

# BUSINESS PLANNING

# LEXISNEXIS LAW SCHOOL ADVISORY BOARD

---

**Lenni B. Benson**

*Professor of Law &  
Associate Dean for Professional Development*  
New York Law School

**Raj Bhala**

*Rice Distinguished Professor*  
University of Kansas, School of Law

**Charles P. Craver**

*Freda H. Alverson Professor of Law*  
The George Washington University Law School

**Richard D. Freer**

*Robert Howell Hall Professor of Law*  
Emory University School of Law

**Craig Joyce**

*Andrews Kurth Professor of Law &  
Co-Director, Institute for Intellectual Property and Information Law*  
University of Houston Law Center

**Ellen S. Podgor**

*Professor of Law &  
Associate Dean of Faculty Development and Electronic Education*  
Stetson University College of Law

**Paul F. Rothstein**

*Professor of Law*  
Georgetown University Law Center

**Robin Wellford Slocum**

*Professor of Law & Director,  
Legal Research and Writing Program*  
Chapman University School of Law

**David I. C. Thomson**

*LP Professor & Director, Lawyering Process Program*  
University of Denver, Sturm College of Law

# BUSINESS PLANNING

---

**Scott B. Ehrlich**

*Professor of Law & Chair, J.D./M.B.A. Dual Degree Program  
California Western School of Law*

**Douglas C. Michael**

*Edward T. Breathitt Professor of Law & Associate Dean for Academic Affairs  
University of Kentucky College of Law*

**Library of Congress Cataloging-in-Publication Data**

Ehrlich, Scott B.  
Business planning / Scott B. Ehrlich, Douglas C. Michael.  
p. cm.  
Includes index.  
ISBN 978-1-4224-1196-4 (hardbound)  
1. Business enterprises--Law and legislation--United States. 2. Commercial law--United States. I. Michael, Douglas C., 1957- II. Title  
KF1355.E367 2009  
346.73'065--dc22

2009016879

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks and Michie is a trademark of Reed Elsevier Properties Inc., used under license. Matthew Bender and the Matthew Bender Flame Design are registered trademarks of Matthew Bender Properties Inc.

Copyright © 2009 Matthew Bender & Company, Inc., a member of the LexisNexis Group.  
All Rights Reserved.

No copyright is claimed in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material exceeding fair use, 17 U.S.C. § 107, may be licensed for a fee of 25¢ per page per copy from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

**NOTE TO USERS**

To ensure that you are using the latest materials available in this area, please be sure to periodically check the LexisNexis Law School web site for downloadable updates and supplements at [www.lexisnexis.com/lawschool](http://www.lexisnexis.com/lawschool).

Editorial Offices  
744 Broad Street, Newark, NJ 07102 (973) 820-2000  
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200  
[www.lexisnexis.com](http://www.lexisnexis.com)

MATTHEW  BENDER

# *ACKNOWLEDGMENTS*

---

I want to acknowledge the following people for their assistance, guidance and inspiration. First, many thanks to my domestic partner of 22 years, Frank DiPalermo, whose warmth and support helped to sustain me during the three years of writing this book. Second, Professor Tom Barton and his wife, Professor Sharon Foster. Both Tom and Sharon have been unwavering in their guidance and enthusiasm for this project. Many thanks to Dean Steven Smith who provided me with the motivation, professional support and guidance necessary for an undertaking of this scope. I owe a sincere debt of gratitude to two other people: Professor Walter Schwidetzky for his gracious and invaluable input with respect to the tax aspects of business entity formation and operation; and my co-author, Douglas Michael, who is a joy to work with. Finally, I must acknowledge the many students in my Business Planning seminars over the last 15 years. I have learned so much from them.

Scott B. Ehrlich

I would like to acknowledge the help of many professional colleagues and mentors: Martin J. McMahon, Jr., who first introduced me to this subject and encouraged my neophyte teaching efforts; Richard A. Westin, who continued in that fashion and provided helpful commentary for some of the tax materials; Rutheford “Biff” Campbell, who did similarly for the securities materials; and mostly Scott Ehrlich, who convinced me that Business Planning is a subject which can be suitable for and valuable to every law student. If these materials can convey even a small portion of his energy and passion for this subject, I will consider them a success. I also want to credit two decades of my Business Planning students who have endured various classroom experiments, successes, and failures and thus have, directly and indirectly, contributed their valuable experiences. Finally, this work would not have been possible without the guidance and patience of my wife Susan and my children Stuart and Amanda, who provided encouragement, persevered with me through long hours of work and episodes of grumpy writer’s block, and deserve the credit for much which is right herein.

Douglas C. Michael



# TABLE OF CONTENTS

<b>Chapter 1</b>	<b>INTRODUCTION TO BUSINESS PLANNING . . . . .</b>	<b>1</b>
A.	INTRODUCTION . . . . .	1
B.	THE CONSTITUENTS IN BUSINESS ENTITY FORMATION AND OPERATION . . . . .	2
1.	The Promoters . . . . .	2
2.	The Equity Holders . . . . .	3
3.	The Business Entity . . . . .	5
4.	Unsecured Creditors . . . . .	5
5.	Secured Creditors . . . . .	6
6.	Managers (Corporate Boards, General Partners, Managing Members) . . . . .	8
7.	Operating Officers, Managers and Employees . . . . .	8
C.	THE ROLE OF ATTORNEYS IN BUSINESS TRANSACTIONS . . . . .	9
1.	Legal Representation — Promoters . . . . .	10
2.	Legal Representation — Equity Holders . . . . .	11
3.	Legal Representation — The Business Entity . . . . .	12
4.	Legal Representation — Other Constituents . . . . .	12
D.	THE ETHICAL CONSTRAINTS ON TRANSACTIONAL LAWYERS . . . . .	13
E.	THE PROBLEM OF MULTIPLE CLIENT REPRESENTATION . . . . .	13
1.	Potential Conflicts of Interest Between Multiple Clients . . . . .	15
a.	Financial Matters . . . . .	15
b.	Tax Considerations . . . . .	16
c.	Control and Management . . . . .	16
d.	Disposition and Buyouts of Equity Interests . . . . .	17
e.	Conclusion — Potential Conflicts of Interest Between Multiple Clients . . . . .	18
2.	Organizations as Clients . . . . .	18
EXERCISE 1-1: REPRESENTING MULTIPLE CLIENTS CONCURRENTLY . . . . .		19
3.	Excerpts: ABA Model Rules of Professional Conduct (2009) . . . . .	21
4.	Sample Informed Consent to Multiple Representation . . . . .	30
F.	THE ATTORNEY CLIENT AGREEMENT . . . . .	33
1.	The Importance of a Written Attorney Client Agreement . . . . .	33
a.	Charges for Legal Services, Fees and Costs . . . . .	33
b.	Billing . . . . .	34
c.	Client’s Obligations . . . . .	34
d.	Scope of Work Undertaken . . . . .	34
e.	Conflicts of Interest and Informed Consent . . . . .	35
f.	Summary — The Attorney Client Agreement . . . . .	35
EXERCISE 1-2: DRAFTING AN ATTORNEY CLIENT AGREEMENT . . . . .		39

---

**TABLE OF CONTENTS**

---

<b>Chapter 2</b>	<b>CHOOSING AND FORMING THE ENTITY</b>	<b>41</b>
A.	TYPES OF BUSINESS ENTITIES	41
1.	The Sole Proprietorship	41
2.	The (General) Partnership	42
	EXERCISE 2-1	43
3.	The Limited Partnership	43
	EXERCISE 2-2	44
4.	The Corporation	45
	EXERCISE 2-3	47
5.	The Limited Liability Company	47
	EXERCISE 2-4	50
6.	The Limited Liability Partnership	50
	EXERCISE 2-5	51
7.	The Limited Liability Limited Partnership	51
8.	The Special-Purpose Regulated Entity	51
9.	The Business Trust and other Variations	52
B.	BIRTH OF AN ENTITY	52
	EXERCISE 2-6	53
	EXERCISE 2-7	53
	EXERCISE 2-8	56
C.	OPERATIONAL ISSUES IN CHOICE AND FORMATION	57
1.	Allocations and Payments to Owners	57
a.	Mechanics of Allocation	57
b.	The Difference between Allocation and Payments	58
c.	Disproportionate Profit and Ownership Interests	58
2.	Authority and Agency	60
a.	General Principles of Agency	60
b.	Types of Agents	61
	EXERCISE 2-9	63
3.	Liability for Debts	63
a.	Liability in Tort or Contract	64
b.	Judicial Disregard of a Limited Liability Entity	64
	EXERCISE 2-10	66
4.	Transfer of Interests	66
a.	The Nature of the Interests in the Entity	66
b.	Default Rules on Transfer	67
c.	Prohibiting Transfers Otherwise Permitted	68
d.	Permitting Transfers Otherwise Prohibited	69
5.	Dissolution	70
	EXERCISE 2-11	72
	COMPREHENSIVE EXERCISE: CHOICE AND FORMATION OF ENTITY	72



---

**TABLE OF CONTENTS**

---

<b>Chapter 3</b>	<b>TAXATION AND BUSINESS ENTITIES</b>	<b>75</b>
A.	INTRODUCTION TO TAX CONSIDERATIONS	75
B.	SOME BASIC TAX CONCEPTS	77
1.	Income Taxes	77
2.	Capital Gains Taxes	78
3.	Basis and Adjusted Basis	80
C.	C CORPORATION ENTITY LEVEL TAXATION	81
1.	The Problem of Double Taxation	81
2.	Some Temporary Relief from the Double Taxation Problem	83
3.	C-Corporation Taxation — Reducing the Impact of Double Taxation	84
a.	Accumulating Earnings Without Paying Dividends	84
b.	Salaries vs. Dividends: Distributing Earnings to Shareholders in the Form of Salaries for Services	85
c.	Rent vs. Dividends: Distributing Earnings to Shareholders in the Form of Rent	88
d.	Interest vs. Dividends: Distributing Income to Shareholders in the Form of Debt Payments	88
4.	C Corporations and the Problem of Losses	91
D.	SUBCHAPTER S CORPORATIONS	93
1.	The Requirements for Subchapter S Status	94
a.	The Shareholders of S Corporations	95
b.	One Class of Stock	96
c.	Timing and Shareholder Consents	98
d.	The Stability of Subchapter S Elections — Disqualification in Future Years	98
E.	TAXATION OF PARTNERSHIPS	99
1.	Partnership Income	99
2.	Partnership Losses	100
F.	TAXATION OF LIMITED PARTNERSHIPS AND LIMITED LIABILITY COMPANIES	101
1.	Limited Partnerships	102
2.	Taxation of Limited Liability Companies	104
G.	LIMITATIONS ON PASS THROUGH TAXATION OF LOSSES	106
1.	IRC § 469 — Limitations on Passive Activity Loss Deductions	106
2.	Section 465 — At-Risk Loss Limitations	108
3.	Increasing At-Risk Basis for Partnership & LLC Debt Liabilities	109
H.	TAX CONSEQUENCES: CONTRIBUTING SERVICES OR PROPERTY TO A BUSINESS ENTITY	111
1.	Contributions of Services to Corporations	111
2.	Contributions of Services to Partnerships	113
<i>Campbell v. Commissioner</i>		114
NOTES AND COMMENTS		122
3.	Contributions of Property	125

---

**TABLE OF CONTENTS**

a.	Contributions of Property to Corporations . . . . .	126
b.	Contribution of Property to Partnerships or Limited Liability Companies . . . . .	127
	EXERCISE 3-1 . . . . .	129
	EXERCISE 3-2 . . . . .	130
<b>Chapter 4</b>	<b>SECURITIES LAW CONSIDERATIONS . . . . .</b>	<b>131</b>
A.	THE TWO PROBLEMS OF THE SECURITIES LAWS . . . . .	131
1.	Registration . . . . .	131
2.	Antifraud . . . . .	133
B.	DEFINITION OF A “SECURITY” . . . . .	134
	<i>Reves v. Ernst &amp; Young</i> . . . . .	134
	NOTES AND QUESTIONS . . . . .	140
	<i>Securities and Exchange Commission v. W.J. Howey Co.</i> . . . . .	141
	<i>Robinson v. Glynn</i> . . . . .	147
C.	EXEMPTIONS FROM REGISTRATION . . . . .	154
1.	Transaction Exemptions for Initial Sales . . . . .	154
a.	Private Offerings . . . . .	155
	<i>Securities and Exchange Commission v. Ralston Purina Co.</i> . . . .	155
	NOTES AND QUESTIONS . . . . .	158
b.	Intrastate Offerings . . . . .	158
	NOTES . . . . .	162
c.	Small or Limited Offerings . . . . .	163
i.	Regulation A . . . . .	163
ii.	Regulation D . . . . .	164
	EXERCISE 4-1 . . . . .	170
iii.	Other small or limited offerings . . . . .	171
d.	Integration . . . . .	171
i.	Integrating exempt transactions . . . . .	172
	EXERCISE 4-2 . . . . .	173
ii.	Integrating later registered offerings . . . . .	174
2.	Transaction Exemptions for Resales . . . . .	175
	EXERCISE 4-3 . . . . .	178
3.	Exempt securities . . . . .	178
	<i>Reves v. Ernst &amp; Young</i> . . . . .	179
	NOTES AND QUESTIONS . . . . .	183
D.	ANTIFRAUD . . . . .	184
	<i>Wharf (Holdings) Ltd. v. United International Holdings, Inc.</i> . . . . .	186
	NOTES AND QUESTIONS . . . . .	189
	William W. Barker, <i>Outside Bucks: A Practical Guide to Raising Capital     for a Business</i> . . . . .	189
E.	STATE REGULATION AND FEDERAL PREEMPTION . . . . .	191
1.	An Overview of State Regulation . . . . .	192

---

**TABLE OF CONTENTS**

a. Securities registration . . . . . 192  
     EXERCISE 4-4 . . . . . 194  
 b. Broker and agent registration . . . . . 194  
 c. Antifraud rules . . . . . 196  
 2. Federal Preemption . . . . . 197  
     NOTES AND QUESTIONS . . . . . 199  
 COMPREHENSIVE PROBLEM: SECURITIES DOCUMENTS FOR ENTITY  
 ORGANIZATION . . . . . 200

---

**Chapter 5 FINANCING OF BUSINESS ENTITIES . . . . . 203**

---

A. INTRODUCTION . . . . . 203  
 B. DEBT FINANCING . . . . . 203  
     1. Examples of Promissory Notes and Types of Loans . . . . . 204  
     2. Lenders . . . . . 207  
     3. Leverage . . . . . 207  
 C. EQUITY FINANCING . . . . . 209  
     The Venture Capital Industry — An Overview . . . . . 211  
 D. STRUCTURING THE FINANCING OF BUSINESS ENTITIES . . . . . 216  
     1. Financing of Corporations . . . . . 217  
        a. The TouchSearch, Inc. scenario . . . . . 219  
        b. Common stock . . . . . 219  
        c. Preferred stock . . . . . 222  
            EXERCISE 5-1 . . . . . 226  
        d. Debt financing from outsiders and investors . . . . . 227  
            i. Availability of secured debt from outsiders . . . . . 228  
            ii. Availability of unsecured debt from outsiders . . . . . 229  
            iii. Availability of unsecured debt from insiders . . . . . 230  
                EXERCISE 5-2 . . . . . 230  
            iv. Recharacterization of debt as equity . . . . . 230  
                *In Re Cold Harbor Assocs., L.P.* . . . . . 231  
                NOTES AND QUESTIONS . . . . . 238  
        e. The Problem of Future Capital Contributions . . . . . 239  
            i. Preemptive rights . . . . . 239  
            ii. New equity participants . . . . . 241  
            iii. Loans from current equity holders . . . . . 242  
     2. The Financing of General Partnerships, Limited Partnerships and  
        LLCs . . . . . 242  
        a. General Partnerships . . . . . 243  
            i. Debt or equity contributions . . . . . 247  
            ii. Types of consideration for partnership interests . . . . . 249  
            iii. Contributions of services . . . . . 250  
            iv. Contributions of property . . . . . 251  
        b. Limited Partnerships . . . . . 251

---

**TABLE OF CONTENTS**

	EXERCISE 5-3 . . . . .	255
i.	A special note about “substantial economic effect” . . . . .	255
ii.	Total failure of the limited partnership . . . . .	256
iii.	Contributions of debt . . . . .	258
iv.	Contributions of services and property . . . . .	259
c.	Limited Liability Companies . . . . .	259
i.	Contributions of debt . . . . .	262
ii.	Contributions of services and property . . . . .	263
d.	Future Equity Contributions to General Partnerships, Limited Partnerships and Limited Liability Companies . . . . .	263
e.	Future Contributions from New Equity Participants . . . . .	266
f.	Debt Financing for Future Operations and Expansions . . . . .	268
<b>Chapter 6</b>	<b>PROFITS AND DISTRIBUTIONS . . . . .</b>	<b>271</b>
A.	AN INTRODUCTION TO FINANCIAL ACCOUNTING . . . . .	271
1.	The Balance Sheet . . . . .	271
	EXERCISE 6-1 . . . . .	273
2.	The Income Statement . . . . .	273
	EXERCISE 6-2 . . . . .	275
3.	Accrual and Deferral . . . . .	275
4.	Accounting Assumptions . . . . .	276
B.	PROFITS AND LOSSES . . . . .	278
	EXERCISE 6-3 . . . . .	280
C.	CORPORATE DIVIDENDS AND DISTRIBUTIONS . . . . .	281
1.	Corporate Equity Accounts . . . . .	281
2.	Accounting for and Regulating Dividends . . . . .	284
	EXERCISE 6-4 . . . . .	289
	<i>Randall v. Bailey</i> . . . . .	290
	EXERCISE 6-5 . . . . .	297
3.	Accounting for and Regulating other Distributions . . . . .	297
	<i>Klang v. Smith’s Food &amp; Drug Centers, Inc.</i> . . . . .	299
	EXERCISE 6-6 . . . . .	303
4.	Distributions Made Over Time . . . . .	303
	EXERCISE 6-7 . . . . .	305
D.	PARTNERSHIP ALLOCATIONS AND DISTRIBUTIONS . . . . .	305
1.	Contributions and Allocations . . . . .	306
2.	Distributions and Repurchases . . . . .	307
E.	LIMITED LIABILITY COMPANY ALLOCATIONS AND DISTRIBUTIONS . . . . .	308
1.	Contributions and Allocations . . . . .	308
2.	Distributions and Repurchases . . . . .	309
F.	RESTRICTIONS ON PAYMENTS UNDER FRAUDULENT TRANSFER LAWS . . . . .	312

---

**TABLE OF CONTENTS**

	NOTES AND QUESTIONS . . . . .	313
G.	FEDERAL INCOME TAXATION OF DISTRIBUTIONS . . . . .	314
1.	Partnerships . . . . .	314
a.	Contributions . . . . .	314
b.	Allocations . . . . .	315
i.	General rules . . . . .	315
ii.	Substantial economic effect . . . . .	316
	Simon Friedman, <i>Partnership Capital Accounts and Their</i>	
	<i>Discontents</i> . . . . .	317
iii.	Determining the “interest in the partnership” . . . . .	318
c.	Distributions . . . . .	319
2.	C Corporations . . . . .	320
a.	Contributions and allocations . . . . .	320
b.	Distributions . . . . .	321
c.	Repurchases . . . . .	322
	EXERCISE 6-8 . . . . .	323
3.	S Corporations . . . . .	323
a.	Background . . . . .	323
b.	Contributions and allocations . . . . .	324
c.	Distributions and repurchases . . . . .	325
	COMPREHENSIVE EXERCISE: DEPARTURE OF AN OWNER . . . . .	326

---

**Chapter 7                   MANAGEMENT AND CONTROL . . . . . 333**

---

A.	CONCEPTUAL OVERVIEW . . . . .	333
1.	The Clients’ Initial Division of Responsibility . . . . .	333
2.	Other Responsibilities . . . . .	334
3.	Resolution of Disagreements . . . . .	336
4.	Decision-Making Process . . . . .	338
B.	IN A PARTNERSHIP . . . . .	340
	<i>Whitney v. Citibank, N.A.</i> . . . . .	341
	NOTES AND QUESTIONS . . . . .	345
	QUESTIONS . . . . .	347
C.	IN A CORPORATION . . . . .	348
1.	Common Law Rules on Shareholder Agreements . . . . .	348
	<i>Galler v. Galler</i> . . . . .	349
2.	Statutory Modifications . . . . .	353
	<i>Zion v. Kurtz</i> . . . . .	353
	NOTES AND QUESTIONS . . . . .	358
	NOTES AND QUESTIONS . . . . .	361
3.	Documenting the Arrangement . . . . .	362
	<i>Blount v. Taft</i> . . . . .	363
	NOTES AND QUESTIONS . . . . .	369
D.	IN A LIMITED LIABILITY COMPANY . . . . .	370

---

**TABLE OF CONTENTS**

1. The Member-Managed LLC . . . . . 371  
     EXERCISE 7-1 . . . . . 372  
 2. The Manager-Managed LLC . . . . . 372  
     EXERCISE 7-2 . . . . . 374  
 3. The Changing LLC Landscape . . . . . 374  
 E. FIDUCIARY DUTIES AND THE BUSINESS PLANNER . . . . . 374  
 COMPREHENSIVE EXERCISE: DRAFTING MANAGEMENT PROVISIONS . . 376

---

**Chapter 8 DEPARTURE OF AN OWNER AND BUY-SELL AGREEMENTS . . . . . 377**

---

A. DEPARTURES OF AN OWNER AND THE NEED FOR A BUY-SELL AGREEMENT . . . . . 377  
 1. Positive Departures . . . . . 377  
 2. Negative Departures . . . . . 378  
 3. All Departures . . . . . 378  
 4. Concerns of Non-Departing Owners . . . . . 379  
 5. Concerns of Departing Owners . . . . . 379  
 6. Preparing for Departures at the Formation or Joinder Stages . . . . . 380  
 7. Summary — Purposes of Buy Sell Agreements . . . . . 380  
 B. THE COMPONENTS OF A BUY-SELL AGREEMENT . . . . . 381  
 1. Permitted Transfers . . . . . 381  
 2. Integration With Organic Documents . . . . . 383  
 C. INTRODUCTION TO TAX ASPECTS OF BUY-SELL AGREEMENTS . . . . . 383  
 1. Partnership Tax Considerations . . . . . 384  
 2. Tax Considerations for Corporations and Stockholders . . . . . 385  
 3. Other Tax Considerations . . . . . 386  
 D. EVENTS TRIGGERING A BUYOUT . . . . . 386  
 1. Death . . . . . 386  
 2. Voluntary Transfers . . . . . 389  
 3. Encumbrances . . . . . 390  
 4. Involuntary Transfers and Bankruptcy . . . . . 392  
 5. Termination of Employment . . . . . 394  
 6. Disability . . . . . 396  
 7. Other Triggers . . . . . 398  
 E. BUYOUT PROCEDURES AND VALUATION . . . . . 398  
 1. Rights of First Refusal . . . . . 398  
 2. Valuation of Ownership Interests . . . . . 401  
 3. The Problems With “Fair Market Value” . . . . . 401  
 4. The Problems With Arbitrators and Appraisers . . . . . 403  
 5. The Problems With Valuation by Agreement . . . . . 405  
 6. Objective Valuation Standards . . . . . 407  
     a. Book Value . . . . . 407

---

**TABLE OF CONTENTS**

b.	Capitalized Earnings . . . . .	409
c.	Rental Income . . . . .	411
d.	Asset Valuation . . . . .	411
e.	Combinations of Valuation Formulas . . . . .	412
7.	Conclusion — Valuation Formulas . . . . .	412
F.	FINANCING THE PURCHASE . . . . .	413
1.	Introduction to Cross-Purchase vs. Entity Purchase Agreements . . . . .	413
	<i>Lubin Meyer, P.C. v. Lubin</i> . . . . .	416
	NOTES AND QUESTIONS . . . . .	420
	<i>Stephenson v. Drever</i> . . . . .	422
	NOTES AND QUESTIONS . . . . .	430
2.	Financing Schemes . . . . .	431
a.	Life Insurance Plans . . . . .	432
b.	Installment Payments . . . . .	435
c.	Reserve Plans . . . . .	440
d.	Borrowing Money . . . . .	441
3.	Summary — Financing The Buyout . . . . .	441
G.	ENTITY-SPECIFIC CONSIDERATIONS . . . . .	442
1.	Statutory Limitations on Corporate Buyouts . . . . .	442
2.	Non-Statutory Considerations & Limitations for Partnership and LLC Buy-Sell Agreements . . . . .	445
3.	Statutory Considerations for General Partnerships . . . . .	445
4.	Statutory Considerations for LLCs . . . . .	447
5.	Regulatory and Licensing Rules . . . . .	451
H.	FRAUDULENT TRANSFERS AND ENTITY REPURCHASES . . . . .	451
<b>Chapter 9</b>	<b>SALE OR RESTRUCTURING OF THE BUSINESS ENTITY . . . . .</b>	<b>455</b>
<hr/>		
A.	METHODS OF RESTRUCTURING . . . . .	455
1.	Sale of Assets . . . . .	455
2.	Sale of Ownership Interests . . . . .	458
3.	Combinations . . . . .	459
B.	ORGANIC LAW ISSUES . . . . .	461
1.	Partnerships . . . . .	462
a.	Sale of Assets . . . . .	462
b.	Sale of Partnership Interests . . . . .	463
c.	Combinations . . . . .	464
	NOTES . . . . .	468
2.	Corporations . . . . .	468
a.	Sale of Assets . . . . .	468
b.	Sale of Stock . . . . .	470
	<i>Harris v. Carter</i> . . . . .	473
	NOTES AND QUESTIONS . . . . .	478

---

**TABLE OF CONTENTS**

c.	Combinations . . . . .	479
	EXERCISE 9-1 . . . . .	480
	<i>Elliott Associates, L.P. v. Avatex Corporation</i> . . . . .	481
	NOTES AND QUESTIONS . . . . .	488
	EXERCISE 9-2 . . . . .	490
3.	Limited Liability Companies . . . . .	491
a.	Sale of Assets . . . . .	491
b.	Sale of Membership Interests . . . . .	492
c.	Combinations . . . . .	493
C.	FEDERAL INCOME TAX ISSUES . . . . .	493
1.	Taxation of Partnership Reorganizations . . . . .	493
a.	Sale of Assets . . . . .	493
b.	Sale of Partnership Interests . . . . .	496
c.	Combinations . . . . .	499
2.	Taxation of Corporate Reorganizations . . . . .	499
a.	The Basic Decision: Taxable or Tax-deferred? . . . . .	500
	Study of the Overall State of the Federal Tax System and	
	Recommendations for Simplification . . . . .	500
	NOTES AND QUESTIONS . . . . .	501
b.	The Taxable Transaction . . . . .	502
i.	Sale of assets . . . . .	502
	<i>Commissioner of Internal Revenue v. Court Holding Co.</i> . . . . .	503
	<i>United States v. Cumberland Public Service Co.</i> . . . . .	504
	NOTES AND QUESTIONS . . . . .	507
ii.	Sale of shares . . . . .	507
c.	The Nontaxable Transaction . . . . .	508
i.	Background on “reorganizations” . . . . .	508
ii.	Consequences of “reorganization” treatment . . . . .	508
iii.	Definition of a “reorganization” . . . . .	509
iv.	General requirements for all reorganizations . . . . .	510
	NOTES AND QUESTIONS . . . . .	512
v.	Particular requirements . . . . .	512
(A)	“A” reorganizations and “triangular” mergers . . . . .	512
(B)	“B” reorganizations . . . . .	514
(C)	“C” reorganizations . . . . .	515
(D)	Nondivisive “D” reorganizations . . . . .	515
(E)	Divisive “D” reorganizations . . . . .	515
	COMPREHENSIVE PROBLEM: SALE OF THE BUSINESS . . . . .	516

---

**Chapter 10                    DISSOLUTION UNDER STATE AND FEDERAL LAW . 521**

A.	INTRODUCTION TO DISSOLUTIONS . . . . .	521
1.	Cooperation and Forums for Dissolutions . . . . .	521
2.	Tax Considerations for Dissolutions . . . . .	522



---

**TABLE OF CONTENTS**

B.	DISSOLUTION OF CORPORATIONS . . . . .	523
1.	Voluntary Dissolutions of Corporations . . . . .	523
2.	Distributions to Stockholders . . . . .	531
	<i>Pacific Scene, Inc. v. Penasquitos, Inc.</i> . . . . .	533
	NOTES AND QUESTIONS . . . . .	540
3.	Involuntary Dissolutions . . . . .	541
a.	Grounds for Involuntary Dissolution . . . . .	541
b.	Parties Entitled to Initiate Involuntary Dissolutions . . . . .	544
c.	Conducting the Dissolution . . . . .	545
4.	The Statutory Buyout Right . . . . .	547
	<i>Mart v. Severson</i> . . . . .	550
	NOTES AND QUESTIONS . . . . .	559
C.	LIMITED LIABILITY COMPANY DISSOLUTIONS . . . . .	560
1.	LLC Dissolution Procedures . . . . .	561
2.	Commencement of an LLC Dissolution . . . . .	563
	<i>Kirksey v. Grohmann</i> . . . . .	565
	NOTES AND QUESTIONS . . . . .	571
3.	Elimination of the Mandatory Buyout in the 2006 ULLCA . . . . .	578
4.	Non-ULLCA Buyout Rights . . . . .	579
5.	Summary — Dissolution of LLCs . . . . .	581
D.	GENERAL PARTNERSHIP DISSOLUTIONS . . . . .	582
1.	The Revised Uniform Partnership Act . . . . .	583
2.	Dissociation . . . . .	584
3.	Dissolution . . . . .	588
a.	Dissolution Triggers — When Will Dissolution Occur? . . . . .	589
i.	Triggers — partnerships at will . . . . .	590
ii.	Triggers — partnerships for a definite term or particular purpose . . . . .	591
iii.	Triggers — all partnerships . . . . .	591
b.	Summary — Triggers for Dissolution and Winding Up . . . . .	591
c.	Stopping Dissolution and Winding Up . . . . .	592
4.	Buyout Rights . . . . .	593
	EXERCISE 10-1 . . . . .	597
5.	Winding Up . . . . .	597
a.	Post-Dissolution Authority . . . . .	597
b.	Creditors Rights . . . . .	599
c.	Distributions to Partners and Balancing Partner’s Accounts . . . . .	601
E.	BANKRUPTCY . . . . .	604
1.	Introduction to the Bankruptcy Code . . . . .	604
2.	History and Sources of Bankruptcy Law . . . . .	606
3.	Why is Understanding Federal Bankruptcy Important for Business Planning Lawyers? . . . . .	607
a.	Bankruptcy Filing Trends . . . . .	607
b.	Business Filings . . . . .	609
4.	Objectives of Bankruptcy . . . . .	610

---

**TABLE OF CONTENTS**

	Sir William Blackstone, Commentaries on the Laws of England . . .	610
a.	The Fresh Start for Honest and Cooperative <i>Individual</i> Debtors . . . .	613
i.	The mechanics of bankruptcy for individual debtors . . . . .	614
ii.	The logic behind the fresh start discharge for individuals . . . . .	619
b.	Liquidation and Reorganization of Business Debtors . . . . .	621
i.	Business entity liquidations . . . . .	621
ii.	The problem of partner, guarantor and joint liability . . . . .	624
iii.	Business entity reorganizations . . . . .	625
iv.	The debtor-in-possession . . . . .	628
v.	BAPCA and “small business reorganizations” . . . . .	629
c.	Fair, Efficient and Maximizing Distribution to Creditors . . . . .	630
5.	Some Essential Bankruptcy Mechanisms . . . . .	633
a.	The Automatic Stay . . . . .	633
b.	Subject Matter Jurisdiction of the Federal Courts . . . . .	634
c.	Delegation of Authority to Bankruptcy Judges . . . . .	635
d.	Involuntary Petitions . . . . .	636
	EXERCISE 10-2 . . . . .	637
e.	Bankruptcy Fraud . . . . .	638
F.	CONCLUSION — DISSOLUTIONS AND BANKRUPTCY . . . . .	639
	<b>Table of Cases</b> . . . . .	TC-1
	<b>Index</b> . . . . .	I-1