purchases or marketing, rather than in proportion to their capital contributions.<sup>36</sup> Governance is typically based on the principle of one vote per member,<sup>37</sup> rather than one vote per share.<sup>38</sup> The

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29. OR. REV. STAT. § 60.047(2)(d); DEL. CODE ANN. tit. 8, § 102(b)(7) (1974 & Supp. 2000); REV. MODEL BUS. CORP. ACT § 2.02(b)(4). Forty-three states have authorizing provisions in articles, charters, or bylaws limiting or eliminating personal liability of directors. Although there are many differences, most appear based on either the Delaware or the Model Act provisions. MODEL BUS. CORP. ACT ANN. §§ 2-31 to -32 (1999).

30. *E.g.* Oregon Professional Corporation Act, OR. REV. STAT. ch. 58 (1999). *See generally* Donald R. Laird, *Professional Corporations*, in *ADVISING OREGON BUSINESSES* ch. 31 (1989 & Supp. 1997). OREGON REVISED STATUTES section 58.015(5) (1999) defines a "professional" as an accountant, architect, attorney, chiropractor, dentist, landscape architect, naturopath, nurse practitioner, psychologist, physician, podiatrist, radiology technologist, real estate appraiser, or other person performing similar services pursuant to a license.

31. OR. REV. STAT. § 58.185.

32. *Id.* §§ 58.325-389.

33. *Id.* § 58.045.

34. *Id.* §§ 62.005, .015(4) ("Cooperative means a cooperative corporation.") (1999); David R. Simon, *Cooperatives*, in *ADVISING OREGON BUSINESSES* ch. 30 (1989 & Supp. 1997).

35. OR. REV. STAT. § 62.513(c). Members own shares, or pay membership fees, or meet other qualifications as set forth in the articles and bylaws. *Id.* § 62.175(2). Both members and shareholders are shielded from liability. *Id.* § 62.215.

36. *Id.* § 62.415. For example, a farmer who contributed 17% of a cooperative's capital, but 5% of the grain stored in the cooperative's silo, will receive 5% of the proceeds of the silo operation.

37. *Id.* § 62.265(1).

38. *Id.* § 62.265(1) ("Shares of stock as such shall not be given voting power except in the specific instances authorized by this chapter.").

cooperative form can be used for nearly any purpose<sup>39</sup> but seems most common in agriculture, consumer organizations (such as buying clubs), and multi-family housing.<sup>40</sup>

Partnership (sometimes called general partnership to distinguish it from limited partnership and limited liability partnership) stands in sharp contrast to the corporate form. Unless the partnership agreement provides otherwise, every owner participates equally in management.<sup>41</sup> Moreover, every partner has apparent agency authority to bind the partnership, even if the partnership agreement denies actual agency authority<sup>42</sup>—an aspect that makes the form unsuitable when centralized management is desired. Partners are exposed to joint and several liability to creditors, though creditors typically must first exhaust their remedies against the business.<sup>43</sup>

Partners are subject to fiduciary duties that cannot be waived but can be defined in the partnership agreement.<sup>44</sup> General partnership is the

39. Cooperatives can engage in any lawful business except banking or insurance. *Id.* § 62.115. For a discussion of common uses, see Simon, *supra* note 34, at 4.

40. For example, a group of farmers might operate a grain storage and loading facility, or a commodity distribution and marketing system, in cooperative form. As one indication of the agricultural connection, the Oregon Cooperative Corporation Act states a public policy in favor of “the efficient production and distribution of agricultural and other products derived from natural resources or labor resources,” and provides protection from antitrust liability. OR. REV. STAT. §§ 62.005, .845. For discussion of development of the cooperative form in Pennsylvania, see William H. Clark, Jr., *What the Business World is Looking for in an Organization Form: The Pennsylvania Experience*, 32 WAKE FOREST L. REV. 149, 158–61 (1997).

41. OR. REV. STAT. §§ 67.140(7), 68.310(5) (1999); UNIF. PARTNERSHIP ACT § 18(e) (1914); REV. UNIF. PARTNERSHIP ACT § 401(f) (1994).

42. OR. REV. STAT. §§ 67.090(1), 68.210(1); UNIF. PARTNERSHIP ACT 9(1); REV. UNIF. PARTNERSHIP ACT § 301(1) (noting that every partner can bind partnership, unless partner in fact has no authority and that fact is known to outside party). See generally ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 4.01(b) (2000 & Supp. 2001) [hereinafter BROMBERG PARTNERSHIP].

43. OR. REV. STAT. §§ 67.105, 68.270; REV. UNIF. PARTNERSHIP ACT § 306; UNIF. PARTNERSHIP ACT § 15.

44. The Uniform Partnership Act labeled partners “fiduciaries” of co-partners but did not define the fiduciary duties, except as to certain narrow issues, such as the duty to render information, OR. REV. STAT. § 68.340; UNIF. PARTNERSHIP ACT § 21, leaving the development of fiduciary duties to courts under the common law. The revised act sought to define and limit the duties. RUPA section 404 provides that “the only fiduciary duties are the duties of loyalty and care.” REV. UNIF. PARTNERSHIP ACT § 404; see also OR. REV. STAT. § 67.155(1). For discussion of fiduciary duties in partnerships and citations to the very extensive debate between proponents of strict fiduciary duties and proponents of freedom of contract, see J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439 (1997). States adopting RUPA have modified the fiduciary duty provision with multiple variations, seriously detracting from uniformity in this field of law. Allan W. Vestal, “Assume a

only form of business entity (other than sole proprietorship) that can be formed without any explicit agreement, filing with the state, or other formality.<sup>45</sup> These factors contribute to its popularity, especially among smaller and less sophisticated businesses.<sup>46</sup> Partnership interests can be assigned but the transferee does not become a partner unless the others agree.<sup>47</sup> Death or withdrawal of any partner can dissolve the partnership,<sup>48</sup> though the remaining partners can continue the business if they compensate the dissociated partner or that person's estate.<sup>49</sup>

Limited partnership, typically governed by a separate statute,<sup>50</sup> divides partners into two distinct classes—general and limited partners—producing a structure combining elements of the other traditionally recognized business forms. General partners have exclusive authority to manage and owe fiduciary duties somewhat like corporate directors.<sup>51</sup> However, general partners are exposed to joint and several liability to creditors, as in a partnership.<sup>52</sup> The limited partners select the

*Rather Large Boat . . .*: *The Mess We Have Made of Partnership Law*, 54 WASH. & LEE L. REV. 487, 519–20 (1997). In Oregon, the duty of loyalty “includes” a number of specified requirements, such as accounting for profits and benefits, avoiding dealings adverse to partnership, and refraining from competing with the partnership, OR. REV. STAT. § 67.155(2), in contrast to RUPA’s provision that the duty of loyalty “is limited to” those requirements. REV. UNIF. PARTNERSHIP ACT § 404(b).

45. UNIF. PARTNERSHIP ACT section 6, REV. UNIF. PARTNERSHIP ACT section 202, and OREGON REVISED STATUTES section 67.055 provide that a partnership is created by an association of two or more persons to carry on as co-owners a business for profit, imposing no requirement for a filing or even a writing.

46. BROMBERG PARTNERSHIP, *supra* note 42, § 1.01(b).

47. OR. REV. STAT. §§ 67.200, 68.440 (stating that transferee receives only profits to which partner would otherwise be entitled); REV. UNIF. PARTNERSHIP ACT § 503; UNIF. PARTNERSHIP ACT § 27.

48. OR. REV. STAT. § 68.530; UNIF. PARTNERSHIP ACT § 31. In the RUPA, death or withdrawal is deemed a dissociation that leads to a buyout of the partner’s interest rather than a windup. OR. REV. STAT. § 67.220; REV. UNIF. PARTNERSHIP ACT § 601.

49. OR. REV. STAT. §§ 67.250, 68.600; REV. UNIF. PARTNERSHIP ACT § 701; UNIF. PARTNERSHIP ACT § 38.

50. The REVISED UNIFORM LIMITED PARTNERSHIP ACT (RULPA), was approved by the National Conference of Commissioners on Uniform State Laws in 1976, and substantially amended in 1985.

51. REV. UNIF. LTD. PARTNERSHIP ACT § 403.

52. *Id.* § 9(1), 6A U.L.A. 346 (1995) (“A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners . . .”). In some states, however, legislation protects the general partner in a limited partnership from liability. Oesterle & Gazur, *supra* note 14, at 105 (citing COLO. REV. STAT ANN. §§ 7-62-101(12), -403(2) (West 1999); DEL. CODE ANN. tit. 6, § 17-214 (Supp. 2000); MICH. STAT. ANN. §§ 20.46, 10.1403(b) (Michie 1960 & Supp. 1996); TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 2.14(a) (Vernon Supp. 1995)).

general partners but otherwise have little or no agency power or managerial authority, except as specifically granted in the partnership agreement, and are not subject to personal liability.<sup>53</sup> In those respects, limited partners resemble corporate shareholders.

*B. The Traditional Dilemma: Limited Liability or Pass-Through Tax Treatment*

In selecting among the business organizational forms that were available prior to 1988, entrepreneurs and their counsel generally were required to balance the importance of limited liability with the value of pass-through tax treatment, selecting one and forfeiting the other. The Internal Revenue Code classifies businesses either as “corporations”<sup>54</sup> or “partnerships.”<sup>55</sup> The term “corporation” includes “association,” covering all businesses that resemble corporations, even if not formally incorporated under state law.<sup>56</sup> The term “partnership,” for tax purposes, includes all multi-owner businesses that are not corporations, trusts, or estates.<sup>57</sup>

Corporations, professional corporations, and cooperatives provided limited liability for all equity owners, but were subject to “double taxation”; business income was taxed at the entity level, and all profits distributed to owners were taxed at the individual level.<sup>58</sup> Alternatively,

One means of avoiding personal liability to any individual, while still providing pass-through tax treatment for the limited partners, is to designate a corporation as a general partner. BROMBERG PARTNERSHIP, *supra* note 42, § 12.11(b).

53. Although limited partners generally are not at risk of personal liability, they can be exposed if they participate in control of the enterprise. Amendments to the RULPA in 1985 provided safe harbors against liability for participation, including one for “matters related to the business . . . which the partnership agreement states in writing may be subject to the approval or disapproval of limited partners.” REV. UNIF. LTD. PARTNERSHIP ACT § 303(b)(6)(ix), 6A U.L.A. 145 (1995). Liability extends only to persons who “reasonably [believe], based upon the limited partner’s conduct, that the limited partner is a general partner.” *Id.* § 303(a), 6A U.L.A. 144. At least one state has eliminated the potential for liability of limited partners for participating in control of the business, and others may follow that lead. GA. CODE ANN. § 14-9-303 (1994), *cited in* Clark, *supra* note 40, at 176 (stating that similar legislation has been proposed in Pennsylvania).

54. I.R.C. § 7701(a)(3) (2000).

55. *Id.* § 7701(a)(2).

56. *Id.* § 7701(a)(3). Classification of businesses for purposes of federal taxation is solely a matter of federal tax law, even though the standards relate to characteristics determined by state law. Treas. Reg. § 301.7701-1(a)(1) (2000); BORIS I. BITTKER & JASON S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 12.61[1] (7th ed. 2000).

57. I.R.C. § 7701(a)(2).

58. *Id.* §§ 11, 301, 302; BITTKER & EUSTICE, *supra* note 56, ¶ 1.03.

a corporation could elect Subchapter S treatment<sup>59</sup> to avoid the entity-level tax, but only subject to restrictions and limitations.<sup>60</sup>

Partnerships and limited partnerships received pass-through tax treatment, avoiding taxation at the entity level, but at the price of exposure of at least some owners to personal liability for business debts. All of the partners in a general partnership and the general partners in a limited partnership are personally liable.<sup>61</sup>

Thus, none of the traditional forms offered the ideal combination of limited liability and pass-through tax treatment. Businesses sought new options and state legislatures responded.

### C. *New Options: LLC, LLP, and LLLP*

During the late 1980s and the 1990s, new business-organization alternatives became available: the limited liability company, limited liability partnership, and a variation, the limited liability limited partnership. State legislatures intended to provide businesses as many corporate characteristics as possible (especially limited liability for investors) coupled with the pass-through treatment under federal tax regulations available to partnerships,<sup>62</sup> enabling businesses to avoid the entity-level tax applicable to corporations.<sup>63</sup> The new forms also offer

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59. I.R.C. §§ 1361–1379.

60. S corporations, for example, cannot have more than seventy-five shareholders, more than one class of stock, or nonresident alien shareholders. 26 U.S.C. § 1361(b) (1994). For discussions of other factors, see Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387, 459 (1991); John W. Nickel et al., *Subchapter S Taxation*, in ADVISING OREGON BUSINESSES ch. 11 (1989 & Supp. 1997); and Oesterle & Gazur, *supra* note 14, at 121 n.109.

61. See *supra* notes 43, 50, and accompanying text.

62. Internal Revenue Service regulations, known as the *Kintner* regulations, determined whether a business entity was taxable as a corporation (or “association”) or instead as a partnership. Four characteristics were relevant: centralized management, free transferability of interests, continuity of existence, and limited liability. An entity with three or more of those characteristics was taxed as a corporation, while one with two or fewer was a partnership. 26 C.F.R. 301.7701-1, -2(a) to -2(e) (repealed in 1996). The regulations were promulgated in response to *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954).

63. Many commentators confirm that statutes creating the LLC and LLP were specifically intended to provide businesses the federal income tax advantages of partnerships coupled with the advantages, especially limited liability, of the corporate form. See, e.g., Susan Saab Fortney, *Seeking Shelter in the Minefield of Unintended Consequences—The Traps of Limited Liability Law Firms*, 54 WASH. & LEE L. REV. 717, 722–24 (1997); Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, But Heading Where?*, 45 SYRACUSE L.

more flexibility in selecting the form of internal management.<sup>64</sup> Once the new forms became available in some states, the others followed quickly, none wanting to be left behind.<sup>65</sup>

The limited liability company originated in Wyoming in 1977,<sup>66</sup> and remained an isolated anomaly for several years.<sup>67</sup> The pivotal event providing the impetus for extensive state legislation was the Treasury Department's revenue ruling in 1988 allowing an LLC pass-through tax treatment.<sup>68</sup> The company's income was allocated directly to its owners, labeled "members," avoiding the double taxation applicable to most corporations. After the revenue ruling the LLC spread swiftly throughout the nation and by 1996 had become available in all states.<sup>69</sup>

In addition to the favorable tax treatment, the LLC form shields all of its members and managers from liability for obligations of the company<sup>70</sup> and provides a choice of management structure. The default provision is member management, whereby all members participate in management and have agency power to bind the entity,<sup>71</sup> much like

REV. 1193, 1272 (1995). Pennsylvania was an especially clear example, stating that motivation explicitly in the statute. Clark, *supra* note 40, at 162.

64. The corporate system delegates centralized control to the board of directors, with investors deprived of participation or agency power except for power to elect directors. That arrangement is better suited to publicly traded corporations than to closely held corporations. *See generally* DOUGLAS A. BRANSON, CORPORATE GOVERNANCE § 4.12 (1993) (noting that owners of smaller corporations serving as directors find traditional forms of governance inappropriate). Of course, shareholder agreements provide a means of modifying corporate governance norms to meet the preferences within a particular corporation, but entail certain costs for negotiation and preparation.

65. Fortney, *supra* note 63, at 722; Goforth, *supra* note 63, at 1272.

66. WYO. STAT. ANN. §§ 17-15-102 to -144 (Michie 1999) (effective June 30, 1977); Gazur & Goff, *supra* note 60, at 389. The statute was enacted as special legislation to assist a mineral company, providing limited liability to all owners and pass-through tax treatment. *Id.* The IRS issued a private letter ruling classifying the company as a partnership for tax purposes. Priv. Ltr. Rul. 81-06-082 (Nov. 18, 1980); Fortney, *supra* note 63, at 722 (citing Goforth, *supra* note 63, at 1199-200).

67. For eleven years, only Florida had followed Wyoming's lead. Fortney, *supra* note 63, at 722 n.21; Oesterle & Gazur, *supra* note 14, at 105 n.23.

68. Rev. Rul. 88-76, 1988-2 C.B. 360, 360-61.

69. Richard A. Booth, *The Limited Liability Company and the Search for a Bright Line Between Corporations and Partnerships*, 32 WAKE FOREST L. REV. 79, 161 (1997); James G. Leyden, Jr., *A Key State's Approach to LLCs: Delaware Can be Different*, BUS. LAW TODAY, May-June 2000, at 51, 53; Oesterle & Gazur, *supra* note 14, at 105; Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1, 27 (1997) (listing citations to LLC statutes of fifty states and District of Columbia).

70. OR. REV. STAT. § 63.165 (1999).

71. *Id.* § 63.130.

partners in a general partnership.<sup>72</sup> Alternatively, an LLC may provide in its articles of organization for management by or under the authority of one or more managers who need not be members,<sup>73</sup> thereby creating a structure comparable to a corporation or a limited partnership. Fiduciary duties likely apply,<sup>74</sup> but the operating agreement may eliminate or limit the liability of a member or manager to the company or its members.<sup>75</sup> Members have the same protection from liability to outsiders as shareholders in corporations.<sup>76</sup> The combination of attributes has made the LLC remarkably popular.<sup>77</sup>

The most recent major addition to the list of organizational options is the limited liability partnership, or LLP (sometimes labeled a registered limited liability partnership). The form originated in Texas<sup>78</sup> in 1991 and was designed primarily to protect attorneys and other professionals from vicarious liability for the negligence of their partners in the wake of the

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72. A member-managed LLC, like a general partnership, may designate one or more persons to be responsible for routine management, but this designation without more will not deprive the other members of apparent agency authority to bind the company to outsiders. To do that requires a provision in the articles of organization specifying management by managers. OR. REV. STAT. § 63.140(2); Culpepper, *supra* note 10, § 39A.19.

73. OR. REV. STAT. § 63.135.

74. The existence and extent of fiduciary duties within an LLC varies from state to state and is not yet fully defined. In Delaware, for example, the statute does not explicitly create fiduciary duties for LLC members or managers, but it is likely that they exist (by analogy to limited partnerships and corporations) when one person controls the entity's property for the benefit of other owners. Leyden, *supra* note 69, at 57. In Oregon, a statutory provision imposes duties of good faith and care on managers but is silent on duties of non-manager members. OR. REV. STAT. § 63.155.

75. OR. REV. STAT. § 63.160 (excluding breaches of manager's duty of loyalty, intentional misconduct, knowing violation of law, unlawful distribution, or improper personal benefit).

76. The extent of liability of LLC members to outsiders has yet to be fully litigated, but one expert's evaluation is that liability protection will be fairly uniform among the states despite differences in statutory language, and will be similar to shareholders in corporations. See Thompson, *supra* note 69, at 7. A couple of similarities are that, even under an LLC act that carefully protects members from nearly all liabilities, members (like shareholders) can be compelled to fulfill their undertakings to make contributions to the entity, and may be required to return improper distributions received from the entity. Leyden, *supra* note 69, at 57 (citing Delaware's LLC act, DEL. CODE ANN. tit. 6, § 18-101 (effective 1992)); see also CALLISON & SULLIVAN, *supra* note 24, § 8.7.

77. As one indication, in Delaware, more than 100,000 LLCs were formed between 1992 and 2000, compared to approximately 290,000 corporations organized over a dramatically longer period. Leyden, *supra* note 69, at 51.

78. TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 45-A to -C (Vernon Supp. 1995); Thompson, *supra* note 69, at 2 n.2 (citing Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065 (1995)).

collapse of many Texas financial institutions.<sup>79</sup> The form spread rapidly and was adopted by 1999 in all fifty states and the District of Columbia.<sup>80</sup>

LLPs are generally governed not by a separate statute (as is the case of each of the other types of business entity) but by the general partnership act, with a few specialized provisions regarding public filings and owners' liability for business obligations.<sup>81</sup> For that reason, and because the LLP is within the general partnership act's definition of partnership, it actually is not a separate form of entity.

Part of the appeal of the LLP was that the partnership form was well-established while the LLC innovation was not well known, and the "partner" title was far more appealing to some than the "member" designation.<sup>82</sup> Another advantage was the ease of conversion, in that existing partnerships could gain the limited liability shield without having to change their form to an LLC.<sup>83</sup> Further, the partnership form

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79. The initial bill, which covered only professionals, appeared to be a "help-a-lawyer-bill," and was heavily criticized by partnership expert Professor Alan Bromberg. See Steven A. Waters & Matthew D. Goetz, *Annual Survey of Texas Law—Partnerships*, 45 SW. L.J. 2011, 2022 (1992), cited in Fortney, *supra* note 63, at 725 n.35. Revisions removed the limitation to professionals, denied protection to partners for misconduct of those under their supervision, required disclosure of LLP status in the firm name, and required liability insurance. *Id.* For descriptions of the origins of the LLP, see ALAN R. BROMBERG & LARRY E. RIBSTEIN, *BROMBERG AND RIBSTEIN ON LIMITED LIABILITY PARTNERSHIPS AND THE REVISED UNIFORM PARTNERSHIP ACT* § 1.01(a), at 3 (2000 ed.) [hereinafter *BROMBERG LLP*] and Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065, 1065 (1995).

80. Fallany O. Stover & Susan Pace Hamill, *The LLC versus LLP Conundrum: Advice for Businesses Contemplating the Choice*, 50 ALA. L. REV. 813, 816 (1999) (providing complete list of citations to LLC statutes); see also *BROMBERG LLP*, *supra* note 79, § 1.01(e).

81. See, e.g., OR. REV. STAT. §§ 67.500–.770 (1999). Most states follow the same pattern of including LLP within the general partnership act. Exceptions exist, such as Pennsylvania, but even there LLPs are governed generally by the general partnership law. Clark, *supra* note 40, at 162 n.60.

82. Fortney, *supra* note 63, at 726 (noting that LLP owners can continue tradition of holding themselves out as partners); Keatinge, *supra* note 24, at 80 (recognizing that some entities select LLP or even convert LLC to LLP in order to label owners as "partners"); Oesterle & Gazur, *supra* note 14, at 105 (noting that, among other things, forms for partnership agreements were more available and trusted than forms for LLC operating agreements); *id.* at 113 (finding that lawyers prefer to be "partners" rather than "members" of law firms).

83. A general partnership wishing to become an LLP need only file its application for registration with the Secretary of State and amend its partnership agreement to add LLP to the name. See, e.g., OR. REV. STAT. §§ 67.590, .625. A partnership that registers as an LLP continues to be the same entity. OR. REV. STAT. § 67.050(2). There is no need to transfer assets and liabilities to a new entity as might be necessary if the entity changed to an LLC. Clark, *supra* note 40, at 164; Fortney, *supra* note 63, at 725–26.

was recognized in all states, which for a period was not true for LLCs—a matter of particular importance to nationwide accounting firms.<sup>84</sup>

When a partnership registers as an LLP, its partners gain protection from liability for obligations of the partnership, although they always remain liable for their own negligence and for the negligence of those they supervise.<sup>85</sup> Many states, including Oregon, protect against both contract and tort liabilities, while some others restrict the liability shield to contract debts.<sup>86</sup> Some statutes condition limited liability on maintenance of a specified level of insurance as a means of providing some protections for creditors.<sup>87</sup> Oregon protects LLP partners who are professionals against liabilities only above a specified dollar amount.<sup>88</sup> This limited liability has some negative consequences not always recognized by the participants but is nevertheless highly attractive.<sup>89</sup>

The characteristics of an LLP are highly similar, though not identical, to those of an LLC,<sup>90</sup> leading some to suggest that the LLC would not

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84. Keatinge, *supra* note 24, at 66, 80. This factor is cited among five others in an article on the Oregon LLP act. Jennifer J. Johnson & James M. Kennedy, *Limited Liability Partnerships*, in *ADVISING OREGON BUSINESSES* § 39B.2 (1989 & Supp. 1997).

85. OR. REV. STAT. §§ 67.105(3)(a), 58.185(3) (1999); Johnson & Kennedy, *supra* note 84, § 39B.3–9. Statutes deal with supervisory liability in various ways, sometimes explicitly, sometimes not. Fortney, *supra* note 63, at 730–32.

86. OR. REV. STAT. § 67.105(3)(a) (stating that obligation of LLP, “whether arising in contract, tort or otherwise, is solely the obligation of the partnership” rather than its partners). Some LLP statutes eliminate vicarious liability for malpractice by co-partners in professional service firms, such as accounting and law firms, while others provide a shield for both contract and tort liabilities. The trend appears to be to protect LLP partners for all liabilities. Larry E. Ribstein, *Possible Futures for Unincorporated Firms*, 64 U. CIN. L. REV. 319, 321–22 (1996). For an extensive discussion, see Thompson, *supra* note 69, at 22–24; Hamilton, *supra* note 79, at 1066–68, 1087–90 (comparing Texas’s original LLP statute with narrow protection for owners against business liabilities with Minnesota and New York statutes offering more liberal protection).

87. Fortney, *supra* note 63, at 729–30.

88. The liability provision in the LLP act, OR. REV. STAT. § 67.105(4), imposes liability on professionals to the same extent provided in the professional corporation act for shareholders who are professionals, *Id.* §§ 58.185, .187. The PC act limits joint and several liability to \$300,000 for one shareholder and \$2 million for two or more shareholders on a single claim of negligent or wrongful acts or omissions, per calendar year. *Id.* § 58.185(5). The amounts are indexed to inflation using the Consumer Price Index. *Id.* § 58.187.

89. Because partners in an LLP are liable for their own negligence and that of anyone they supervise, but not for negligence of co-partners, the incentive is for partners not to consult or oversee the work of others within the firm. Fortney, *supra* note 63, at 730–37; Vestal, *supra* note 44, at 516.

90. For a detailed comparison, see Stover & Hamill, *supra* note 80, at 821–38. Among the significant differences are that partners (including those in LLPs) have apparent authority to bind the partnership to third parties, while members in manager-managed LLCs do not, partners can dissociate at any time while members cannot, voting rights differ, and fiduciary duties differ, at

have developed had the LLP come first.<sup>91</sup> The form is especially attractive to lawyers, accountants, and other professionals. In Oregon and some other states, the LLP form is available only to professionals.<sup>92</sup>

A variation of the LLP is the limited liability limited partnership (LLLLP). An LLLLP is a limited partnership (organized under the limited partnership statute) that has registered as a limited liability partnership (under provisions of the general partnership statute).<sup>93</sup> Oregon does not authorize LLLLPs,<sup>94</sup> but some states specifically provide for them<sup>95</sup> and others impliedly allow them by including limited partnership within the definition of “partnerships” entitled to register as LLPs.<sup>96</sup>

In an LLLLP, management is centralized in the general partner as in a limited partnership. The limited partners are better shielded from liability than in a standard limited partnership in which participation in control can cause loss of limited liability.<sup>97</sup> In many ways, an LLLLP is comparable to a manager-managed LLC.<sup>98</sup>

#### D. *Current Choices and Prospects for the Future*

The new forms of business organization—LLC, LLP, and LLLLP—are in a sense artifacts of a federal income tax policy that has since been

least for non-managing participants. Ribstein, *supra* note 86, at 319–40; Stover & Hamill, *supra* note 80, at 845–46. LLCs shield owners from all types of business debts, while LLP statutes sometimes protect only from contract liabilities. Ribstein, *supra* note 86, at 321–27. Oregon’s LLC act allows perpetual existence while the LLP provisions do not. Culpepper, *supra* note 10, § 30A.11.

91. Oesterle & Gazur, *supra* note 14, at 105–06 (suggesting that “the LLC is a historical accident”); Thompson, *supra* note 69, at 5.

92. OR. REV. STAT. § 67.500(1) (stating that LLP must either render professional service or be affiliated with LLP that renders professional service); *see also* N.Y. PARTNERSHIP LAW § 121-1500(a) (McKinney Supp. 1997) (stating that LLP is available only for individuals and services providing professional services).

93. BROMBERG LLP, *supra* note 79, § 5.04, at 191. For a full discussion of the LLLLP, *see id.*, ch. 5.

94. Under Oregon’s Revised Partnership Act, “a partnership, not including a limited liability partnership, may register as a limited liability partnership.” OR. REV. STAT. § 67.500; *see also* BROMBERG LLP, *supra* note 79, at 185 n.1 (citing to uncodified Oregon law).

95. *E.g.*, PA. CONS. STAT. ANN. § 820(a) (West 1995), *cited in* BROMBERG LLP, *supra* note 79, at 185 n.1.

96. BROMBERG LLP, *supra* note 79, § 5.04, at 191.

97. *Id.* at 191.

98. *Id.* §5.01, at 186. The two forms are not identical, however. For example, the shield from liability for a limited partner in a limited partnership may be different from the shield for a general partner in an LLLLP. *Id.*

abandoned. Legislatures authorized the new forms primarily to allow closely held businesses limited liability together with pass-through tax treatment (and without the restrictions imposed on S corporations). Subsequent changes to the federal tax regulations rendered that original tax motivation moot.

“Check-the-box” regulations<sup>99</sup> effective in 1997 abandoned the traditional pattern of categorizing non-corporate<sup>100</sup> business entities as either “associations” (like corporations) or partnerships, based on the specified characteristics.<sup>101</sup> Instead, an unincorporated entity can simply elect the tax treatment it prefers.<sup>102</sup> Some differences in tax treatment continue to apply, however, and can be significant in certain circumstances.<sup>103</sup>

Nevertheless, the LLC, LLP, and LLLP forms not only continue to exist but grow in popularity. The combination of characteristics that the newer entities offer, especially limited liability and flexibility in tax treatment and management structure, have great appeal, notwithstanding the change in tax regulations. Indeed, some wonder why any well-advised, closely held business would select any of the older forms.<sup>104</sup>

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99. Treas. Reg. § 301.7701-1 to -3 (1996).

100. The definition of corporation for purposes of the check-the-box regulations includes any entity organized under a state law describing it as incorporated, a corporation, body corporate, body politic, joint-stock company, or joint-stock association. *Id.* § 301.7701-2(b)(1), (3).

101. *See supra* note 62 and accompanying text.

102. An “eligible entity” (meaning one that is not a trust or a corporation) with two or more members can elect classification as either a partnership or an association taxed as a corporation. An eligible entity with only one owner can elect classification as either a corporation or a “disregarded entity.” Treas. Reg. § 301.7701-3(a), -3(b)(1).

103. Mark J. Silverman et al., *Use of Limited Liability Companies in Corporate Transactions, TAX STRATEGIES FOR CORPORATE ACQUISITIONS, DISPOSITIONS, SPIN-OFFS, JOINT VENTURES, FINANCINGS, REORGANIZATIONS & RESTRUCTURINGS* 1998, 424 PLI/Tax 1107 (1998) (noting that some states do not recognize federal “check-the-box” election for purposes of state tax); Thompson, *supra* note 69, at 4-5 (noting that LLC members pay more self-employment taxes than S corporation shareholders, that rules for tax basis of assets are less favorable for S corporations, and that state tax laws sometimes do not recognize S status, instead taxing LLCs as corporations). *See generally* Diane C. Kerns, *Income Tax Consequences of Incorporation*, in *ADVISING OREGON BUSINESSES* ch. 10 (1989 & Supp. 1997); Charles S. Lewis III & Christopher K. Heuer, *Partnership Taxation*, in *ADVISING OREGON BUSINESSES* ch. 4 (1989 & Supp. 1997).

104. Ribstein, *supra* note 24, at 331 (“In the wake of the development of the LLC and the LLP and the ‘check the box’ rule there is a new rule of thumb for entrepreneurs who are considering whether to incorporate: Don’t.”); Vestal, *supra* note 44, at 515 (“[I]t is difficult to conceive of a reason why knowledgeable and well-represented participants would organize a firm as a general partnership or limited partnership.”).

Still more business entity forms are available in some states<sup>105</sup> or have been proposed.<sup>106</sup> Some commentators have suggested that the entity legislation be reorganized, placing elements common to all forms of business organization into a single statute, defining alternatives more clearly, and reducing unintended overlaps.<sup>107</sup> Another view is to reduce the number of choices.<sup>108</sup> These proposals, however, are not likely to gain acceptance because they would have to overcome substantial inertia<sup>109</sup> and would need a clear political constituency.

The new organizational forms clearly supplement rather than supplant the older ones. Some statutes and regulations, often written before the new entities became available, favor the more traditional forms.<sup>110</sup> Familiarity among the business community and its counsel, as well as the more fully developed body of case law and document forms, assure that the older forms will not soon disappear. The corporation remains the predominant choice for new enterprises, due to such factors as inertia, well-developed rules, and a perception that formation of a corporation is

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105. The limited partnership association, dating from an 1874 Pennsylvania statute, is available in Pennsylvania, Michigan, New Jersey, Ohio, and Colorado. Gazur & Goff, *supra* note 60, at 393; *see also* COLO. REV. STAT. ANN. §§ 7-80-101 to -1101 (West 1999). Connecticut, Delaware, Pennsylvania, and Wyoming offer a statutory business trust. Oesterle & Gazur, *supra* note 14, at 101-02, 123-24. By statute, Connecticut and Washington recognize the Massachusetts business trust. 1996 Conn. Acts. 271, §§ 219-253 (Reg. Sess.); WASH. REV. CODE §§ 23.90.030, .040, .050, .060, .900 (2000).

106. Professor Ribstein proposes a "limited liability sole proprietorship," which would allow a single owner to gain limited liability without forming a single-shareholder corporation or one of the several entities requiring two or more owners. Larry E. Ribstein, *The Loneliest Number: The Unincorporated Limited Liability Sole Proprietorship*, J. ASSET PROTECTION, May-June 1996, at 46.

107. *See, e.g.*, Clark, *supra* note 40, at 173-75; Keatinge, *supra* note 24, at 31 (proposing business entity statutes comparable to traditional ones but "revised to eliminate the differences in the rules that are accidental rather than driven by policy differences"); Oesterle & Gazur, *supra* note 14, at 141-48. One basic approach would create a single business form, which might be called Universal Contractual Organization, Universal Business Organization or Limited Liability Entity. Another approach would create a "hub and spoke" statutory structure, with provisions applicable to all types of entities in one statute, and provisions specific to each type of entity in the individual organic acts governing those entities. Keatinge, *supra* note 24, at 81; *see also* Ribstein, *supra* note 24, at 334-35 (discussing several approaches).

108. One commentator argues that the "check-the-box" regulations removed the reasons for some of the distinctions and that some could be combined. For example, limited partnership could be absorbed by limited liability company. Clark, *supra* note 40, at 173-74.

109. Clark, *supra* note 40, at 173-74.

110. Vestal, *supra* note 44, at 515 nn.124-25 (referring to some federal programs and franchise tax provisions in some states that favor limited partnership over LLP).

simpler and cheaper than formation of the alternatives.<sup>111</sup> General partnership will continue by default, especially for the many businesses organized by persons who are less sophisticated in legal matters, because it is the only form that does not require a filing or other formality.

The proliferation of entities adds considerable complexity to the choice confronting business owners and their counsel, but also provides opportunities. One important consequence is that a particular business initially organized in one form may see advantages to converting to a different form, as its circumstances and its owners' sophistication and needs develop over time. Also, the likelihood of dissimilar entities wishing to combine, particularly in a strong economy, increases as the number of entity forms increases.

### III. CONVERSION AND MERGER UNDER TRADITIONAL LAW

Statutes authorizing changes in organizational form commonly treat the issue in a haphazard and inconsistent manner, without an apparent rationale. Although merger statutes provide direct and effective means of combining businesses, they apply only to certain combinations. Conversions have rarely been authorized. Where statutes do not explicitly provide for merger or conversion, they are not permitted by common law.<sup>112</sup>

#### A. *Transactions and Problems in the Absence of Statutes*

Absence of statutory authority for changing an entity's organizational form or for combining with another entity does not mean that such transactions will not occur. Instead, it means that businesses and their

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111. Larry F. Ribstein, *The New Choice of Entity for Entrepreneurs*, 26 CAP. U. L. REV. 325, 331-33 (1997) (arguing that perception that corporations entail fewer costs and rights is illusory or focused on interests of lawyer rather than client).

112. MODEL BUS. CORP. ACT § 11.02, cmt. (1999). The United Kingdom provides an interesting illustration. In U.K. corporate law, the concept of merger does not exist. Nevertheless, corporate combinations and buyouts occur by use of more complicated techniques. One approach is for an acquiring company to first create a special-purpose vehicle—"Newco"—which borrows money and uses it to buy the stock of the target company, thereby becoming its holding company. Because the device of merger is not available to transfer the target's assets to Newco, the target guarantees the obligations of Newco, thereby providing security to the lenders. Marc R. Paul & Charles A.A. Whitefoord, *All Buyouts Are Not the Same: It Can Be Different in England*, BUS. LAW TODAY, Mar.-Apr. 2000, at 18.

counsel are required to engage in procedures that are more creative, more cumbersome, and more expensive but accomplish the same result.

For example, a partnership can become a corporation or an LLC without benefit of statutory authority. At least three procedures achieve that result:

(1) The partnership dissolves, distributing its net assets in cash or in kind to the former partners. The former partners then transfer the assets to a newly organized corporation or LLC in exchange for stock or LLC membership interests.

(2) The partnership sells its assets to a newly organized corporation or LLC in exchange for the corporation's stock or LLC's membership interests. The partnership then dissolves, distributing its only asset, the stock, to the former shareholders.

(3) The partners transfer their partnership interests to a newly organized corporation or LLC in exchange for stock or membership interests. The corporation or LLC, which has become the sole "partner," dissolves the partnership, acquiring the partnership's assets.<sup>113</sup>

In all three variations, the partnership dissolves, the assets and business continue in the hands of the corporation, and the former partners become shareholders of the corporation. A fourth approach, applicable when the jurisdiction authorizes cross-entity merger but not conversion, is for the partners to organize a corporation and then arrange for the partnership to merge into it.<sup>114</sup>

Though these processes work, they can be extremely burdensome and problematic. Under the tax code, distribution of assets to partners is a taxable event.<sup>115</sup> Under the Uniform Partnership Act, in a dissolution any partner may compel sale of the partnership property, with the proceeds used first to discharge its liabilities and then to pay in cash the amount owing to the partners.<sup>116</sup> Under the Revised Uniform Partnership Act, a partner can dissociate, compelling the remaining partners who wish to

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113. Culpepper, *supra* note 10, § 39A.65; Lubin, *supra* note 9, at 362; Lion & Chacun, *supra* note 5, at 213. The IRS lists the same three methods for incorporating a partnership. Rev. Rul. 84-111, 1984-2 C.B. 88, cited in Culpepper, *supra* note 10, § 39A.65.

114. Lubin, *supra* note 9, at 362.

115. Culpepper, *supra* note 10, § 39A.65 (citing I.R.C. § 708 (2000); Priv. Ltr. Rul. 93-21-047 (Feb. 25, 1993); Priv. Ltr. Rul. 92-26-035 (Mar. 26, 1992)).

116. OR. REV. STAT. § 68.600(1) (1999); UNIF. PARTNERSHIP ACT § 38(1) (1914).

continue the business to pay the value of the dissociated partner's interest and indemnify against all partnership liabilities, both previously and subsequently incurred.<sup>117</sup> Pragmatically, any dissenting partner can probably block a transaction intended to change the organizational form of the business by threatening to dissociate if it occurs.<sup>118</sup>

After dissolution, each partner continues to have power to bind the partnership not only for winding up<sup>119</sup> but also for any other transaction if the other party had no knowledge or notice of the dissolution and the fact of dissolution had not been published.<sup>120</sup> Thus, partners may be subjected to personal liability to third parties for post-dissolution debts.<sup>121</sup> In addition, the corporation receiving an assignment of the partnership property may also be liable for these post-dissolution debts.<sup>122</sup> If the entity continues the dissolved partnership's business and assumes its debts, then creditors of the dissolved partnership are also creditors of the person or entity continuing the business.<sup>123</sup>

The dissolution of the partnership and sale of its assets may trigger or breach terms of existing contracts, requiring accelerated payment of debts or other changes.<sup>124</sup> For example, mortgages commonly contain due-on-sale clauses requiring payment of the entire debt when the collateral is conveyed. Long-term commercial leases and franchise agreements commonly prohibit assignment without the express written consent of the landlord or franchiser.<sup>125</sup> The mortgagee, landlord, or franchiser could either prevent the transfer, or impose burdensome terms or additional payments as the price for granting consent. Finally, some

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117. OR. REV. STAT. § 67.250 (1999); REV. UNIF. PARTNERSHIP ACT § 701 (1994).

118. Ribstein, *supra* note 86, at 325.

119. "Winding up" entails completion of the entity's business, discharge of its debts, and distribution of remaining assets. OR. REV. STAT. § 67.300(3).

120. OR. REV. STAT. § 68.570(1); UNIF. PARTNERSHIP ACT § 35(1).

121. Ribstein, *supra* note 86, at 325.

122. *Id.*

123. *Id.* (citing UNIF. PARTNERSHIP ACT § 41). The equivalent Oregon provision is OREGON REVISED STATUTES section 68.630(4).

124. See Ribstein, *supra* note 86, at 326.

125. See, e.g., Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, Inc., 238 S.W.2d 321, 322-23 (Mo. 1951); Jay M. Zitter, Annotation, *Merger or Consolidation of Corporate Lessee as Breach of Clause in Lease Prohibiting, Conditioning, or Restricting Assignment or Sublease*, 39 A.L.R.4th 879, 881 (1985).

real estate titles are subject to restraints on alienation that might be triggered by a transfer.<sup>126</sup>

At a minimum, documentation will be necessary for transfer of assets, with the attendant expense and delay. Transfers of real estate require deeds and recording, may incur transfer taxes, and may trigger re-assessment of property valuation.<sup>127</sup> Title insurance that protected the original insured party will likely not cover the transferee unless the title insurer consents to the transfer or provides an endorsement to the policy, which will probably be at additional cost.<sup>128</sup> For personal property, bills of sale and assignments must be prepared. Sales or transaction taxes may apply.<sup>129</sup>

Any transaction involving a transfer of a security will trigger federal and state securities law, requiring either registration or an exemption.<sup>130</sup> Corporate stock is always a security, assuming it has the usual characteristics of stock.<sup>131</sup> Interests in a general<sup>132</sup> or limited partnership,<sup>133</sup> an

126. See RALPH E. BOYER ET AL., *THE LAW OF PROPERTY: AN INTRODUCTORY SURVEY* 144–46 (4th ed. 1991).

127. In California, for example, many counties and cities impose a documentary transfer tax when real estate is conveyed and the property assessment may be changed. See Lion & Chacon, *supra* note 5, at 172–74 (discussing when these results occur upon conversion of existing enterprise to LLC form).

128. Joyce Dickey Palomar, *Limited Liability Companies, Corporations, General Partnerships, Limited Partnerships, Joint Ventures, Trusts—Who Does the Title Insurance Cover?*, 31 REAL PROP., PROB. & TR. J. 605, 619 (1997). Title policies generally protect only the named insured and are not assignable; therefore, a transferee of real property seeking certainty that the policy will transfer should obtain consent from the title insurer or purchase a successor endorsement. *Id.* at 621. When a general partner leaves a general or a limited partnership, the result may be dissolution of the partnership and termination of the title policy, even if the remaining partners continue the business under the same name. *Id.* at 625–28. Similar problems occur if a general partnership changes its form to a limited partnership or corporation. *Id.* In an LLC, a member's withdrawal may cause dissolution and lapse of the title policy. *Id.* at 635. Problems of this nature can be avoided or minimized if a statute makes clear that property of a business entity that engages in a conversion or merger passes by operation of law.

129. Real property transfer taxes apply in some jurisdictions when a deed is recorded, though policies of cities and counties differ when the deed merely reflects a change in the owner's organizational form. Lubin, *supra* note 9, at 363.

130. For a discussion of federal and state requirements and exemptions, see Henry H. Hewitt et al., *The Private Placement of Securities*, in *ADVISING OREGON BUSINESSES* ch. 15 (1989 & Supp. 1997) and Robert J. McGaughey & James G. Harlan, *Oregon Securities Law*, in *ADVISING OREGON BUSINESSES* ch. 16 (1989 & Supp. 1997).

131. *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 851 (1975) (noting that stock is characterized by free alienability, opportunity for dividends and appreciation, and voting rights proportional to number of shares owned).

132. Because partners in general partnerships typically have managerial power, the interests do not satisfy the *Howey* test and are not securities. See, e.g., *SEC v. W.J. Howey Co.*, 328 U.S. 293,

LLC,<sup>134</sup> or an LLP are likely to be deemed “investment contracts” and hence securities<sup>135</sup> if the owner lacks meaningful control over management.<sup>136</sup> Exemptions to registration are commonly available,<sup>137</sup> but the applicability of securities law adds complexity and risk to the transaction.<sup>138</sup>

### B. *Benefits of Conversion and Merger Statutes*

Conversion and merger statutes greatly facilitate and simplify transactions to which they apply, in terms of property, transfer

301 (1946); *Williamson v. Tucker*, 645 F.2d 404, 425 (5th Cir. 1981); *Casablanca Prods. v. Pace Int'l Research*, 697 F. Supp. 1563 (D. Or. 1988). When a partner either does not have managerial power or does not have the experience and expertise to exercise formal power in a meaningful way, then the partnership interest can be a security. *Koch v. Hankins*, 928 F.2d 1471, 1477 (9th Cir. 1991).

133. *Pratt v. Kross*, 555 P.2d 765 (Or. 1976) (finding limited partnership interest to be a security); *Kennedy & Owren*, *supra* note 19, § 6.23.

134. In an LLC, a critical factor in determining whether a member's interest is a security is whether the company is member-managed or manager-managed. If it is member-managed, the member does not rely on the essential managerial efforts of others, and so likely does not own a security. If it is manager-managed, a non-manager member likely does own a security. See generally LARRY E. RIBSTEIN & ROBERT R. KEATINGE, *LIMITED LIABILITY COMPANIES* §§ 14.02-.03 (1993); *Culpepper*, *supra* note 10, § 39A.71; *Lion & Chacun*, *supra* note 5, § 5.5, at 175-76; James J. Wheaton, *Limited Liability Company Interests and the Securities Laws*, in MARTIN I. LUBANOFF & BRIAN L. SCHOOR, *FORMING AND USING LIMITED LIABILITY COMPANIES AND LIMITED LIABILITY PARTNERSHIPS* 487, 500-07 (1994).

135. 15 U.S.C. §§ 77b, 78c (1994); OR. REV. STAT. § 59.015(17) (1999).

136. No case law was found discussing whether an LLP is a security, but no reason appears why an LLP should be treated differently for this purpose than other partnerships. LLPs are not merely like partnerships but by statute actually are partnerships. Ribstein, *supra* note 86, at 320. The special feature of limited liability is not one of the factors in the “economic realities” analysis of whether a form of investment is a security. The classic economic-realities test is that a particular instrument is within the statutory phrase “investment contract” if it represents an investment of money in a common enterprise with an expectation of profits from the efforts of others. *Howey*, 328 U.S. at 298-99.

137. In the federal system, for example, there are exemptions from registration for non-public transactions, under § 4(2) of the Securities Act of 1933 (codified at 15 U.S.C. § 77d(2) (1994 & Supp. 1999)) and SEC Rule 506 (codified at 17 C.F.R. § 230.506 (1999)); for small transactions under SEC Rules 504 and 505 (codified at 17 C.F.R. §§ 230.504-.505); and intrastate transactions under § 3(a)(11) (codified at 15 U.S.C. § 77c(a)(11)), and SEC Rule 147 (codified at 17 C.F.R. § 230.147). The exemptions involve various limitations on dollar amount, number and qualifications of offerees or investors, form of solicitation, and resale.

138. For example, section 12(a)(1) of the Securities Act allows an investor to rescind a purchase of a security if the offering was neither registered nor exempt, even if no fraud was involved. 15 U.S.C. § 77(l)(a)(2). Other provisions such as section 12(a)(2) of the Securities Act and SEC Rule 10b-5 impose liability for fraud. 15 U.S.C. § 77i; 17 C.F.R. § 240.10b-5; see also *Lion & Chacun*, *supra* note 5, at 197 (discussing whether conversions or mergers constitute “sales” of securities).

restrictions, and transaction costs. Property of the converting or disappearing entity becomes property of the converted or surviving entity by operation of law, without the need for bills of sale, deeds, assignments, or other documents of conveyance.<sup>139</sup> Title insurance continues in force in favor of the converted or surviving entity.<sup>140</sup> Sales taxes and transfer taxes do not apply.<sup>141</sup> Restrictions on transfer, such as due-on-sale clauses in mortgages and non-assignment clauses in leases, are not triggered unless specifically drafted to cover mergers.<sup>142</sup>

The treatment of conversion and merger under federal income tax, a critically important consideration, is complex and outside the scope of this Article. Change in the entity's classification, from corporation (or "association") to partnership, or the reverse, can be deemed a taxable liquidation, with consequences to both the entity and the owners.<sup>143</sup> Certain other transactions are disregarded, producing no tax consequences, based on either the form or substance of the transaction.<sup>144</sup>

### C. *Limited Availability of Conversion and Merger: Oregon as an Example*

Both conversion and merger have been recognized in the statutes for many years, but restricted to certain combinations. The development of the law in this field has been arbitrary and haphazard, explained only by history, not by policy rationale. The evolution of Oregon law provides an example.

Prior to 1993, the four chapters of Oregon statutes governing corporations, cooperatives, limited partnerships, and general partnerships varied considerably in rules for conversion and merger. Corporations and cooperatives were each authorized to convert to the

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139. See *infra* Part IV.H.

140. Palomar, *supra* note 128, at 619.

141. See *infra* Part IV.H.

142. See *infra* Part IV.H.

143. See, e.g., Sheldon I. Banoff, *Conversions of Legal Entities: Should Form or Substance Control?*, 416 PLI/Tax 101, 127 (1998) (finding "a frustrating absence of consistency as to the form versus substance issue" and repeated reversals of positions by IRS); Joseph H. Newberg & Stephen A. Evans, *Entity Transfer Actions: Conversions of Existing Entities and Mergers; Dissolutions*, in A PRACTICAL GUIDE TO MASSACHUSETTS LIMITED LIABILITY COMPANIES §§ 7.1-.1.2 (1996) (stating that converting S or C corporation into LLC will trigger taxation at corporate and shareholder levels, but converting partnership into LLC is tax-free); Silverman et al., *supra* note 103; Philip B. Wright, *Disregarded Entities Issues & Opportunities*, 416 PLI/Tax 59 (1998).

144. Banoff, *supra* note 143, at 127.

other form—apparently the first example of cross-entity conversion.<sup>145</sup> Each could merge with like entities (such as a corporation with another corporation),<sup>146</sup> or could merge with the other forms (such as a corporation with a cooperative).<sup>147</sup> Professional corporations were permitted to convert to or from business corporations by filing restated articles of incorporation.<sup>148</sup>

Those combinations, however, were the only ones authorized. Corporations could not convert or merge with any type of partnership. The partnership law, based on the Uniform Partnership Act, contained no reference at all to mergers or conversions, so one partnership could not merge or convert even with another, much less a different type of entity.<sup>149</sup> The limited partnership act had corresponding rules.<sup>150</sup> The LLC act, adopted in 1993, allowed merger with another LLC, but not with any other entity.<sup>151</sup>

The RUPA proposed by the ABA in 1994 and adopted in Oregon in 1997<sup>152</sup> made a number of major doctrinal innovations, laying the groundwork for more comprehensive reform. The RUPA authorized general partnerships, for the first time, to merge with other general partnerships and with limited liability partnerships.<sup>153</sup> Further, the RUPA

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145. OR. REV. STAT. § 62.635 (1997).

146. Prior to the 1999 amendments, two or more corporations could merge, *id.* § 60.481 (1997), and two or more cooperatives could merge, *id.* § 62.610 (1997).

147. Prior to the 1999 amendments, a cooperative could merge with a corporation. *Id.* § 60.625 (1997).

148. *Id.* § 58.125 (1997); Laird, *supra* note 30, § 31.44 (describing practice of Oregon Secretary of State's Office, in absence of specific statutory provision for conversions).

149. UNIF. PARTNERSHIP LAW, OR. REV. STAT. §§ 68.010--650 (repealed 1997). Legislation in 1997 repealed the law, replaced it with a revised partnership act, and established a transition period ending January 1, 2003. 1997 Or. Laws 75, §§ 100, 84, 101 (codified at OR. REV. STAT. § 68.010 note (1999)).

150. UNIF. LTD. PARTNERSHIP ACT (ULPA), OR. REV. STAT. §§ 70.005--490. The Act was adopted in 1985. 1985 Or. Laws 677. Provisions regarding conversion and merger were not added until 1999. OR. REV. STAT. §§ 70.500--540. Neither ULPA nor RULPA provided for merging limited partnerships, either with like or unlike entities. Michael K. Pierce, *Substantive Partnership Law: Special Problems of General and Limited Partnerships*, SB 85 ALI-ABA 1, 86 (May 1, 1997).

151. 1993 Or. Laws 173, § 90. The provision was not changed until the 1999 amendments, effective in 2000. OR. REV. STAT. § 63.481 (1999).

152. OREGON REV. PARTNERSHIP ACT, 1997 Or. Laws 775, §§ 1--84 (codified at OR. REV. STAT. §§ 67.005--815 (1999)).

153. REV. UNIF. PARTNERSHIP ACT § 905 (1994); OR. REV. STAT. § 67.360 (1997) (repealed 1999).

introduced cross-entity merger to partnership law by authorizing a general or limited liability partnership to merge with a limited partnership<sup>154</sup> subject to the limitation of LLPs to professionals,<sup>155</sup> although curiously the Limited Partnership Act had no corresponding or reciprocal provision. Indeed the ULPA and RULPA did not even authorize merger of an LP into another LP.<sup>156</sup>

In another innovative provision, the RUPA allows a general or limited liability partnership to convert into a limited partnership<sup>157</sup> or the reverse.<sup>158</sup> The primary purpose of the provision was to allow existing LPs to convert to the newly available LLP form, which is more attractive in some respects.<sup>159</sup>

Finally, a general partnership, but not a limited partnership, can register as an LLP by filing a document with the state.<sup>160</sup> In the opposite direction, an LLP can cancel its registration, thereby becoming a general partnership and subjecting its partners to personal liability for

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Because an LLP is not a separate organizational form but rather a general partnership with special liability rules, this aspect by itself does not constitute cross-entity merger. The partnership act specifies that the term "partnership includes a limited liability partnership." OR. REV. STAT. § 67.005(7) (1999). Thus a partnership that registers as an LLP, or cancels its registration, never changes its status as a partnership.

154. REV. UNIF. PARTNERSHIP ACT § 905; *see also* OR. REV. STAT. § 67.360 (1997) (repealed 1999).

155. OR. REV. STAT. § 67.400(1) (1999) (providing that partnership can register as LLP if it renders professional service or is affiliated with and provides services or facilities for LLP that renders professional service). A "professional" is defined for this purpose as an accountant, architect, attorney, chiropractor, dentist, landscape architect, naturopath, nurse practitioner, psychologist, physician, podiatrist, radiology technologist, real estate appraiser, or similar professionals. *Id.* § 67.005(12).

156. Pierce, *supra* note 150, at 86. Delaware and several other states, however, provide for LPs to merge with one another. *Id.*

157. REV. UNIF. PARTNERSHIP ACT § 902; *see also* OR. REV. STAT. § 67.345 (1997) (amended 1999).

158. REV. UNIF. PARTNERSHIP ACT § 903; *see also* OR. REV. STAT. § 67.350 (1997) (amended 1999). Oregon's LP act, however, did not contain any corresponding provision, which was anomalous. The 1997 provision was replaced by more encompassing language in 1999. OR. REV. STAT. §§ 67.342, 70.505 (1999).

159. Primarily, the former LP's general partner would no longer have personal liability and the former limited partners would no longer be precluded from participating in management. OR. REV. STAT. § 70.185 (1999) (subjecting general partners to liability); § 70.135 (protecting limited partners from liability unless they participate in management).

160. REV. UNIF. PARTNERSHIP ACT § 1001; *see also* OR. REV. STAT. § 67.500 (1999). However, in Oregon, LLP status is available only to partnerships that render professional services. OR. REV. STAT. § 67.500.

subsequent business debts.<sup>161</sup> The business remains the same entity that it was before filing the registration, or before its registration ceased.<sup>162</sup>

The RUPA dealt specifically with the situation of a general partner becoming a limited partner as a result of a conversion, without the knowledge of outside parties. As to obligations incurred before the conversion, the partner remained personally liable.<sup>163</sup> As to obligations incurred within ninety days after the conversion to limited partnership, an outside party who reasonably believed that the limited partner was a general partner could impose liability.<sup>164</sup>

It is particularly noteworthy that the RUPA authorized a general partnership to merge with, convert into, or register as an entity with limited liability for owners. Those provisions opened significant opportunities for businesspeople to exit from business forms imposing personal liability. This option likely will be used most frequently by persons who enter into business, without legal sophistication or counsel, as general partners, due to failure to affirmatively seek limited-liability status, and later decide on another organizational form.

Despite the many advances included in the RUPA, limitations remained. It affected general (including LLP) partnerships and limited partnerships, but no other form of business organization. The RUPA does not authorize merger of any type of partnership with a corporation or an LLC, or conversion of any type of partnership with any non-partnership entity.

The resulting array of merger and conversion rules was inconsistent and irrational in Oregon. Several types of cross-entity mergers and conversions were possible, while others were not. This disarray is likely to remain in any state that has not comprehensively examined and revised its laws.

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161. OR. REV. STAT. § 67.595. Changes between general partnership and LLP are arguably not conversions to a different entity form, because the act treats LLP not as a separate type of entity but rather as a partnership with special characteristics, but that distinction seems more metaphysical than meaningful.

162. REV. UNIF. PARTNERSHIP ACT § 904; *see also* OR. REV. STAT. § 67.500.

163. REV. UNIF. PARTNERSHIP ACT § 902(e); *see also* OR. REV. STAT. § 67.345 (1997) (amended 1999).

164. REV. UNIF. PARTNERSHIP ACT § 902(e); *see also* OR. REV. STAT. § 67.345 (1997) (amended 1999).

D. *The Issue of Personal Liability Entities Changing to Limited Liability Entities*

A significant theoretical issue is whether an entity in which owners are subject to personal liability for business debts (general partners in general partnerships or in limited partnerships) should have the option of converting or merging into a business form protecting them from liability such as corporation, LLC, or LLP. A concern is that creditors of a partnership might be unfairly hindered or disadvantaged in pursuing their claims against the owners once it becomes, for example, a corporation. Some case law has held that partners who incorporate remain liable to creditors who do not receive notice of incorporation.<sup>165</sup> Conversely, shareholders of a corporation that converts or merges into a partnership might unfairly or unwillingly be subjected to personal liability.

Consistent with those concerns, merger of corporations with partnerships is authorized by relatively few states, including Colorado,<sup>166</sup> Maryland,<sup>167</sup> Pennsylvania,<sup>168</sup> and Texas.<sup>169</sup> Delaware is an example of a state that generally offers great flexibility in cross-entity conversion and merger<sup>170</sup> but excludes the possibility of entities such as corporations converting or merging with general partnerships.<sup>171</sup>

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165. See, e.g., *Burke Mach. Co. v. Copenhagen*, 6 P.2d 886 (Or. 1932); Annotation, *Liability of Former Partners as Such in Respect of Transactions Subsequent to Incorporation of Their Business*, 89 A.L.R. 986 (1943).

166. COLO. REV. STAT. ANN. § 7-90-203(1), (2) (West Supp. 1998) (allowing domestic entity to merge with one or more domestic or foreign entities).

167. MD. CODE ANN., CORPS. & ASS'NS § 3-102(4) (allowing Maryland corporation to merge into Maryland or foreign partnership), § 4A-211(a) (allowing Maryland general or limited partnership to convert to LLC), § 4A-701 (allowing Maryland LLC to merge with LLC, general or limited partnership, corporation, or business trust), § 9A-901(a) (allowing Maryland partnership to merge with partnership, LLC, limited partnership, corporation, or business trust), § 10-208(b) (allowing Maryland limited partnership to merge with any other entity) (1999).

168. 15 PA. CONS. STAT. ANN. § 1921 (West 1995 & Supp. 2000).

169. TEX. BUS. CORP. ACT ANN. art. 5.01A(2) (Vernon Supp. 2001); Curtis W. Huff, *New Texas Business Corporation Act Merger Provisions*, 21 ST. MARY'S L.J. 109, 140 (1989).

170. Pierce, *supra* note 150, at 86. In Delaware, limited partnerships may merge with other limited partnerships or with general partnerships, joint stock companies, corporations, and other entities if permitted by the laws governing those entities. DEL. CODE ANN. tit. 6, § 17-211 (LP act); tit. 8, § 263(a) (corporation act) (Supp. 2000).

171. A Delaware corporation may merge with a business or nonprofit corporation, joint stock association, and limited partnership. DEL. CODE ANN. tit. 8, § 251 (1974 & Supp. 2000). However, the term "joint stock association" specifically excludes partnership, making merger with a partnership unauthorized. *Id.* § 254(a); Huff, *supra* note 169, at 140 n.100.

In a broader perspective, however, conversion or merger of personal liability entities to or with limited liability entities is well established. Sole proprietorships and partnerships have long been allowed to organize corporations, for example, and to transfer their property to the new entity. Several states allow an LLC to merge with an LP, and an LP to merge with a general partnership, even though every LP includes at least one general partner with personal liability.<sup>172</sup> Of greater importance, the RUPA allows a general partnership (with personal liability) to register as an LLP (with limited liability) merely by filing a statement of qualification<sup>173</sup> and allows an LLP to abandon limited liability protection for its partners by canceling its registration.<sup>174</sup>

*E. A Situation Ripe for Reform*

The overall pattern was difficult to defend. A general partnership, whose partners are subject to personal liability, could merge or convert into an LP or LLP, which provides limited liability, but not into an LLC or corporation, which also provides limited liability. An LLP, which provides limited liability, could convert or merge into a general partnership, but an LLC or corporation could not do likewise. Even entities with limited liability could not merge into other entities with limited liability, such as an LLC with a corporation.<sup>175</sup>

The only explanation for that anomalous state of the law appeared to be that the new policy reflected in the RUPA had not yet been reflected in the other statutes. As a result, the opportunities available to newly organizing businesses to select among the recently expanded list of entity choices were not as readily available to existing businesses.

The logical course was to extend the opportunities to change business entity form to all possible combinations. Moreover, changes should be permitted for two entities, in the form of merger, or for a single entity, in the form of conversion.

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172. *E.g.*, COLO. REV. STAT. ANN. § 7-90-203(1), (2) (West Supp. 1998); DEL. CODE ANN. tit. 6, § 17-211 (Supp. 2000); MD. CODE ANN., CORPS. & ASS'NS § 4A-701.

173. REV. UNIF. PARTNERSHIP ACT § 902 (1994).

174. *Id.* § 903.

175. For example, Oregon's merger provision prior to 1999 allowed a corporation to merge only with another corporation but not with any other type of entity. OR. REV. STAT. § 60.481 (1997).

#### IV. THE TREND TOWARD CONVERSION AND MERGER OF DISPARATE ENTITIES

A number of states authorize conversions and mergers of disparate business entities, though in different forms. Since 1988, Delaware has permitted corporations to merge with partnerships,<sup>176</sup> nonprofit corporations,<sup>177</sup> joint-stock associations,<sup>178</sup> and limited partnerships.<sup>179</sup> In addition, Delaware limited partnerships can merge with multiple business entities.<sup>180</sup> Texas amended its corporation act in 1989 to broadly authorize cross-entity conversion and merger.<sup>181</sup> Colorado<sup>182</sup> and Nevada<sup>183</sup> have comprehensive approaches with modernized provisions. Other states that authorize at least some conversion and merger of disparate business entities include California,<sup>184</sup> Georgia,<sup>185</sup> Illinois,<sup>186</sup> Kansas,<sup>187</sup> Maryland,<sup>188</sup> Oklahoma,<sup>189</sup> Tennessee,<sup>190</sup> and West Virginia.<sup>191</sup>

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176. *Id.* at 43 (citing DEL. CODE ANN. tit. 8, § 263 (Supp. 2000)).

177. DEL. CODE ANN. tit. 8, § 257 (1974 & Supp. 2000).

178. *Id.* § 256.

179. *Id.* § 263.

180. Keatinge, *supra* note 24, at 76 n.193 (citing DEL. CODE ANN. tit. 6, § 17-211 (Supp. 2000), amended by 65 Del. Laws 199, § 1 (1996)); Craig B. Smith, *Limited Partnerships—Expanded Opportunities under Delaware’s 1988 Revised Uniform Limited Partnership Act*, 15 DEL. J. CORP. L. 43, 51 (1990). The same policy extended to LLCs. DEL. CODE ANN. tit. 6, § 18-209 (Supp. 2000).

181. TEX. BUS. CORP. ACT ANN. art. 1.02.A(8), (18), (20) (Vernon 1980 & Supp. 2001) (defining conversion, merger, and “other entity”); *id.* art. 5.01, 5.03, 5.06 (permitting mergers with “other entities”). For a summary of its operation, see Curtis W. Huff, *Choice of State of Incorporation—Texas Versus Delaware: Is it Now Time to Rethink Traditional Notions?*, BULL. BUS. L. SEC. ST. B. TEX., Dec. 1994, at 9, 37.

182. COLO. REV. STAT. ANN. §§ 7-90-203(1), (2) (West 1999) (allowing domestic entity to merge with one or more domestic or foreign entities). The bill resulting in this provision is discussed in Keatinge, *supra* note 1, at 43–45.

183. NEV. REV. STAT. ANN. 92A.005–.510 (Michie 1999).

184. CAL. CORP. CODE § 1112 (West 1990) (authorizing corporation merging with nonprofit corporation).

185. GA. CODE ANN. §§ 14-2-1108 to -1109 (1994) (authorizing corporation merging with joint-stock or unincorporated associations or trusts).

186. 32 ILL. COMP. STAT. ANN. 5/11-37 (West 1993) (authorizing corporation merging with nonprofit corporation).

187. KAN. STAT. ANN. §§ 17-6704 to -6708 (1995 & Supp. 1999) (authorizing corporation merging with joint-stock, non-stock, and nonprofit corporation).

188. MD. CODE ANN., CORPS. & ASS’NS § 3-102 (1999) (authorizing corporation merging with business trust, limited partnership, LLC, or partnership).

189. OKLA. STAT. ANN. tit. 18, §§ 1084–1087 (West 1999) (authorizing corporation merging with non-stock or nonprofit corporation).

In 1999, the Model Business Corporation Act was amended to authorize mergers of corporations with “other entities,” though the reform did not provide for conversions.<sup>192</sup>

Flexibility in a state’s laws in this regard is mentioned among the reasons to select a particular state as the state of incorporation or organization.<sup>193</sup> Business headquarters or operations need not be located in the state selected for organization. Moreover, the initiative taken by some states to permit conversion and merger of disparate entities tends to lead the remaining states in the same direction.

A. *Use of Foreign Law To Accomplish What Domestic Law Fails To Provide*

The differing policies among states, coupled with traditional full faith and credit principles, opens opportunities for business counsel to accomplish goals not directly authorized by the laws of the state of organization of the business entity. For example, an Oregon corporation seeking to convert to LLC form, prior to the 1999 legislative amendments, was precluded from doing so directly because Oregon statutes allowed mergers of like entities only.<sup>194</sup> However, the Oregon corporation could organize a Texas or Delaware LLC and merge into it under Texas and Delaware law allowing cross-entity mergers.<sup>195</sup> The enterprise could then operate in Oregon as a foreign LLC.<sup>196</sup>

Similarly, if an Oregon corporation wished to merge into an Oregon limited partnership, it could not do so directly prior to the 1999

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190. TENN. CODE ANN. § 48-21-101 (1988) (authorizing corporation merging with nonprofit corporation).

191. W. VA. CODE ANN. § 31-1-38 (Michie 1999) (authorizing corporation merging with stock, nonstock, or nonprofit corporation).

192. MODEL BUS. CORP. ACT §§ 11.01-.02 (1999); Comm. on Corp. Laws, *Changes in the Model Business Corporation Act—Fundamental Changes*, 54 BUS. LAW. 685 (1999).

193. A commentator in a Texas bar journal, for example, notes that both Texas and Delaware permit corporations to merge with other types of entities, including nonprofit corporations and limited partnerships, but that Texas offers a wider range of entities and clearly permits some mergers on which Delaware statutes are ambiguous. Huff, *supra* note 181, at 37.

194. OR. REV. STAT. § 60.481 (1997) (amended 1999).

195. DEL. CODE ANN. tit. 8, § 264(a) (1974 & Supp. 2000) (authorizing merger of domestic corporation with foreign or domestic LLC); TEX. BUS. CORP. ACT art. 5.01, .03, .06 (Vernon 2001) (authorizing mergers of corporations with “other entities”).

196. A foreign LLC (meaning one organized under the laws of another state, regardless of where the company actually is located or does business) need merely pay a fee and obtain a certificate of authorization from the Oregon Secretary of State. OR. REV. STAT. § 62.027 (1999).

amendments, but could nevertheless accomplish its objective. First, the Oregon corporation could organize and merge into a Texas corporation, and the Oregon LLC could similarly organize and merge into a Texas LLC. The two Texas entities could then merge under Texas law,<sup>197</sup> and the business could continue to operate in Oregon as a foreign entity. Accordingly, a state's failure or refusal to explicitly authorize cross-entity mergers does not prevent those transactions. The state merely subjects its businesses to unnecessary complexity and expense for no apparent benefit.

When a state does decide to modify its statutes, at least two drafting approaches are available. One is the "junction box" model, with cross-entity provisions in a single statute. Another is the self-contained approach, repeating the cross-entity provisions in each of the statutory chapters governing one of the business-entity forms.

### B. *The "Junction Box" Model*

One legislative drafting model, which has been characterized as a "junction box,"<sup>198</sup> is used in Colorado<sup>199</sup> and Nevada.<sup>200</sup> In this model, provisions governing mergers of dissimilar forms are located in a statute separate from the organic statute such as the corporation act and the partnership act. The approach is said to assure consistency and require fewer provisions than if cross-entity provisions were inserted into each organic statute.<sup>201</sup>

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197. Pierce, *supra* note 150, at 85.

198. H. Gregory Austin, *An Introduction to the Colorado Uniform Partnership Act (1997)*, 27 COLO. LAW. 5, 12 (1998); Keatinge, *supra* note 1, at 44. The junction box statute is formally known as the Colorado Corporations and Associations Act, enacted in 1997. Austin, *supra*, at 12-14. Its provisions for inter-entity merger and conversion overlap with provisions of Colorado's Uniform Partnership Act authorizing merger and conversion of partnerships with other general or limited partnerships. Without reason, differences exist in the procedures for conversion and mergers in the junction box statute as compared to the partnership act. *Id.* at 12-13.

199. COLO. REV. STAT. ANN. §§ 7-90-201 to -206 (West Supp. 2000).

200. NEV. REV. STAT. ANN. 92A.005-510 (Michie 1999). The statute allows merger of any "entities," defined to include corporations, nonprofit corporations, LLC, limited partnerships, and business trusts. *Id.* 92A.045.

201. One author calculated that provisions to allow each of six types of entity to merge or convert into each of the other five types would result in twenty possible transactions per statute, or 120 provisions total. Keatinge, *supra* note 24, at 76 n.194. In fact, however, that unreasonable result can readily be avoided by the expedient of amending each of the six organic statutes to authorize conversion or merger of the form of entity it governs into any "business entity," defined to include all six forms. Procedures and rights applicable to each form are specified in its own

In the Colorado statutes, general provisions applying to all types of business entities permit any domestic or foreign entity to convert to any other or to merge with any other.<sup>202</sup> The terms “domestic entity” and “foreign entity” are defined to include corporation, general partnership (which includes LLP), cooperative, LLC, LP, limited partnership association, nonprofit association, and non-profit corporation.<sup>203</sup> The entity resulting from a conversion or merger is for all purposes the same entity as the previous entity or entities. The statute describes the procedures and the effect on property, liability, and governing documents.<sup>204</sup>

Following those provisions, however, is another that provides that any conversion or merger is subject to the rules of any organic statute or the common law that prohibit or restrict the transaction, grant dissenters rights, or impose other requirements.<sup>205</sup> Hence, any business converting to a different form, and any business merging with a business of unlike form, must refer to three statutes. For a conversion, the entity will refer to the statute applicable to the entity before the transaction, the separate statute allowing conversion, and the statute applicable to the converted entity. For a cross-entity merger, the statutes are the ones applying to each of the entities, plus the one permitting merger of unlike entities.

### C. *The Self-Contained Model*

A more direct approach to drafting statutes authorizing conversion and merger of disparate business entities is used in states such as Maryland<sup>206</sup> and now Oregon.<sup>207</sup> Similarly, 1999 amendments to the

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organic statute, but in a manner that is coordinated with the others and uniform wherever possible. See the Appendix of this Article for a chart illustrating that approach in Oregon’s laws.

202. COLO. REV. STAT. ANN. §§ 7-90-201 to -206 (West Supp. 2000). The provision is located in title 7 of the Colorado Revised Statutes, Corporations and Associations, which encompasses the nonprofit corporation, cooperative, partnership (including general, limited, and limited liability partnership), LLC, and corporation forms of business organization. The provision was labeled and positioned in the code in a manner making it difficult to find. The merger provision is in a category located between LLCs and corporations labeled merely “Corporations and Associations” (the same label as the entire Title).

203. *Id.* § 7-90-102.

204. *Id.*

205. *Id.* § 7-90-206.

206. MD. CODE ANN., CORPS. & ASS’NS § 3-102 (1990).

207. OR. REV. STAT. §§ 60.470–487 (corporation), 60.605–623 (cooperative), 63.467–497 (LLC), 67.340–365 (partnership), 70.500–540 (limited partnership) (1999).

Model Business Corporation Act authorizing cross-entity merger but not conversion use the self-contained drafting approach.<sup>208</sup> Each organic statute contains all of the provisions needed to convert or merge that type of entity, and is the only one that need be consulted if the transaction involves another entity of the same type.<sup>209</sup> For cross-entity conversions or mergers, the statute governing each type of entity applies. For example, the partnership act specifies that when a partnership and corporation intend to merge, the corporation must follow the procedures specified by the corporation act.<sup>210</sup>

As compared to Colorado's "junction box" approach, this drafting technique entails somewhat more repetition and length, but produces a result easier for business executives and their counsel to utilize. Those seeking to convert an entity to a different form need consult only the chapters applicable to the entity before conversion and the chapter applicable after conversion, and not a third chapter for the transaction itself, as in Colorado. Similarly, an entity merging with an entity of unlike form need consult only the statutory chapters for the two entity forms, and not a third chapter for the transaction. The risk of inconsistency is avoided by consciously making the provisions identical except as necessary to reflect the distinctive characteristics of a particular form of organization.

## V. OREGON'S BUSINESS ENTITY CONVERSION AND MERGER LEGISLATION

### A. *Legislative History*

In Oregon, efforts to reform and expand statutory authorization for conversion and merger of different business entities resulted in formation of a Task Force on Multi-Entity Mergers of the state bar's

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208. The Model Act, as revised in 1999, allows a merger of a corporation with a corporation or "other entity," defined as "any association or legal entity, other than a domestic or foreign corporation, organized to conduct business, including, without limitation, limited partnerships, general partnerships, limited liability partnerships, limited liability companies, joint ventures, joint stock companies, and business trusts." MODEL BUS. CORP. ACT §§ 11.01(d), .02(a). (1999).

209. MD. CODE ANN., BUS. REG. §§ 3-102 (allowing corporation to merge with multiple other types of entities), 4A-701 (allowing merger with LLC), 10-208 (LP), 10-208(f) (general partnership) (1999).

210. *Id.* § 9-903(2)(iii); OR. REV. STAT. § 60.481.

Business Law Section in 1997<sup>211</sup> and 1998.<sup>212</sup> The task force included a law professor, representatives of the Corporation Division of the Secretary of State's office and the title industry, and lawyers from around the state who advise businesses ranging from small, closely held enterprises to large, publicly traded corporations.

In 1998, the task force developed a proposal that received the approval of the business law section and the state bar. It was submitted to the 70th Oregon Legislative Assembly in its 1999 Regular Session, where it became Senate Bill 145.<sup>213</sup> Hearings were held before the Senate Judiciary Committee and the House Committee on Business and Consumer Affairs. The task force chair Douglass Schmor, and its principal drafter, the author of this Article, testified. Questions and commentary from the legislators were minimal, the only amendment was a technical correction requested by the task force,<sup>214</sup> and enactment was not controversial.

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211. The first committee, chaired by Eva Kripilani, studied the issue and prepared a table comparing the laws of many states.

212. The second committee was chaired by Douglass Schmor of Brophy, Mills, Schmor, Gerking & Brophy. Robert Art, law professor at Willamette University and author of this Article, served as principal drafter for the committee. Other members were Ernest Bootsma of Dunn, Carney, Allen, Higgins & Tongue, David C. Culpepper of Miller Nash Wiener Hager & Carlsen, Jacob A. Heth of Hagen, Dye, Hirschy, & DiLorenzo, Margaret Kushner of Stoel Rives, and Jennifer Holt Mair of Louisiana Pacific Corporation. Representing the state agency that would be responsible for conversion and merger filings were Jan Sullivan, director of the Secretary of State Corporation Division, and Tom Wrosch of the Corporation Division. The task force consulted David R. Aldrich of Transnation Title Insurance Company on property transfer issues. Peter J. Bragdon of Stoel Rives was the business law section's legislative committee chair. Susan Grabe of the Oregon State Bar was liaison to the state bar.

213. Senate Bill 145 was printed at the request of the Senate Interim Judiciary Committee.

214. The amendment was a change to a single line, repeated in each of the five chapters of the Oregon Revised Statutes, to eliminate a possible unintended inference from the original formulation that obligations of an entity could be imposed on business owners as a result of a merger. The corrected formulation is: "(c) All obligations of each of the business entities that were parties to the merger, including, without limitation, contractual, tort, statutory and administrative obligations, are obligations of the surviving business entity . . ." House Amendments to Senate Bill 145 by Committee on Business and Consumer Affairs; 1999 Or. Laws 362 §§ 14(1)(c) (corporation), 27(1)(c) (cooperative), 39(1)(c) (LLC), 49(1)(c) (partnership), 64(1)(c) (LP). House Amendments by the Committee on Business and Consumer Affairs changed the earlier phraseology, which was: "(c) All obligations of each of the business entities or its owners, including, without limitation, contractual, tort, statutory and administrative obligations, are obligations of the surviving business entity," or other phraseology that was similar but by error not identical. SB 145 §§ 14(1)(c) (corporation), 27(1)(c) (cooperative), 39(1)(c) (LLC), 49(1)(c) (partnership), 64(1)(c) (LP). A second amendment on an unrelated matter was inserted because filing deadlines made it difficult to introduce that issue as a separate bill. 1999 Or. Laws 362, amending OR. REV. STAT. §§ 732.521, .538 (regarding health care service contractors).

### B. *The Central Premise: Continuity of Entity Existence*

The existence of a business throughout a conversion or merger is vital for such purposes as title to property, contract rights, and claims of creditors. For example, if a limited partnership converts or merges into a LLP, it does not dissolve and then reorganize but rather continues on in the new LLP form. This distinction, which might appear metaphysical, has major substantive consequences.

Such clarity has long been present as to mergers of corporations. For example, when a corporation that owns real estate subject to a mortgage to a lender and protected by a title insurance policy merges with another corporation, the real estate transfers by operation of law.<sup>215</sup> No deed is required.<sup>216</sup> The succession in ownership does not trigger a due-on-sale clause in the mortgage or transfer taxes unless the contractual clause or tax legislation specifically applies to mergers, because a merger is not deemed to be a transfer of assets.<sup>217</sup> The title policy that covered the first corporation now covers the surviving corporation.<sup>218</sup> Statutes allowing conversion of general partnerships to LLPs, or limited partnerships to or from other partnership forms, have been similarly clear that the business remains the same entity.<sup>219</sup>

The same certainty is now provided for conversion or merger of any business entity to or with any other business entity. For conversions, the principle that the business entity remains the same one despite the

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215. See, e.g., FRANKLIN A. GEVURTZ, CORPORATION LAW § 7.2(b) (2000) (“[T]he surviving corporation in a merger . . . succeeds by operation of law to all of the assets and liabilities of the disappearing corporations . . .”).

216. See, e.g., MODEL BUS. CORP. ACT § 11.07(a) (1999). (“[A]ll property owned by, and every contract right possessed by, each corporation or other entity that merges into the survivor is vested in the survivor . . .”). The Official Comment to section 11.07 further specifies that “the survivor automatically becomes the owner of all real and personal property.” MODEL BUS. CORP. ACT § 11.07 cmt.

217. The Official Comment to the Model Business Corporations Act emphasizes that “[a] merger is not a conveyance, transfer, or assignment,” and the vesting of property in the surviving corporation “does not give rise to a claim that a contract with a party to the merger is no longer in effect on the ground of nonassignability, unless the contract specifically provides that it does not survive a merger.” MODEL BUS. CORP. ACT § 11.07, cmt.

218. Palomar, *supra* note 128, at 619 (citing American Land Title Ass’n Owner’s Policy, Conditions & Stipulations para. 1(a) (Oct. 17, 1992)).

219. REV. UNIF. PARTNERSHIP ACT § 904 (1994).

change in organizational form is stated unequivocally.<sup>220</sup> For mergers, the corresponding phraseology is that the “separate existence” of every business entity other than the survivor ceases,<sup>221</sup> indicating that existence continued throughout the merger and that only separateness ceased.

### C. *Principles and Goals*

The legislation provides opportunities to all types of business, without favoring one size or organizational form over another. Moreover, it carefully protects the interests of business owners, creditors, and others dealing with businesses. Key policy decisions, reflected throughout the legislation and explained in greater depth later in this Article, include the following:

(1) *Utilization of existing procedures and rules applicable to each type of entity.*<sup>222</sup> Wherever possible, the conversion and merger provisions coordinate with the procedures, rules, and rights applicable to the business entity prior to the legislation. Provisions previously applicable to mergers between like entities also apply to newly authorized mergers between unlike entities and to conversions. If mergers were not previously authorized at all, procedures and rights were written to be consistent with those applicable to other organic decisions such as dissolution.

(2) *Protection of owners' rights.*<sup>223</sup> Conversions and mergers, like other organic changes, are critically important to owners of the enterprise, changing their ownership, control relationships, and exposure to liability. Moreover, such changes could provide an occasion for freeze-out or other serious detriment to certain owners. The law addressing these issues should be consistent with the law and agreements applicable before the transaction, which will vary among the different types of entities.

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220. The “effects of conversion” provision in each statute clearly states the continuity principal. OR. REV. STAT. §§ 60.478(1)(a) (corporation), 62.613(1)(a) (cooperative), 63.479(1)(a) (LLC), 67.348(1)(a) (partnership), 70.520(1)(a) (LP) (1999).

221. The “effects of merger” provision in each statute has the same continuity language. *Id.* §§ 60.497(1)(a) (corporation), 62.623(1)(a) (cooperative), 63.497(1)(a) (LLC), 67.365(1)(a) (partnership), 70.540(1)(a) (LP).

222. See *infra* Part V.E.

223. See *infra* Part V.G.

(3) *Coordination among business entity statutes.*<sup>224</sup> The procedures (including requirements for filing with the state) and rights of owners and creditors are identical among the statutory chapters governing each of the various entities, except as necessary to accommodate the distinctive characteristics of some of the entities. Business owners, counsel, and others should not be faced with inconsistent or incompatible provisions in different chapters.

(4) *Preservation of rights of creditors and litigants.*<sup>225</sup> Scrupulous protection of the rights of creditors of the business and litigants is critical, lest conversion and merger be used as a means of defrauding or disadvantaging innocent parties. Rights and claims arising before a conversion or merger, by or against the business or its owners, are not to be changed by the transaction. Rights and claims arising after a conversion or merger are determined according to the law applicable to the converted or surviving entity. Special treatment is accorded, however, to creditors who deal with an entity in which the owners have personal liability (almost always general partners), and then continue to deal with it after a conversion to a limited liability form.

(5) *Efficient filings and effective tracking.*<sup>226</sup> A public record is maintained of every conversion and merger so that, among other reasons, creditors of businesses can track the disposition and location of assets and obligees. The procedure is as efficient and direct as possible, requiring only a single filing to report the exit of a business from one form of entity and the entrance to a new form.

(6) *Coordination with foreign jurisdictions.*<sup>227</sup> The flexibility and advantages that Oregon law provides to domestic business entities extend to entities organized under the laws of other jurisdictions, including states of the United States and foreign countries, to the extent permitted by the law of the foreign jurisdictions.

The rules and processes designed to accomplish those policies are uncomplicated, direct, and consistent. The merger provision in the

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224. See *infra* Parts V.F., V.I.

225. See *infra* Part V.F.

226. See *infra* Part V.I.

227. OR. REV. STAT. §§ 60.472, 60.481, 62.607, 62.617, 63.470, 63.481, 67.342, 67.360, 70.505, 70.525 (1999).

Oregon Business Corporation Act,<sup>228</sup> which had considerable history of interpretation, was used as the model for not only the new section on corporate conversions but also the new conversion and merger provisions in the statutes governing the other entities.<sup>229</sup> The provisions are coordinated and parallel among the several chapters to eliminate the danger of incompatible rules. Nevertheless, including conversion and merger provisions in each chapter allowed the opportunity to tailor them as necessary to address the distinctive characteristics of each type of entity. Prior provisions allowing certain specified combinations or conversions were repealed and replaced by provisions that more broadly authorize any cross-entity conversion or merger.<sup>230</sup>

#### *D. Types of Business Entities Included*

Cross-entity conversion and merger are allowed for any “business entity.” That key term is defined to include corporation, professional corporation, cooperative, partnership, limited partnership, and limited liability company.<sup>231</sup> The definition is repeated verbatim in all of the organic acts to preclude any inconsistencies.

Both general and limited liability partnerships can convert or merge. However, for a transition period ending in 2003, general partnerships are eligible for this treatment only if they are governed by the most recent partnership act (based on the RUPA).<sup>232</sup> The reason is that the 1999

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228. OR. REV. STAT. § 60.497 (1997) (amended 1999).

229. OR. REV. STAT. §§ 60.472, 60.481, 62.607, 62.617, 63.470, 63.481, 67.342, 67.360, 70.505, 70.525 (1999).

230. For example, the old partnership act allowed conversion of a partnership to a limited partnership, and the reverse. OR. REV. STAT. §§ 67.345–350 (1997) (repealed in 1999). Those provisions were repealed in 1999, SB 145 § 65 (Feb. 25, 1999), and replaced by provisions allowing those or any other type of conversion. OR. REV. STAT. §§ 67.342 (partnership), 70.505 (limited partnership) (1999).

231. OR. REV. STAT. §§ 60.470(1) (corporation), 62.605(1) (cooperative), 63.467(1) (LLC), 67.340(1) (partnership), 70.500(1) (LP) (1999).

232. The definition of “business entity” for the conversion and merger provisions includes “[a] partnership organized in Oregon after January 1, 1998, or that is registered as a limited liability partnership, or that has elected to be governed by [OR. REV. STAT. ch. 67], and a partnership governed by law of another jurisdiction that expressly provides for conversions and mergers . . . .” OR. REV. STAT. §§ 60.470(1)(e) (corporation), 62.605(1)(e) (cooperative), 63.467(1)(e) (LLC), 67.340(1)(e) (partnership), 70.500(1)(e) (LP) (1999). Hence, a partnership governed by the older OREGON REVISED STATUTES chapter 68 (based on UPA) is not a “business entity” eligible to convert or merge under the new provisions. Starting January 1, 2003, all partnerships will be governed by the new act. 1997 Or. Laws 775, § 84 (codified at OR. REV. STAT. § 67.005 note, § 68.010 note (1999)).

legislation utilizes internal governance procedures specified in the new partnership act,<sup>233</sup> for approving conversions and mergers.<sup>234</sup> Such procedures are absent from the earlier partnership act,<sup>235</sup> which was silent on conversions and mergers. There seemed to be no benefit in amending the old act that was already scheduled to be repealed in 2003. A partnership currently governed by the older act can easily amend its partnership agreement or register as an LLP to take advantage of the new legislation.<sup>236</sup>

Foreign partnerships can take advantage of the proposed legislation if they are governed by a statute similar to the RUPA or any other statute that authorizes conversions and mergers.<sup>237</sup> For professional corporations, matters of internal governance and organization are determined by the business corporation act. As a result, the 1999 amendment was limited to a simple cross-reference.<sup>238</sup>

The list of business forms permitted to convert or merge does not include certain additional entities such as real estate investment trusts, although some states do extend the list to those forms.<sup>239</sup> The 1999

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233. OR. REV. STAT. §§ 67.005–.815 (based on RUPA).

234. *Id.* §§ 67.344 (action on plan of conversion), 67.361 (action on plan of merger).

235. *Id.* §§ 68.010–.650 (based on UPA).

236. 1997 Or. Laws 775, § 84(2)(b) (codified at OR. REV. STAT. § 67.005 note, § 68.010 note).

237. OR. REV. STAT. § 67.340(1)(e).

238. *Id.* § 58.045.

239. The Texas Business Corporation Act, for example, is exceptionally liberal in authorizing conversion or merger with a long list of unlike entities, extending to

any entity, whether organized for profit or not, that is a corporation . . . , limited or general partnership, limited liability company, real estate investment trust, joint venture, joint stock company, cooperative, association, bank, trust, insurance company or other legal entity organized pursuant to the laws of this state or any other state or country.

TEX. BUS. CORP. ACT ANN. art. 1.02.A(20) (Vernon Supp. 2001). Delaware authorizes conversion among “a corporation, business trust or association, real estate investment trust, common law trust, or any other unincorporated business, including a partnership (whether general . . . or limited . . . ), and a foreign limited liability company . . . .” DEL. CODE ANN. tit. 6 § 18-209(a) (1974 & Supp. 2000), § 18-209(b) (domestic limited liability company), §§ 18-214(a)–(b) (merger among same entities). The Colorado Corporations and Associations Act authorizes conversion and merger among nine forms: corporations, nonprofit corporations, general partnerships, limited partnerships, LLPs, LLCs, limited partnership associations, cooperatives, and nonprofit associations. COLO. REV. STAT. ANN. § 7-90 (West 1999). The Model Business Corporation Act, as revised in 1999, allows a merger (but not conversion) of a corporation with an “other entity,” which is defined as “any association or legal entity, other than a domestic or foreign corporation, organized to conduct business, including, without limitation, limited partnerships, general partnerships, limited liability partnerships, limited liability companies, joint ventures, joint stock companies, and business trusts.” MODEL BUS. CORP. ACT §§ 11.01(d), .02(a) (1999).

amendment makes no change to existing law on merger of nonprofit corporations,<sup>240</sup> which are allowed to merge with business corporations under certain circumstances.<sup>241</sup> Nothing prevents a nonprofit that wishes to merge with another entity, such as an LLC, from doing so in a two-step process: first the nonprofit corporation merges into a business corporation, and then the business corporation merges into an LLC.<sup>242</sup>

Both domestic and foreign entities can use the provisions, provided that the statutes governing all affected entities permit the transaction. For conversion, the statutes governing the entity before and after the transaction must permit it.<sup>243</sup> For merger, statutes governing all parties must permit it.<sup>244</sup> The policy of respecting the authority of other states and countries to determine whether the business entities organized under their laws can convert or merge is consistent with prior Oregon law.<sup>245</sup>

For Oregon corporations, cooperatives, limited liability companies, partnerships, and limited partnerships, this limitation will present no

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240. The task force considered whether the 1999 amendments should be extended to cover nonprofits, and decided against it. Nonprofit organizations raise issues not involved with the other types of entities, including property tax exemptions, bingo for charitable organizations, protecting the charitable nature of its assets, and monitoring by the Oregon Department of Justice. The issue was deemed best left for another day, and the term selected to encompass the entities eligible for conversion or merger was "business entity."

241. Nonprofit corporations may merge with other nonprofit or business corporations, OR. REV. STAT. § 65.481 (1999), but special rules apply to public-benefit or religious corporations. Unless they obtain the prior consent of the Attorney General or approval of a circuit court, they can merge only with a similar corporation, or with a business corporation provided that the fair market value of the public-benefit or religious corporation's assets are transferred to a similar corporation, and that no member receives an improper benefit. *Id.* § 65.484. If a business corporation is a party, it must comply with the provisions of the Business Corporation Act. *Id.* § 65.504. The Nonprofit Corporation Act makes no mention of conversion and no mention of merger with entities other than corporations.

The special provisions for public-benefit and religious corporations respond to the danger of diversion of charitable resources to non-charitable uses. A comparable approach in Colorado allows conversions or mergers of a nonprofit corporation with a business corporation only if the same result could be achieved without using the conversion or merger statute. For example, a nonprofit corporation can merge with a business only if it transfers the value of its assets to another nonprofit. Austin, *supra* note 198, at 12 (citing COLO. REV. STAT. § 7-90-206(2) (1998)).

242. The first step is permitted by OREGON REVISED STATUTES sections 65.481 and 60.481, and the second step is permitted by sections 60.481 and 63.481. Similar transactions are described *supra* note 10 and accompanying text.

243. OR. REV. STAT. §§ 60.472(1) (corporation), 62.607(1) (cooperative), 63.470 (LLC), 67.342 (partnership), 70.505 (limited partnership) (1999).

244. *Id.* §§ 60.481(1) (corporation), 62.617(1) (cooperative), 63.481 (LLC), 67.360 (partnership), 70.525 (limited partnership).

245. See, e.g., OR. REV. STAT. § 63.501 (1997) (amended 1999) (authorizing merger of Oregon LLC and foreign LLC only if law of foreign jurisdiction allows).

problem; authorization is explicit and uniform.<sup>246</sup> For entities organized in other states and countries, it will be necessary to investigate the law of the applicable jurisdiction, which will vary. Oregon does not assert power to affect the existence or form of an entity governed by law of a different jurisdiction without that jurisdiction's concurrence.

Oregon entities also are authorized to convert or merge into entities governed by the law of other jurisdictions, if permitted by that law. For example, an Oregon limited partnership could convert into a Texas corporation using Texas law.<sup>247</sup> Although certain provisions expressly allowing mergers based on law other than Oregon's were repealed,<sup>248</sup> that was not intended to and did not negate the possibility.<sup>249</sup>

### *E. Procedures for Approving the Transaction*

A plan of conversion or plan of merger must be prepared before any transaction, stating the key elements and consequences.<sup>250</sup> Such plans identify the names and types of entities before and after the transaction, and the means of converting ownership rights to some other form of property.<sup>251</sup> Plans supply whatever information is required to be in the organizational document of the surviving or converted entity. For example, a partnership converting to a corporation would include in its plan of conversion all the information required in articles of incorporation. Similarly, a corporation merging into an LLC would

246. OR. REV. STAT. §§ 60.472 (corporation conversion), 60.481 (corporation merger), 62.607 (cooperative conversion), 62.617 (cooperative merger), 63.470 (LLC conversion), 63.481 (LLC conversion), 67.342 (partnership conversion), 67.360 (partnership merger), 70.505 (LP conversion), 70.525 (LP merger) (1999).

247. TEX. BUS. CORP. ACT ANN. art. 5.17.B (Vernon Supp. 2001) (allowing any foreign entity to convert to Texas corporation if conversion is permitted by or not inconsistent with laws of state or country under which it is organized).

248. *E.g.*, OR. REV. STAT. § 67.370 (1997) (repealed 1999) (specifying that Oregon statute on merger is not exclusive, and that partnership or LP can convert or merge "in any other manner provided by law").

249. The definition of each "business entity" includes an entity organized under Oregon statutes or "comparable law of another jurisdiction." OR. REV. STAT. §§ 60.470(1) (corporation), 62.605(1) (cooperative), 63.467(1) (LLC), 67.340(1) (partnership), 70.500(1) (LP) (1999). Hence a foreign business entity can convert to or merge with a domestic one.

250. OR. REV. STAT. §§ 60.472 (corporation conversion), 60.481 (corporation merger), 62.607 (cooperative conversion), 62.617 (cooperative merger), 63.470 (LLC conversion), 63.481 (LLC conversion), 67.342 (partnership conversion), 67.360 (partnership merger), 70.505 (LP conversion), 70.525 (LP merger) (1999).

251. *Id.* Owners of the pre-transaction entity will most often receive equity interests in the surviving or converted entity, but could also receive debt or other property.

include in its plan of merger any new or amended provision necessary in the articles of formation.

The procedures for approving a plan are specified in the statute and organizational document governing each business entity prior to the transaction.<sup>252</sup> When an LLC merges with a corporation, for example, the members and managers of the LLC vote as provided in the LLC act and operating agreement, while the shareholders and directors of the corporation vote as provided in the corporation act and articles of incorporation. For a partnership, procedures were modeled on previous procedures for LLP action on plan of mergers.<sup>253</sup>

However, private agreements may supercede or modify the statutory norms, and in many cases negotiated clauses will be advisable. In a limited partnership, for example, the statutory rule is that conversion or merger must be approved by all the partners, unless the certificate of limited partnership provides for a lesser vote.<sup>254</sup> Such a unanimity requirement provides a veto and hence the possibility of inordinate bargaining power to a dissident owner.<sup>255</sup> A well-counseled limited partnership might well establish a lesser voting requirement in its limited partnership agreement, superceding the statutory default rule.

The procedures that previously existed in the LLC act for approving mergers<sup>256</sup> were extended to conversions of LLCs and served as a model for the corresponding provisions for the other entities. When statutes were silent as to mergers, the procedures applicable to organic changes, such as amending the organic document, served as a model for approving conversion and mergers. For example, the Limited Partnership Act had not previously allowed mergers, so its provisions for amending the certificate of limited partnership were used instead.

After the plan is approved, the business files articles of conversion or articles of merger with the Corporation Division of the Secretary of

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252. One aspect of the Oregon statutory revisions was to move a couple provisions from one business entity chapter of the statutes to another. OREGON REVISED STATUTES sections 67.345 and 67.360 (1997), relating to conversion of partnership to or from limited partnership, were moved to section 70.505 (1999) on limited partnerships.

253. OR. REV. STAT. § 63.487 (1997) (amended 1999).

254. OR. REV. STAT. §§ 70.510 (conversion), 70.530 (merger) (1999).

255. In corporation law, for example, the requirement has been a simple majority of all shares entitled to vote, by voting group, unless the articles of incorporation provide otherwise. *Id.* § 60.487(5), (6).

256. OR. REV. STAT. § 63.481 (1997) (modified 1999).

State.<sup>257</sup> That single document, accompanied by a copy of the plan, is all that is necessary. This aspect of the procedure was modeled on previous provisions in the Corporation Act<sup>258</sup> and the LLC Act.<sup>259</sup>

### *F. Creditors' Rights and Owners' Liabilities*

Neither conversion nor merger allows an escape from debts or other forms of obligation to outside parties, such as those under building codes, labor law, environmental regulation, or other statutory, administrative, and regulatory regimes.<sup>260</sup> Moreover, neither conversion nor merger causes a dissolution or other event requiring a winding up. Obligations incurred prior to the conversion or merger are treated differently from obligations incurred following the transaction.

#### *1. Obligations Incurred Prior to Conversion or Merger*

Because a business entity continues in existence without interruption by a conversion or merger, the post-transaction entity is liable for all obligations incurred by the entity in its earlier form.<sup>261</sup> Owners of the entity who were previously liable for business debts remain liable for those pre-transaction debts, whether or not they are owners after the transaction.<sup>262</sup> Thus, for example, general partners (in either a general partnership or a limited partnership) cannot evade their joint and several

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257. OR. REV. STAT. §§ 60.476(1) (corporate conversion), 60.494(1) (corporate merger), 62.611(1) (cooperative conversion), 62.621(1) (cooperative merger), 63.476(1) (LLC conversion), 63.494(1) (LLC merger), 67.346(1) (partnership conversion), 67.364(1) (partnership merger), 70.515(1) (LP conversion), 70.535(1) (LP merger) (1999).

258. OR. REV. STAT. § 60.494 (1997) (modified 1999) (addressing corporate articles of merger or share exchange).

259. OR. REV. STAT. § 63.481 (1997) (modified 1999) (addressing LLC articles of merger).

260. Among the regulatory authorities consulted by the task force drafting Oregon's cross-entity conversion and merger provisions were the State Department of Revenue, Department of Labor, and Workers' Compensation Division.

261. For conversions, the relevant provisions are OREGON REVISED STATUTES sections 60.478(1)(c) (corporation), 62.613(1)(c) (cooperative), 63.479(1)(c) (LLC), 67.348(1)(c) (partnership), and 70.520(1)(c) (limited partnership) (1999). For mergers, the provisions are sections 60.497(1)(c) (corporation), 62.623(1)(c) (cooperative), 63.497(1)(c) (LLC), 67.365(1)(c) (partnership), and 70.540(1)(c) (limited partnership).

262. For conversions, the relevant provisions are OREGON REVISED STATUTES sections 60.478(1)(f)(A) (corporation), 62.613(1)(f)(A) (cooperative), 63.479(1)(f)(A) (LLC), 67.348(1)(f)(A) (partnership), and 70.520(1)(f)(A) (limited partnership). For mergers, the provisions are sections 60.497(1)(g)(A) (corporation), 62.623(1)(g)(A) (cooperative), 63.497(1)(g)(A) (LLC), 67.365(1)(g)(A) (partnership), and 70.540(1)(g)(A) (limited partnership).

liability for existing obligations of the business by arranging for the partnership to convert or merge into an entity providing limited liability, such as a corporation or LLC.

A further issue is responsibility of owners to make capital contributions. The Partnership Act and Limited Partnership Act include provisions not found in the acts governing the other business organizational forms. When a party to a conversion or merger is a partnership other than an LLP and does not satisfy the obligations it incurred prior to the conversion or merger, then the persons who previously were partners must contribute the amount necessary to satisfy the obligations as if the party was dissolved.<sup>263</sup> The same rule applies in a limited partnership, but only to the general partners.<sup>264</sup> The rule is designed to prevent an owner who had undertaken an obligation to contribute capital, but had not yet completed the contribution, from escaping the obligation in a conversion or merger in a manner that might damage the interest of outside parties.

Any litigation or proceeding pending against an entity or its owners at the time of a conversion or merger may be continued in the original name as if the transaction had not occurred. Alternately, the party bringing the action may substitute the new name but without any loss of rights.<sup>265</sup>

## 2. *Obligations Incurred After Conversion or Merger: the General Rule*

For obligations incurred after the transaction, the law applicable to the converted or surviving entity and its owners controls in almost all cases.<sup>266</sup> This rule is fair in most instances to creditors, who extend credit to the business with knowledge or at least the opportunity to learn in

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263. *Id.* §§ 67.348(1)(g) (conversion), .365(1)(h) (merger).

264. *Id.* §§ 70.520(1)(g) (conversion), .540(1)(h) (merger).

265. For conversions, the relevant provisions are OREGON REVISED STATUTES sections 60.478(1)(d) (corporation), 62.613(1)(d) (cooperative), 63.479(1)(d) (LLC), 67.348(1)(d) (partnership), and 70.520(1)(d) (limited partnership). For mergers, the relevant provisions are sections 60.497(1)(d) (corporation), 62.623(1)(d) (cooperative), 63.497(1)(d) (LLC), 67.365(1)(d) (partnership), and 70.540(1)(d) (limited partnership).

266. For conversions, the relevant provisions are OREGON REVISED STATUTES sections 60.478(1)(f)(B) (corporation), 62.613(1)(f)(B) (cooperative), 63.479(1)(f)(B) (LLC), 67.348(1)(f)(B) (partnership), and 70.520(1)(f)(B) (limited partnership). For mergers, the provisions are sections 60.497(1)(g)(B) (corporation), 62.623(1)(g)(B) (cooperative), 63.497(1)(g)(B) (LLC), 67.365(1)(g)(B) (partnership), and 70.540(1)(g)(B) (limited partnership).

advance of the credit-worthiness and extent of liability of the entity and its owners. For example, a supplier who furnishes goods to a corporation relies on the credit of the corporation and not of the shareholders, whose protection from liability is well established. Conversion of the corporation into a limited liability company does not significantly change the risk to the creditor. The creditor will still have rights against the business entity and no rights (except in extraordinary circumstances, such as “piercing the veil”) against its owners (now members rather than shareholders).

A merger of a corporation into an LLC or LLP with a less solid financial status admittedly might increase the risk to creditors who extend credit after the merger. This type of risk, however, is no different from the risk following like-entity mergers (such as a corporation merging into a second corporation with less solid finances), which the law has traditionally countenanced. The risk is also comparable to the risk that a known customer will suffer business reverses making it less able or likely to pay bills—the sort of risk inherent in every credit decision.

In general, the law relies on the concept of constructive notice to creditors and potential creditors. A conversion or merger always requires a filing with the state, which is a matter of public record.<sup>267</sup> Those who deal or consider dealing with the entity after the filing are presumed to know the contents of the filing. The same principle applies to real estate conveyances and liens, Uniform Commercial Code security interests<sup>268</sup> and, notably, business-entity documents such as articles of incorporation.<sup>269</sup> The legal fiction—or, more charitably, legal principle—of constructive notice admittedly can surprise morally innocent but unsophisticated parties, who are not aware of or proficient with the public filing system, but this is accepted as a necessary element of a workable commercial system.

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267. Articles of conversion are required by OREGON REVISED STATUTES sections 60.476(1) (corporation), 62.611(1) (cooperative), 63.476 (LLC), 67.346 (partnership), and 70.515 (LP) (1999). Articles of merger are required by sections 60.494(1) (corporation), 62.621(1) (cooperative), 63.494 (LLC), 67.364 (partnership), and 70.535 (LP).

268. OR. REV. STAT. § 79.3010 (1999) (providing priority for secured transactions that are properly filed and otherwise perfected, whether or not other claimants have actual knowledge of filing).

269. *See, e.g., id.* § 60.051(1) (specifying that corporate existence begins when articles of incorporation are filed by Secretary of State). With corporate existence comes the shield for shareholders from liability for acts and debts of the corporation, *id.* § 60.151(2), which applies whether or not an outside party has actual knowledge of the incorporation.

### 3. *Special Provisions for Entry into Limited Liability Status*

Special issues of fairness and notice are raised when an entity without limited liability transacts business with a creditor, converts or merges into an entity form providing limited liability for owners, and then engages in further transactions with the creditor. The creditor might well have no actual knowledge of the change and be significantly disadvantaged when the information becomes known. Although the concept of constructive notice could be applied, realists recognize the improbability of creditors actually gaining information from the public records in this circumstance.

For example, "A&B Plumbing," a general partnership, may have purchased pipe and fittings for years as needed from a plumbing-supply company on account, paying at the end of each month. The supplier relied on the reputation and creditworthiness not only of A&B Plumbing but also of A and B individually, who were jointly and severally liable for partnership debts. A&B Plumbing then converts to "A&B Plumbing, LLC," and continues to purchase pipe on account from its supplier, who does not know of the change. Realistically, such a conversion is most probable when the owners (but not creditors) recognize that business is declining and insolvency is a real danger. If the LLC later defaults, the supplier will then discover, to its surprise and detriment, that A and B are no longer personally liable.

The constructive notice concept would deny relief, on the premise that the supplier could have avoided surprise by checking with the state every time A or B ordered a new faucet or pipe fitting on credit, to assure that the company that had been a general partnership for years is still a general partnership. Plainly, however, the burden to continually search is too expensive, wasteful, and impractical for most businesses to even consider. Constructive notice has reached its limit of plausibility.

An alternative might be to impose on the converting or merging entity the obligation to provide actual notice to parties with whom it has done business in the past. Placing the duty on the party seeking to benefit from the conversion or merger is more practical, economical, and fair than imposing a duty of search on outside parties. Yet such a rule is also subject to objection. No general rule applies in other contexts for businesses to notify those with whom they have transacted business in the past of mergers or other developments which might negatively affect the likelihood of payment of new obligations. Also, such a rule of actual notice could generate litigation by creditors asserting that they did not

receive actual notice and hence are entitled to pursue former partners despite a conversion or merger long ago.

Provisions responding to issues such as these were included in RUPA and Oregon's partnership act prior to the 1999 amendments. A partner in a general partnership who became a limited partner in a limited partnership remained liable as a general partner for obligations incurred before the conversion,<sup>270</sup> which is not surprising. However, the partner also was liable as a general partner for obligations incurred within ninety days after the conversion to an outside party who reasonably believed when entering the transaction that the person was a general partner.<sup>271</sup> The Task Force drafting the 1999 Oregon legislation was concerned that the "reasonable belief" standard did not provide the partner a conclusive means of terminating exposure to liability early and that ninety days seemed unrealistically brief.

A separate RUPA section relating to dissociation reflected a similar concern for post-conversion creditors without actual knowledge of a conversion, but a somewhat different approach. If the dissociation had not been advertised in a newspaper, a dissociated partner retained apparent agency authority for a period after dissociation to bind a partnership to a third party who reasonably believed that the person was still a partner and did not have notice.<sup>272</sup> The period was two years in the Uniform Act, and six months in the Oregon statutes.<sup>273</sup>

The Oregon cross-entity conversion and merger legislation in 1999 established a one-year window of exposure to liability,<sup>274</sup> seeking to balance the competing interests and perspectives of the business entity owners and the third parties who deal with the entity without actual knowledge of the change. When a general or limited partnership converts or merges into a form of business organization that normally shields owners from liability, a former general partner continues to be

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270. OR. REV. STAT. § 67.345(5) (1997) (repealed 1999); REV. UNIF. PARTNERSHIP ACT § 902(e) (1994).

271. OR. REV. STAT. § 67.345(5) (1997) (repealed 1999); REV. UNIF. PARTNERSHIP ACT § 902(e). Because this provision applies only to limited partnerships, it belongs more logically in the Limited Partnership Act, not the Partnership Act. Oregon repealed the provision in 1999, replacing it with more encompassing legislation, parallel in the two chapters.

272. OR. REV. STAT. § 67.255 (1999); REV. UNIF. PARTNERSHIP ACT § 702.

273. OR. REV. STAT. § 67.255; REV. UNIF. PARTNERSHIP ACT § 702.

274. OR. REV. STAT. §§ 60.478(1)(h) (corporation conversion), 60.497(1)(h) (corporation merger), 62.613(1)(g) (cooperative conversion), 62.623(1)(g) (cooperative merger), 63.479(1)(g) (LLC conversion), 63.497(1)(h) (LLC merger), 67.348(1)(h) (partnership conversion), 67.365(1)(h) (partnership merger), 70.520(1)(h) (LP conversion), 70.540(1)(i) (LP merger) (1999).

personally liable on obligations incurred during the one year following the conversion or merger, if the outside party reasonably believes that the owner would be personally liable and had not received notice of the conversion or merger.<sup>275</sup>

This provision was drafted by the Task Force, not drawn directly from any uniform act or other state's statute. It provides the former general partner a conclusive means of assuring freedom from personal liability for post-conversion transactions by sending notice to outside parties.<sup>276</sup> It imposes a burden of notice (or, perhaps more accurately, the risk of failure to notify) on the party with the information, in contrast to the constructive notice principle, which imposes a burden of searching on the party without the information. The reasonable expectations of the outside party, when entering into post-merger or post-conversion transactions, are protected, but only for one year. That period was selected arbitrarily but was considered sufficient for creditors to become aware of the current form of business entity. After the year, the constructive notice principle operates, conclusively presuming notice based on the public filings.<sup>277</sup>

The form of actual notice is not specified in the statute, though it must be more than merely filing with the state.<sup>278</sup> Adding the new entity type to the business name, by appending such terms as "corporation," "incorporated," "limited liability company," "limited partnership," "limited liability partnership," or an abbreviation, should be sufficient if

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275. For conversion, the provisions on liability of former partners are OREGON REVISED STATUTES sections 60.478(1)(g) (corporation), 62.613(1)(g) (cooperative), 63.479(1)(g) (LLC), 67.348(1)(h) (partnership), and 70.520(1)(h) (LP). For merger, the provisions are sections 60.497(1)(h) (corporation), 62.623(1)(h) (cooperative), 63.497(1)(h) (LLC), 67.365(1)(i) (partnership), and 70.540(1)(i) (LP).

276. OR. REV. STAT. §§ 60.478(1)(g) (corporation conversion), 62.613(1)(g) (cooperative conversion), 63.479(1)(g) (LLC conversion), 67.348(1)(h) (partnership conversion), 70.520(1)(h) (LP conversion); *id.* §§ 60.497(1)(h) (corporation merger), 62.623(1)(h) (cooperative merger), 63.497(1)(h) (LLC merger), 67.365(1)(i) (partnership merger), 70.540(1)(i) (LP merger).

277. OR. REV. STAT. §§ 60.478(1)(g) (corporation conversion), 62.613(1)(g) (cooperative conversion), 63.479(1)(g) (LLC conversion), 67.348(1)(h) (partnership conversion), 70.520(1)(h) (LP conversion); *id.* §§ 60.497(1)(h) (corporation merger), 62.623(1)(h) (cooperative merger), 63.497(1)(h) (LLC merger), 67.365(1)(i) (partnership merger), 70.540(1)(i) (LP merger).

278. Each provision imposes liability unless "the other party" to a business transaction "received notice" of the conversion or merger. OR. REV. STAT. §§ 60.478(1)(g) (corporation conversion), 62.613(1)(g) (cooperative conversion), 63.479(1)(g) (LLC conversion), 67.348(1)(h) (partnership conversion), 70.520(1)(h) (LP conversion); *id.* §§ 60.497(1)(h) (corporation merger), 62.623(1)(h) (cooperative merger), 63.497(1)(h) (LLC merger), 67.365(1)(i) (partnership merger), 70.540(1)(i) (LP merger). The filing of a document with the state by a converting or merging entity does not, without more, constitute receipt of notice by a party to a business transaction.

the creditor would likely see it. Factors would include the size and prominence of the new name on business cards, order forms, vehicles, or other contexts to determine when the creditor should be charged with notice. To avoid these issues, the principals of the converting or merging entity are best advised to provide the most direct, most specific notice possible: a letter addressed to the creditor explicitly stating the transaction.

In the A&B Plumbing example, A and B will be individually liable as general partners for orders placed with the supplier before the conversion, whether or not notice is given. They will also be individually liable for orders placed within one year after conversion to a limited liability company, unless they give adequate actual notice of the conversion to supplier. As to orders placed more than a year after conversion, the LLC statute applies, whether or not actual notice is given, protecting members from personal liability for business debts.

### G. Owners' Rights

Rights of owners are determined in the plan of conversion or merger and by the statutes, common law, and private agreements (including the organizational documents) governing the entity before the transaction.<sup>279</sup> The results vary, reflecting the variations in the business forms.

Shareholders have dissenters' and appraisal rights, except in corporations with publicly traded shares.<sup>280</sup> The same substantive rights and procedures that traditionally applied to mergers between or among corporations<sup>281</sup> have been extended to mergers between or among a corporation and a non-corporate entity, and to conversions of a

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279. For conversion, the provisions applicable to owners' rights are OREGON REVISED STATUTES sections 60.478(2) (corporation), 62.613(2) (cooperative), 63.479(2) (LLC), 67.348(2) (partnership), and 70.520(2) (LP). For merger, the provisions are sections 60.497(2) (corporation), 62.623(2) (cooperative), 63.497(2) (LLC), 67.365(2) (partnership), and 70.540(2) (LP).

280. *Id.* § 60.554; REV. MODEL BUS. CORP. ACT § 3.02 (1996). Examples of state corporation acts that deny dissenter and appraisal rights to shareholders of publicly traded corporations include DELAWARE CODE ANNOTATED title 8, section 262(b)(1) (Supp. 2000) and 15 PENNSYLVANIA CONSOLIDATED STATUTES ANNOTATED section 1571(b)(1) (West 1995). One view, not yet adopted by any state, is that this difference between public and nonpublic corporations will be resolved by eliminating dissenter and appraisal rights for all corporations. Clark, *supra* note 40, at 177.

281. OR. REV. STAT. §§ 60.551–.594 (regarding dissenters rights and judicial appraisal of shares).

corporation to another entity.<sup>282</sup> All such transactions significantly change the nature of the shareholders' investment.

In cooperatives, shareholders have only what rights may be provided in the articles of conversion and merger. Dissenters' or appraisal rights are not provided,<sup>283</sup> consistent with the general pattern in cooperative law that the entity is for the mutual benefit of members, not primarily to generate financial return to investors.<sup>284</sup>

Partners who disapprove (when a decision may be effectively made without unanimity) are deemed to have dissociated effective immediately before the conversion or merger, unless they notify the partnership within sixty days of a contrary intent, and the dissociation is not deemed wrongful.<sup>285</sup> In this situation, as in other situations in which partners dissociates rightfully and the partnership continues the business, the entity must purchase those persons' interests and indemnify them against all liabilities of the partnership.<sup>286</sup>

The right to dissociate and to be bought out is granted because a conversion drastically changes the relationship of the partner to the entity and to creditors in ways that are not entirely favorable. For example, a partner who becomes a shareholder gains the shield of limited liability from creditors but loses managerial powers and the protection of some fiduciary duties owed to partners but not to shareholders. A partner confronted with such a fundamental change should be allowed to cash out.

In a limited partnership, the limited partners are treated in a manner comparable to partners in a general partnership. A limited partner who did not vote in favor of a conversion or merger is deemed to have withdrawn immediately upon conversion, unless the partner gives notice to the contrary and the withdrawal is not deemed wrongful.<sup>287</sup> Unless

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282. *Id.* §§ 60.478(2)(a) (establishing rights of shareholders in conversion), .554(1)(f) (listing conversion as one event triggering right to dissent).

283. *Id.* § 62.623(2) (providing that owners have only rights provided in plan of merger).

284. Simon, *supra* note 34, § 30.1. Dissenters rights in cooperatives are discussed in David C. Crago, *Cooperative Dissent: Dissenting Shareholder Rights in Agricultural Cooperatives*, 27 IND. L. REV. 495 (1994).

285. OR. REV. STAT. §§ 67.348(2)(a) (conversion), 67.365(2)(a) (merger). The provisions were modeled on the clause in the pre-1999 statute on conversion of LP to partnership, and extended to mergers. OR. REV. STAT. § 67.350(2) (1997) (repealed 1999); *cf.* OR. REV. STAT. § 67.360(4) (1997) (repealed 1999) (applying to mergers of partnerships with partnerships).

286. OR. REV. STAT. § 67.250 (1999); REV. UNIF. PARTNERSHIP ACT § 701 (1994).

287. OR. REV. STAT. §§ 70.520(2)(a) (conversion), .540(2)(a) (merger) (1999). In addition, a limited partner may withdraw at the time or occurrence of an event specified in the partnership

otherwise agreed, withdrawing partners are entitled to receive the fair value of their interests.<sup>288</sup>

As to general partners in limited partnerships, no statutory sections specifically address rights in the conversion or merger situation. General partners have only whatever rights are provided in the partnership agreement and plan of conversion or merger, plus the general statutory provisions.<sup>289</sup> Usually, general partners may withdraw at any time by giving written notice, subject to liability for damages if withdrawal violates the partnership agreement, and then be paid the fair value of their interest.<sup>290</sup> No statutory provision indicates that withdrawal of a general partner in a conversion or merger situation is not wrongful.

Members of limited liability companies, under the laws of Oregon and many other states, have only the rights specified in the LLC agreement, plus a very restricted power to withdraw.<sup>291</sup> A member may voluntarily withdraw as provided in the articles of organization or upon six month's notice unless the articles expressly deny that power, but the member is exposed to liability if the withdrawal breaches any provision of the articles of organization or an operating agreement.<sup>292</sup> Dissenters' rights are not provided.<sup>293</sup>

agreement, or if the agreement is silent, upon six month's prior written notice. OR. REV. STAT. § 70.255(2) (1999); RULPA § 603 (amended 1985), 6A U.L.A. 217-18 (1995). Some statutes have modified the rules to authorize partnership agreement clauses preventing withdrawal of a limited partner prior to dissolution and winding up. *See* Keatinge, *supra* note 24, at 58 (citing Delaware, Maine, Nebraska, Pennsylvania, Rhode Island, and Tennessee statutes).

The provision is comparable to the policy reflected in the earlier provision regarding mergers of partnerships with partnerships. OR. REV. STAT. § 67.360(4) (1997) (amended 1999).

288. OR. REV. STAT. § 70.260 (1999).

289. *Id.* §§ 70.185, 70.190.

290. *Id.* § 70.255(1); RULPA § 602 (amended 1985), 6A U.L.A. 216 (1995).

291. Culpepper, *supra* note 10, § 39A.63 (discussing Oregon LLC Act before 1999 amendments, although relevant provisions were not changed). Dissenters' rights are not provided in either the Uniform or the Prototype Limited Liability Company Acts. UNIF. LTD. LIAB. CO. ACT §§ 901-907, 6A U.L.A. 491-97 (Supp. 2000) (authorizing conversions and mergers but not dissenters rights); PROTOTYPE LTD. LIAB. CO. ACT § 1202 (1992) (prepared by working group of ABA Section of Business Law) (cited in Clark, *supra* note 40, at 167-68).

292. OR. REV. STAT. § 63.205 (1999). Oregon's provision for withdrawal is more limited than some other statutes. The UNIFORM LIMITED LIABILITY COMPANY ACT provides a right to withdraw from an at-will LLC, and several states follow that model. Keatinge, *supra* note 24, at 62, (citing HAW. REV. STAT. ANN. § 428-601 (Michie 1997); VT. STAT. ANN. tit. 11, § 3081 (1997); W. VA. CODE ANN. § 31B-6-601 (Michie 1996); UNIF. LTD. LIABILITY CO. ACT § 701 (amended 1996), 6A U.L.A. 38 (Supp. 1997)). However, at least two other states, Virginia and Washington, are similar to Oregon in providing that an LLC member may not voluntarily withdraw, unless the LLC agreement provides to the contrary. *Id.* (citing VA. CODE ANN. §§ 13.1-1032 (Michie Supp. 1997); WASH. REV. CODE § 25.15.130(3) (2000)).

In addition to the rights formally granted by statute or private agreement, owners of businesses are typically protected from oppression or other breach of fiduciary duty by the controlling owners. The extent and definition of fiduciary duty varies among the different organizational forms, and are undergoing development within many of the forms. For example, partners were traditionally protected and subjected to a strict fiduciary duty of loyalty, but the trend is toward freedom of contract with fiduciary duties that are more narrowly defined and often subject to waiver by contract.<sup>294</sup> In an LLC, fiduciary duties usually apply at least to the managers in manager-managed companies, but may be modified by agreement.<sup>295</sup>

Whether the disparities in protection of owners of the different entities is justified is open to debate, but they are a matter of preexisting law. The 1999 Oregon legislation extends the provisions in preexisting law regarding like-entity mergers to conversions and cross-entity mergers, but does not otherwise change the rules.

#### H. Property

The converted or surviving business entity becomes the owner, by operation of law, of all of the property (real or personal, tangible or intangible) of the converted or disappearing entity.<sup>296</sup> This principle that the owner of the property changes without a transfer of the property may

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293. Part of the explanation may be that the uncertainty and delay occasioned by dissenters rights were not necessary or desirable in light of fiduciary-duty protection and the members' right to withdraw or dissolve the LLC, thereby obtaining the fair value of their interests. Clark, *supra* note 40, at 168 (quoting and discussing PROTOTYPE LTD. LIAB. CO. ACT §1202 cmt. (1992)). The rule may also be based on federal tax considerations no longer applicable in light of the "check-the-box" regulations. *Id.*

294. See generally Henry N. Butler & Larry E. Rubstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990); Frank H. Easterbrock & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993); Donald J. Weidner, *RUPA and Fiduciary Duty: The Texture of Relationship*, 58 LAW & CONTEMP. PROBS. 81 (1995).

295. OREGON REVISED STATUTES section 63.155 (1999) establishes duties of care and loyalty, with provisions for private agreements reducing the duties or defining activities that do not violate them. Section 63.160 provides for indemnification or exculpation of a member from liability.

296. For conversion, the provisions applicable to change of ownership of property are OREGON REVISED STATUTES sections 60.478(1)(b) (corporation), 62.613(1)(b) (cooperative), 63.479(1)(b) (LLC), 67.348(1)(b) (partnership), and 70.520(1)(b) (LP). For merger, the provisions are sections 60.497(1)(b) (corporation), 62.623(1)(b) (cooperative), 63.497(1)(b) (LLC), 67.365(1)(b) (partnership), and 70.540(1)(b) (LP) (1999).

have metaphysical connotations, but also has substantial practical import.

One major consequence is that no deeds, bills of sale, assignments, or other documents of conveyance are necessary or appropriate, thus significantly reducing the cost of documentation. Taxes on transfer of property should not apply, because the conversion or merger of the owner of the property is not deemed to be a transfer.

Nevertheless, for real estate, some documentation is advisable because the lack of a deed in the name of the converted or surviving entity may create difficulties in the future, especially when the entity seeks to sell the property to a third party.<sup>297</sup> Accordingly, although the statute does not mention or require it, the business is well advised to prepare a memorandum of the conversion and merger, establishing the identity of the owner before the transaction and the identity afterwards, perhaps attaching the plan of conversion or merger. The memorandum should be filed with the recorder of deeds of every county in which the business owned an interest in real estate, serving to prevent misunderstanding by others as to ownership and expediting future conveyances and title insurance.

Title insurance on real property typically applies only to the purchaser, not to any transferee of the real estate unless the title company specifically agrees to such an extension of coverage.<sup>298</sup> Nevertheless, the original title policy will operate in favor of a converted or surviving entity because of statutory provisions specifying that entity existence continues and all property, which includes rights under the insurance policy, vests in the converted or surviving entity.<sup>299</sup> The same principles also apply to other forms of insurance.<sup>300</sup>

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297. For example, if a corporation owning a building converts to an LLC or merges with an LLC, the LLC becomes the owner of the building. Recorded title to the building remains in the corporate name, however. A potential purchaser from the LLC, or a potential purchaser's title insurance company, might demand proof that the LLC is the owner.

298. Palomar, *supra* note 128, at 621.

299. For conversion, the provisions are OREGON REVISED STATUTES sections 60.478(1)(a)–(b) (corporation), 62.613(1)(a)–(b) (cooperative), 63.479(1)(a)–(b) (LLC), 67.348(1)(a)–(b) (partnership), and 70.520(1)(a)–(b) (LP). For merger, the provisions are sections 60.497(1)(a)–(b) (corporation), 62.623(1)(a)–(b) (cooperative), 63.497(1)(a)–(b) (LLC), 67.365(1)(a)–(b) (partnership), and 70.540(1)(a)–(b) (LP).

300. *See, e.g., Imperial Enters. Inc. v. Fireman's Fund Ins. Co.*, 535 F.2d 287, 292–93 (5th Cir. 1976) (finding that when insured party merged, surviving entity became insured by operation of law, despite non-assignment clause in insurance policy).

Long-term commercial leases and franchise agreements routinely have non-assignment clauses, and mortgages have due-on-sale clauses, all prohibiting transfer without consent. The landlord, franchiser, or mortgagee sometimes denies consent to a transfer, or conditions it on a payment or a renegotiation of terms. However, because a conversion or merger of the business entity owning the interest of the tenant, franchisee or mortgagor is by operation of law, the clauses are normally not triggered.<sup>301</sup> To overcome this rule requires careful drafting of contractual clauses restricting transfer, specifying that merger or conversion is an event of default.<sup>302</sup>

The statute specifies that title vests in the converted or surviving business entity “without reversion or impairment.”<sup>303</sup> The application of that phrase includes title in a defeasible estate: fee simple determinable, fee simple subject to condition subsequent, or fee simple subject to executory interest.<sup>304</sup> For example, the fee simple determinable<sup>305</sup> resulting from a grant “to Alpha Corporation for so long as it operates a railroad on the land” does not terminate if Alpha Corporation converts to Alpha LLC or merges with Beta LP, because the converted or surviving entity is deemed the same entity as Alpha Corporation.

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301. See, e.g., *Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, Inc.*, 238 S.W.2d 321, 325 (Mo. 1951) (finding that merger of lessee corporation with another corporation did not breach contractual prohibition on assignments because transfer was by operation of law); *accord Segal v. Greater Valley Terminal Corp.*, 199 A.2d 48, 51 (N.J. 1964). See generally Zitter, *supra* note 125. Patents, however, may not be treated similarly. Some cases find that the merger of patent licenses with other corporations violates anti-assignment clauses. *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1095 (6th Cir. 1979); *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d 1303, 1306 (7th Cir. 1972).

302. Contractual provisions specifying that certain assets such as licenses and permits are non-assignable and nontransferable, by merger or otherwise, are valid. *Citizens Bank & Trust Co. v. Barlow Corp. of Maryland*, 456 A.2d 1283 (Md. 1983); *Pac. First Bank v. New Morgan Park*, 876 P.2d 761 (Or. 1994); *O.K. Delivery Sys., Inc. v. Haley*, 487 P.2d 1391 (Or. App. 1971); Culpepper, *supra* note 10, § 39A-64 (discussing LLC Act provisions that preceded 1999 amendments but were not significantly changed by them).

303. For conversion, the provisions applicable to change of ownership of property are OREGON REVISED STATUTES sections 60.478(1)(b) (corporation), 62.613(1)(b) (cooperative), 63.479(1)(b) (LLC), 67.348(1)(b) (partnership), and 70.520(1)(b) (LP). For merger, the provisions are sections 60.497(1)(b) (corporation), 62.623(1)(b) (cooperative), 63.497(1)(b) (LLC), 67.365(1)(b) (partnership), and 70.540(1)(b) (LP).

304. See generally WILLIAM B. STOEBUCK & DALE A. WHITMAN, *THE LAW OF PROPERTY* §§ 2.3–.9 (3d ed. 2000).

305. The estate is a fee simple determinable because it is capable of lasting forever, but subject to automatic early termination upon occurrence of a stated condition. See generally *id.* § 2.4.

Similarly, if title is held subject to a valid restraint on alienation, a conversion or merger will not be a violation because it is not deemed a transfer of property.<sup>306</sup> For example, if a grantor conveyed “the family farm to Smith Limited Partnership, which may never convey to anyone else,” a subsequent conversion of the limited partnership to a corporation or a merger with another business entity is not a problem. The question of whether the restraint is valid should not even arise, because conversion or merger is, by statute, deemed not to be a conveyance.

### *I. Documentation and Public Filings*

Each transaction requires only one filing with the state—articles of conversion or articles of merger.<sup>307</sup> The plan that must accompany that document includes any additional information that is required to organize the converted or surviving entity.<sup>308</sup> Consequently, there is no need to file separate documents, such as articles of incorporation, articles of organization, or amended articles.

For example, a limited partnership that opts to be a corporation files articles of conversion with a plan of conversion that contains all the items statutorily required in all articles of incorporation, but no separate articles of incorporation.<sup>309</sup> Assumed business names of the converting or merging entities automatically become assumed business names of the converted or surviving entities.<sup>310</sup>

Consistent with this approach, the definitions of the organic documents were amended. For example, the definition of “articles of

306. Because of the public policy against restraints on alienation, courts construe anti-assignment clauses narrowly and hold that transfers by operation of law do not violate them. *See, e.g., Segal*, 199 A.2d at 51.

307. Articles of conversion are required by OREGON REVISED STATUTES sections 60.476(1) (corporation), 62.611(1) (cooperative), 63.476 (LLC), 67.346 (partnership), and 70.515 (LP) (1999). Articles of merger are required by sections 60.494(1) (corporation), 62.621(1) (cooperative), 63.494 (LLC), 67.364 (partnership), and 70.535 (LP).

308. *Id.* §§ 60.472(2)(e) (corporation conversion), 60.481 (corporation merger), 62.607(2)(e) (cooperative conversion), 62.617(2)(e) (cooperative merger), 63.470(2)(e) (LLC conversion), 63.481(2)(e) (LLC merger), 67.342(2)(e) (partnership conversion), 67.360(2)(e) (partnership merger), 70.505(2)(e) (LP conversion), 70.525(2)(e) (LP merger).

309. OR. REV. STAT. § 60.051.

310. *Id.* §§ 60.478(1)(h) (corporate conversion), 60.497(1)(i) (corporate merger), 62.613(1)(h) (cooperative conversion), 62.623(1)(i) (cooperative merger), 63.479(1)(h) (LLC conversion), 63.497(1)(i) (LLC merger), 67.348(1)(i) (partnership conversion), 67.365(3) (partnership merger), 70.520(3) (LP conversion), 70.540(1)(j) (LP merger).

incorporation” was changed to include articles of conversion and articles of merger,<sup>311</sup> to coordinate with the preexisting provision that “corporate existence begins when the articles of incorporation are filed by the Secretary of State.”<sup>312</sup> Comparable changes were made to the definitions of articles for a cooperative,<sup>313</sup> articles of organization of an LLC,<sup>314</sup> and certificate of limited partnership.<sup>315</sup> No comparable provision applies to partnership, which can be created without a filing with the state.

The system permits tracking of entities that change form, an essential element for the protection of creditors, claimants, and parties considering transacting business with a business.<sup>316</sup> A creditor of an LP, for example, will be able to determine from the Secretary of State’s records that the LP converted to an LLC, as well as the current address and registered agent of the LP. Moreover, the public can search the Secretary of State’s records for earlier organizational documents.

The filing requirement is somewhat different for general partnerships which, unlike all other business organization forms, can be created without a filing (or even a writing), unless it registers as an LLP. When a non-LLP partnership merges with another non-LLP partnership, no filing is required.<sup>317</sup> In all other merger or conversion transactions, however, filings are required to update the previous filing or to establish the new organizational form.<sup>318</sup>

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311. *Id.* § 60.001(2).

312. *Id.* § 60.051(1).

313. *Id.* § 62.015(2).

314. *Id.* § 63.001(2).

315. *Id.* § 70.005(1). The 1999 legislation repealed OREGON REVISED STATUTES section 67.365(5) (1997) (repealed 1999), which had provided for cancellation of an LLP’s registration upon merger, followed thirty days later by filing of a cancellation notice or, if the LLP survived, filing of an amendment to registration thirty days after the merger. This two-step process was unnecessary and problematic for the Corporation Division, and therefore was replaced by the single filing of articles of merger. Also repealed was OREGON REVISED STATUTES section 67.365(6) (1997) (repealed 1999), which required an LP merging out of existence to cancel its certificate of LP. Matters relating to LPs were moved to the LP act (and, again, the rule only requires filing articles of merger).

316. If tracking were not possible, a business entity could convert or merge into another form, disappearing from the Corporation Division’s records under the original name and making it difficult or impossible for a creditor to find the entity and its owners.

317. After approval of a plan of merger, the surviving entity must deliver articles of merger to the Secretary of State, “except that no filing is required if all of the parties to the merger are partnerships that have not registered as limited liability partnerships.” OR. REV. STAT. § 67.364(1) (1999).

318. For example, an LLC converting to or merging with a general partnership will have previously filed articles of organization under Oregon Revised Statutes section 63.044. In this case,

Unlike other conversion situations, the Secretary of State will not be able to cross-reference a partnership's articles of conversion to a previous filing. For that reason, a partnership must include in its articles of conversion the names of at least two of the partners, providing creditors information needed to locate the partnership.<sup>319</sup> Comparable disclosures are not present or necessary in parallel provisions in the corporation, LLC, and LP acts because those business entities file annual reports disclosing addresses.<sup>320</sup> The accompanying plan of conversion will contain all of the information required in the organizational document, such as articles of incorporation, for the resulting entity. In the opposite direction of an entity converting to a general partnership, which does not normally require a filing, the articles of conversion will serve as public notice of exit from the previous form of doing business, which did require a filing.

#### J. Income Tax Consequences

The income tax effects of a conversion or merger are separate from the business organization aspects discussed above, and beyond the scope of this Article. The tax consequences depend largely on whether the entities before and after the transaction are classified as corporations or as partnerships for tax purposes.

In general, merger or conversion of a partnership into or with another partnership, or into or with a corporation, does not result in tax. Merger or conversion of a corporation into or with a partnership does result in tax.<sup>321</sup> However, exceptions to these generalizations exist, and secondary consequences such as changes in basis can be important. The IRS can recharacterize a conversion or merger as being a liquidation, generating gain or loss recognition,<sup>322</sup> but has indicated that it will generally not do so.<sup>323</sup>

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the filing should be updated. Conversely, a general partnership converting to an LLC will need articles of organization—a purpose served by the articles of conversion. *Id.* §§ 67.342(1)(e), 63.044.

319. *Id.* § 67.346(1).

320. *Id.* §§ 60.787 (1999) (corporation annual report), 63.787 (LLC annual report), 67.645 (LP annual report).

321. STEVEN L. CHRISTENSEN, *MERGERS AND CONVERSIONS OF OREGON BUSINESS ENTITIES UNDER SB 145 2* (Multnomah Bar Association Continuing Legal Education Series, June 15, 2000).

322. I.R.C. §336 (2000).

323. CHRISTENSEN, *supra* note 321, at 9 (citing Rev. Rul. 84-111, 1984-2 C.B. 88). A number of sources discuss the tax treatment of mergers and conversions in detail. *See, e.g.*, Kevin D.

K. *Early Experience with Conversion and Merger of Disparate Business Entities*

In the first year after the cross-entity amendments became effective on January 1, 2000, eighty-two conversion documents were filed.<sup>324</sup> The Business Registry database of the Corporation Division of the Oregon Secretary of State reported the following conversions among domestic entities:<sup>325</sup>

- 26 General partnerships converted to LLCs
- 21 LLCs converted to corporations
- 18 Corporations converted to LLCs
- 3 LLCs converted to PCs
- 3 PCs converted to corporations
- 2 LLCs converted to LPs
- 2 LLPs converted to corporations
- 1 LP converted to an LLC
- 1 Cooperative converted to a corporation<sup>326</sup>

In addition, one foreign corporation (from Washington) converted to an Oregon corporation and four Oregon LLCs converted to foreign LLCs.<sup>327</sup> These statistics suggest that the greatest use of the conversion option is for general partnerships to become LLCs, and for corporations and LLCs to change to the other form. Mergers among disparate entities were far fewer and displayed no clear trend.<sup>328</sup>

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Anderson, *Slicing, Dicing and Combining Partnerships: A Look at the Proposed Regulations on Partnership Mergers and Divisions*, Tax Management Memorandum (Mar. 27, 2000); Sheldon Banoff, *Mr. Popeil Gets "Reel" About Conversions of Legal Entities: The Pocket Fisherman Flycasts for "Form" but Snags on Substance*, 75 TAXES 887 (1997); Christensen, *supra* note 321, at 14; Steven Frost, *The Federal Tax Consequences of Business Entity Conversions*, 26 J. REAL EST. TAX'N 83 (1999).

324. E-mail from Twila K. Coakley, Oregon Secretary of State's Office, to Janet M. Sullivan, director of the Corporation Division, and to the author (Mar. 13, 2000) (on file with author).

325. *Id.*

326. *Id.*

327. *Id.*

328. E-mail from Twila K. Coakley, Oregon Secretary of State's Office, to the author (Jan. 29, 2001) (on file with author). Records of five cross-entity mergers included two corporations merging with LLCs, and one merger each of a corporation with an LLC, an LLC with an LLP, and an LP with an LLC. *Id.* However, the records were not complete, omitting several additional cross-entity mergers. *Id.* Still, the number of cross-entity mergers appears far below the number of cross-entity conversions.

## VI. CONCLUSION

Legislation allowing business entities to merge with entities of disparate organizational form or to convert into an alternative business form, is logical, workable and, in most states, overdue. As has been demonstrated, such legislation provides many benefits and violates no policy.

The development of new forms of business entities in recent years, especially the limited liability company and limited liability partnership, presents new opportunities to businesses and their counsel. Many existing businesses, as well as newly organizing firms, will see advantages in converting to the new forms or in merging with other firms that may well have a different organization form.

The absence of legislation does not prevent cross-entity conversion or merger, but merely forces businesses to engage in burdensome, expensive, and complex transactions to accomplish the equivalent goals. Moreover, given the federal system, inadequacy of laws in one state leads businesses to organize or reorganize in whichever state offers the most attractive legal regime, and then to conduct business as a foreign entity in whichever state is most economically attractive.

Current legislation in many states, especially those that have adopted the Revised Uniform Partnership Act, already authorizes cross-entity conversion and merger, thereby conceding the legitimacy of the concept. In particular, the RUPA allows entities that impose personal liability on some or all of the owners (general partners in general partnerships or limited partnerships) to transform themselves into entities shielding all owners from liability. That those same states do not freely allow any entity to convert or merge into any other entity is merely anomalous.

Drafting issues are numerous and involved, but not insuperable. Oregon presents an example of comprehensive, parallel, and tailored legislation. The statutory provisions provide flexibility and simplicity, protect the interests of creditors and owners, and maintain a public record of the transactions. Other states should emulate Oregon's step forward in this field.

APPENDIX

OREGON REVISED STATUTES (1999) on  
Business Entity Conversion and Merger

SUBJECT	CORP. CH. 60	CO-OP. CH. 62	LLC CH. 63	PART. CH. 67	LP CH. 70
<u>DEFINITIONS</u>	60.470	62.605	63.467	67.340	70.500
<u>CONVERSION</u>	60.472	62.607	63.470	67.342	70.505
(1) both ways (2) plan must set forth (3) plan may set forth					
Action on plan (1) approval (2) abandonment	60.474	62.609	63.473	67.344	70.510
Articles of conversion (1) filing (2) effective date	60.476	62.611	63.476	67.346	70.515
Effect of conversion (1) existence, property, obligations, actions, liabilities of owners, amendments, ABN (2) owners' rights	60.478     60.554	62.613	63.479	67.348     67.255 67.260	70.520
<u>MERGER</u>	60.481	62.617	63.481	67.360	70.525
(1) both ways (2) plan must set forth (3) plan may set forth					
Action on plan (1) approval (2) abandonment	60.487	62.619	63.487	67.362	70.530

## Cross-Entity Conversion and Merger

SUBJECT	CORP. CH. 60	CO-OP. CH. 62	LLC CH. 63	PART. CH. 67	LP CH. 70
Effect of merger (1) existence, property, obligations, actions, liabilities of owners, amendments, ABN (2) owners' rights	60.497	62.623	63.497	67.365	70.540

