

Structuring Your LLC for Resale or Closure

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Planning Your Exit

“[T]he process for getting out of business successfully requires the same amount of planning as going into business. While the process should be easier, it is likely to be less enjoyable and more stressful. The best advice for business owners is to think about the future during the early stages of getting into business. Exert managerial influence to ensure that complications and problems which could affect dissolution and net value do not develop into roadblocks. When the time for getting out of business comes, engage the invaluable expertise you will need, and prepare a plan.”

Source: Small Business Administration



A Few Statistics About Small Businesses

Turnover of Small Businesses Nationally

	2004	2005	2006	2007	2008
Openings	628,917	644,122	670,058	663,100	627,200
Closings	541,047	565,745	599,333	571,300	595,600
Bankruptcies	34,317	39,201	19,695	28,322	43,546

Source: U.S. Small Business Administrations, Office of Advocacy, *The Small Business Economy: A Report to the President*, Appendix A, Table A.2 (2009 ed.)

A Few Statistics About Small Businesses in Alabama

Turnover of Small Businesses in Alabama

	2007	2008
Openings	16,052	15,496
Closings	14,809	16,128
Bankruptcies	306	536

Source: U.S. Small Business Administrations, Office of Advocacy, *The Small Business Economy: A Report to the President*, Appendix A, Table A.5 (2009 ed.)

CLOSURE STRATEGIES

1. Bankruptcy
2. Dissolution

BANKRUPTCY



Bankruptcy: Overview

- Liquidation
- Reorganization

Chapter 7: Liquidation

- The company stops all operations and goes completely out of business
- A trustee is appointed to liquidate all the company's assets
- The money from the liquidation is used to pay the company's creditors
- Filing for bankruptcy stays most collection actions



Automatic Stay

- Once the bankruptcy petition is filed, a stay of creditor actions automatically goes into effect.

Conversion

- The debtor may convert a Chapter 7 case to a Chapter 11 case.

Continue Operations?

- The court can authorize the trustee to operate the business for a limited period, if it is in the best interest of the estate.

Liability for Business Debts

- If there is a deficiency of assets to pay all creditors' claims, the trustee shall have a claim against a member to the extent that under applicable non-bankruptcy law such member is personally liable.
 - Example: a personal guarantee given by a member in order for LLC to obtain a loan

Chapter 11: Reorganization

- Chapter 11 can be filed either voluntarily by the business or involuntarily by the creditors.
- Chapter 11 does not get rid of debts. Rather, debts are reorganized, either by restructuring or changing the terms, to give the business a better chance of repaying its debts in the future.

Debtor in Possession

- The debtor in possession is put in the position of a fiduciary, with the rights and powers of a trustee, and required to perform all functions of a trustee.
- Moreover, the debtor in possession, unless the court orders otherwise, operates the business.
- The bankruptcy administrator monitors the progress of the Chapter 11 case and the debtor in possession.



Conversion

- A debtor can convert a Chapter 11 case to a Chapter 7 case unless they is not a debtor in possession or the bankruptcy was involuntary.
- On request by a party in interest or the bankruptcy administrator, the court can convert a Chapter 11 case to a Chapter 7 case.



Who May File a Plan

- The debtor has a 120 day period where it has the exclusive right to file a plan.
- After this period, any party in interest may file a competing plan if the debtor did not file a plan before 120 days, or the debtor has not filed a plan that was accepted within 180 days.

Liquidation Plan

- Liquidating plans are permissible under Chapter 11, and sometimes allow the debtor in possession to liquidate the business under better circumstances than a Chapter 7 liquidation.

Acceptance of a Plan

- The holder of a claim or interest may accept or reject a plan.
- A class of creditors has accepted a plan if the plan was accepted by creditors that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class of creditors.

Modification of a Plan

- At any time before confirmation of a plan, the proponent may modify the plan; the plan as modified becomes the plan.
- At any time after confirmation of a plan and before substantial consummation, the proponent may modify the plan; the modification becomes the plan only if circumstances warrant such modification.



Discharge

- Confirmation of a plan discharges a debtor from any debt that arose before the date of confirmation.
- The debtor is required to make plan payments and is bound by the provisions of the plan for reorganization.

DISSOLUTION AND LIQUIDATION OF LLC

- Authorize dissolution and liquidation
- File Articles of Dissolution
- Adopt Plan of Dissolution, Liquidation and Distribution
- Give notice to creditors

Dissolution

Authorization of Dissolution

1. Articles of Organization
2. Operating Agreement
3. Alabama Limited Liability Company Act

Alabama Limited Liability Company Act

A limited liability company is dissolved upon the occurrence of the first of the following events:

1. Events specified in the Articles of Organization or Operating Agreement
2. Written consent of all members
3. When there is no remaining member
4. A merger or consolidation in which the LLC is not the successor or surviving entity
5. Judicial dissolution



Winding-Up

Once an LLC is dissolved, its existence continues but the LLC may not carry on any business except as necessary or appropriate to wind up and liquidate its business and affairs.

Who May Wind Up?

- Any member who has not wrongfully dissolved the LLC may wind up the LLC's business and affairs.
- Winding-up member elected by members; usually the manager in a member-managed LLC is chosen as winding-up member.

Powers of Winding-Up Member

A person winding up an LLC's business may:

1. Preserve the company business or property as a going concern for a reasonable time
2. Prosecute and defend actions and proceedings, whether civil, criminal, or administrative
3. Settle and close the LLC's business
4. Dispose of and transfer the LLC's property
5. Discharge, settle, or pay off the LLC's liabilities
6. Distribute the assets of the LLC



Fiduciary Duties of Winding-Up Member

- Duty of Loyalty
- Duty of Care
- “Obligation of good faith and fair dealing” in discharging duties and exercising rights

Duty of Loyalty

- To account to the LLC and hold as trustee any property of LLC, including any profit or benefit derived by the person winding up the LLC's business or derived from use of the LLC's property, including appropriation of the LLC's business opportunity.
- To refrain from dealing with the LLC in winding up of the LLC's business as, or on behalf of, a party having an adverse interest to the LLC.



Duty of Care

- To refrain from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law.



Notice to Creditors

- Known Creditors
- Unknown Creditors

Giving Notice to Known Creditors

- The dissolved LLC shall notify its known creditors in writing of the dissolution. The written notice shall:
 - Describe information that must be included in a claim.
 - Provide a mailing address for claim to be sent.
 - State the deadline, which may not be less than 120 days from the date of mailing the written notice.
 - State the claim shall be barred if not received by the deadline.



Claim is Barred

- A claim against the dissolved LLC is barred in any of the following circumstances:
 - If a claimant who was given notice does not deliver the claim by the deadline.
 - If a claimant whose claim was rejected by the LLC does not commence a proceeding to enforce the claim within 180 days of the rejection notice.



Giving Notice to Unknown Creditors

- The dissolved LLC may publish notice of its dissolution which requests persons present their claims against the LLC.
- The notice shall:
 - Be published once in a newspaper of general circulation in the county where the dissolved LLC's principal office was located.
 - Describe the information that should be included in a claim and provide a mailing address.
 - State that Articles of Dissolution have been filed.
 - State that a claim against the LLC shall be barred unless a proceeding to enforce the claim is commenced within two years after publication of the notice.



Claim is Barred

- If the LLC publishes a newspaper notice, the claims of each of the following claimants are barred unless they commence a proceeding to enforce the claim within two years after the publication of the notice:
 - A claimant who did not receive written notice
 - A claimant whose claim was timely sent but not acted upon
 - A claimant whose claim is contingent or based upon an event occurring after the date of dissolution



Distribution of Assets

- Assets of an LLC shall be distributed in the following order of priority:
 - First to creditors, including members who are creditors
 - Second to members of the LLC
 - First in proportion to their contributions
 - Second in proportion to their membership interests

Articles of Dissolution

- After the approval of dissolution of the LLC, the LLC must file Articles of Dissolution in the office of the probate judge of the county where the LLC was formed. The Articles of Dissolution must contain:
 - The name of the LLC
 - The date of filings its Articles of Organization
 - The reason for filing the Articles of Dissolution (that is, the event causing dissolution)
 - The effective date of the Articles of Dissolution
 - Any other information the member(s) or manager(s) deem appropriate

Dissolution Does Not

- Transfer title to the LLC's assets
- Terminate or suspend a proceeding pending by or against the LLC on the effective date of the Articles of Dissolution
- Terminate the authority of the registered agent of the LLC

RESALE STRATEGIES

- Merger – LLC ceases to exist or survives depending upon structure
- Sales – Assets or membership interests/units of LLC are sold

Overview of Transaction Process

- Term Sheet or Letter of Intent
- Non-disclosure/Confidentiality Agreement
- Due Diligence
- Negotiation and Drafting of Transaction Documents
- Closing
- Post-Closing



Term Sheet or Letter of Intent

- Generally, non-binding, except for:
 - Due diligence provision
 - Confidentiality provision
 - Expenses provision
 - Lock-up provision
 - No-shop provision
 - Break-up provision

Lock-up Provision

- An option granted to a buyer to buy additional units/membership interests (usually, majority or controlling interest) or major assets (a “crown jewel lock-up”)
- Prelude to a takeover
- Hard (unconditional) or soft (may terminate if superior offer received)



No-shop Provision

- Limits the selling company's ability to market the sale of the company or to respond to offers by other prospective buyers
- Fiduciary out

Break-up Provision

- Selling company is required to pay consideration (usually, a pre-determined, set amount of money) to the buyer in the event that the transaction is terminated by seller (i.e., seller does not sale or sells to another buyer)
- Amount must bear a reasonable relation to the value of the transaction
- Or can be treated as liquidated damages



MERGER

- LLC may merge with or into another LLC or any “other business entities formed or organized under the laws of this state, any other state, the United States, or any foreign jurisdiction”
- Except as provided in Operating Agreement, merger must be approved by all members



Effect of Merger

All of the following vest in the surviving or resulting entity as a result of the merger:

- All rights, privileges and powers of LLC
- All property, real, personal and mixed of LLC
- All debts due to LLC (e.g., accounts receivable)
- All other things and causes of actions belonging to LLC

Effect of Merger (cont'd)

All of the following continue unimpaired and can be enforced against the surviving or resulting entity as a result of the merger

- All rights of creditors and all liens upon any LLC property
- All debts, liabilities and duties of LLC attach to surviving entity

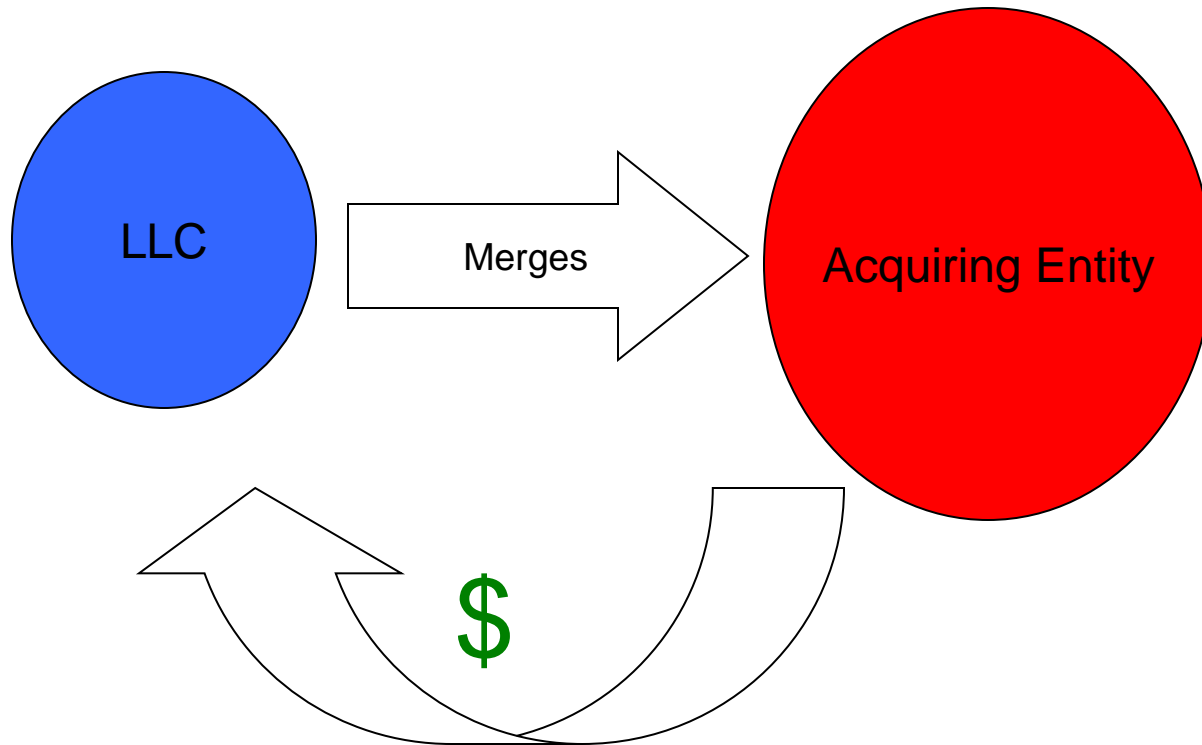
Types of Mergers

1. Forward Cash Merger
2. Forward Subsidiary Cash Merger
3. Reverse Subsidiary Cash Merger
4. Forward Stock Merger
5. Forward Triangular Merger
6. Reverse Triangular Merger

Forward Cash Merger

- LLC merges directly into acquiring entity
- LLC membership interests converted into equity interests of acquiring entity or cancelled
- Former members of the LLC receive cash in exchange for their membership interests

Forward Cash Merger

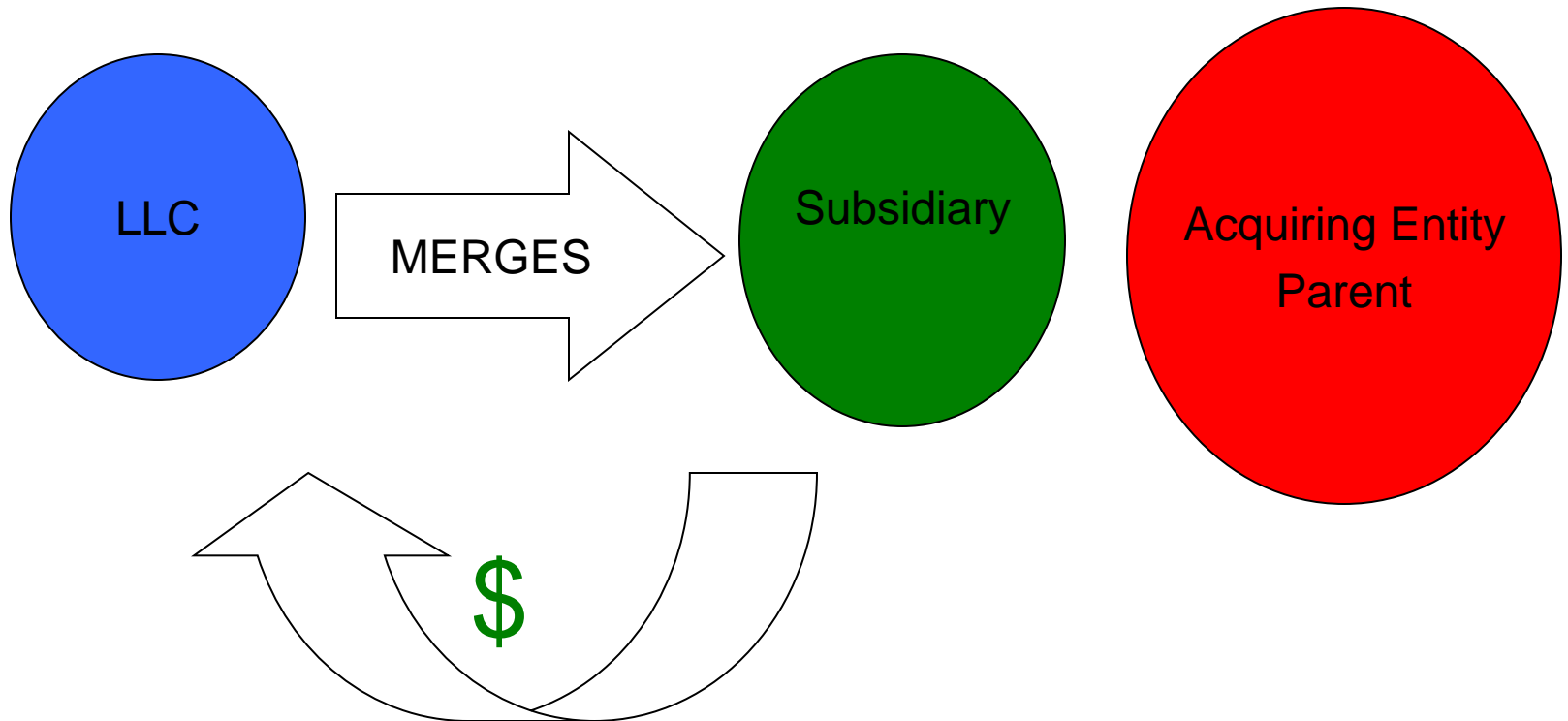


Forward Subsidiary Cash Merger

- LLC merges into a subsidiary of acquiring entity
- Subsidiary equity interests converted into LLC membership interests or cancelled
- Former members of LLC receive cash in exchange for their membership interests



Forward Subsidiary Cash Merger

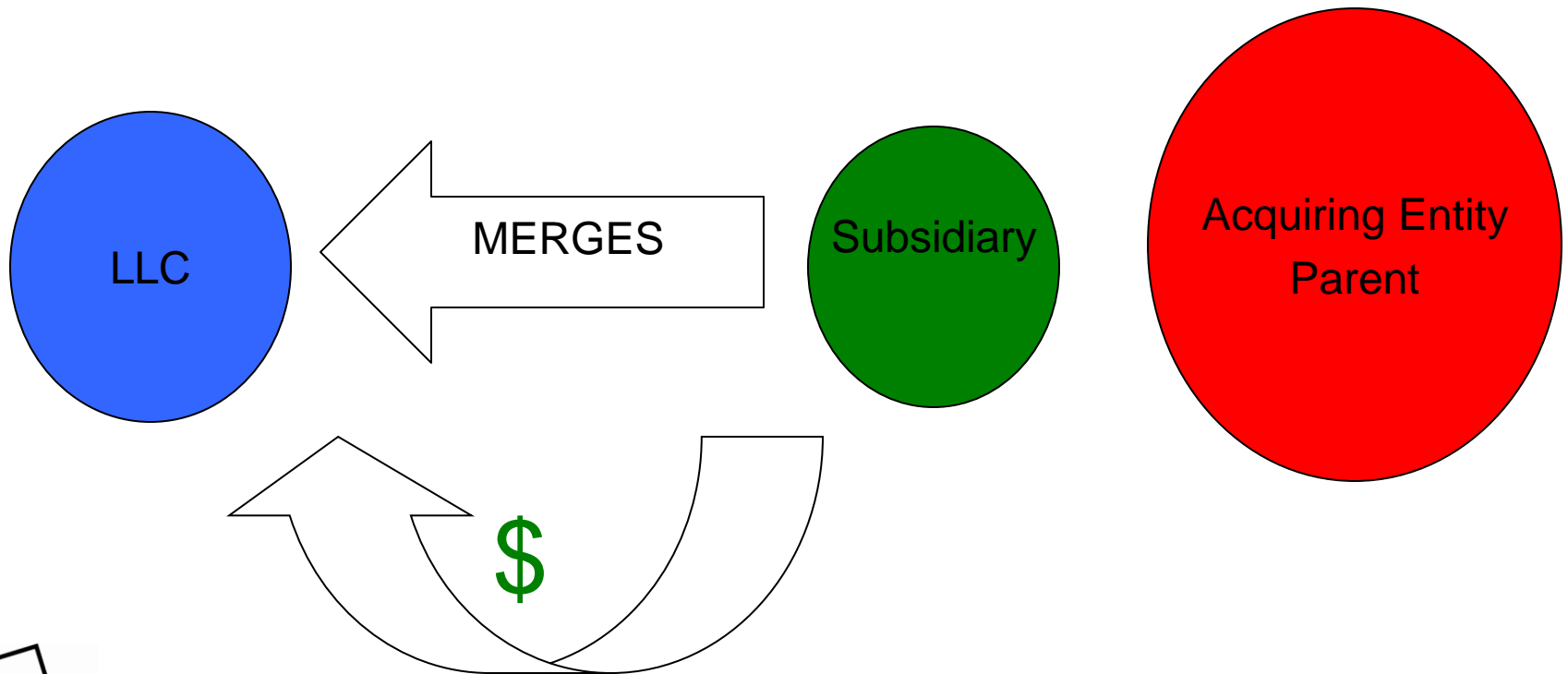


Reverse Subsidiary Cash Merger

- Acquiring entity forms a subsidiary and the newly formed subsidiary merges into the LLC
- LLC membership interests converted into equity interests of subsidiary or cancelled
- Former members of the LLC receive cash in exchange for their membership interests
- Parent becomes the owner of LLC; that is, the sole member of LLC is Parent and LLC is a subsidiary of Parent



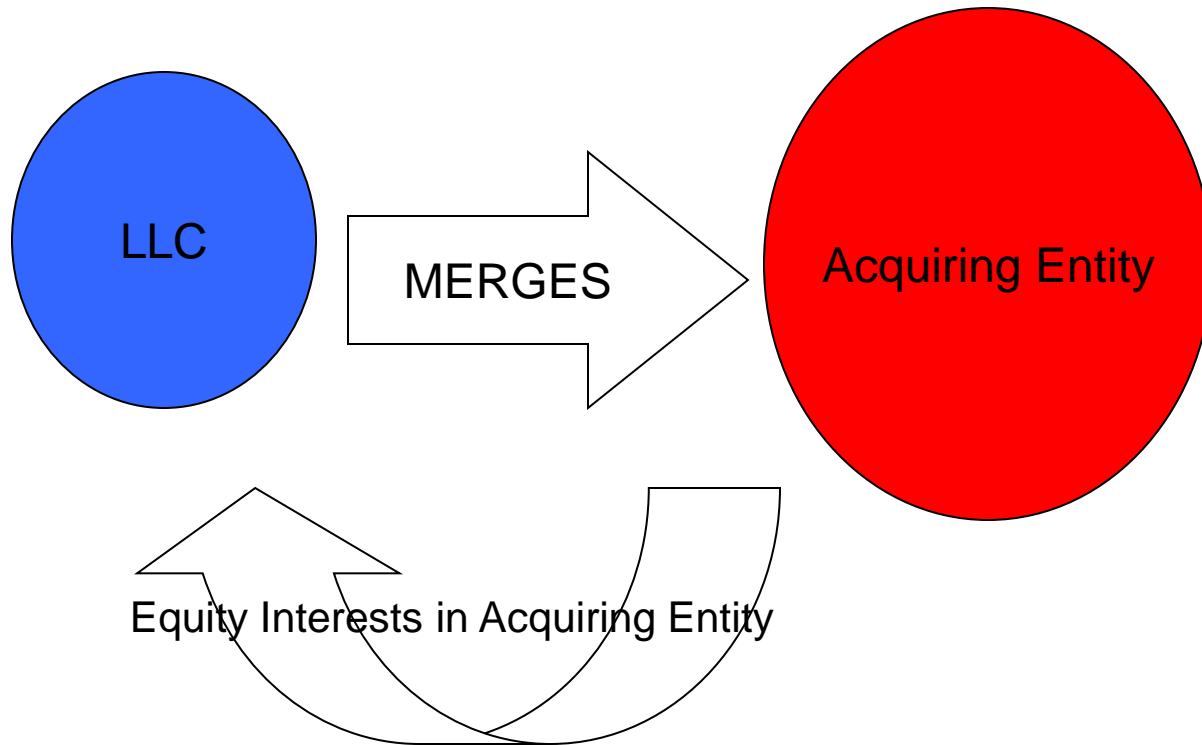
Reverse Subsidiary Cash Merger



Forward Stock Merger

- LLC merges directly into acquiring entity
- Former members of the LLC receive equity interests in acquiring entity in exchange for their membership interests
- Former members of acquired LLC become members of acquiring entity

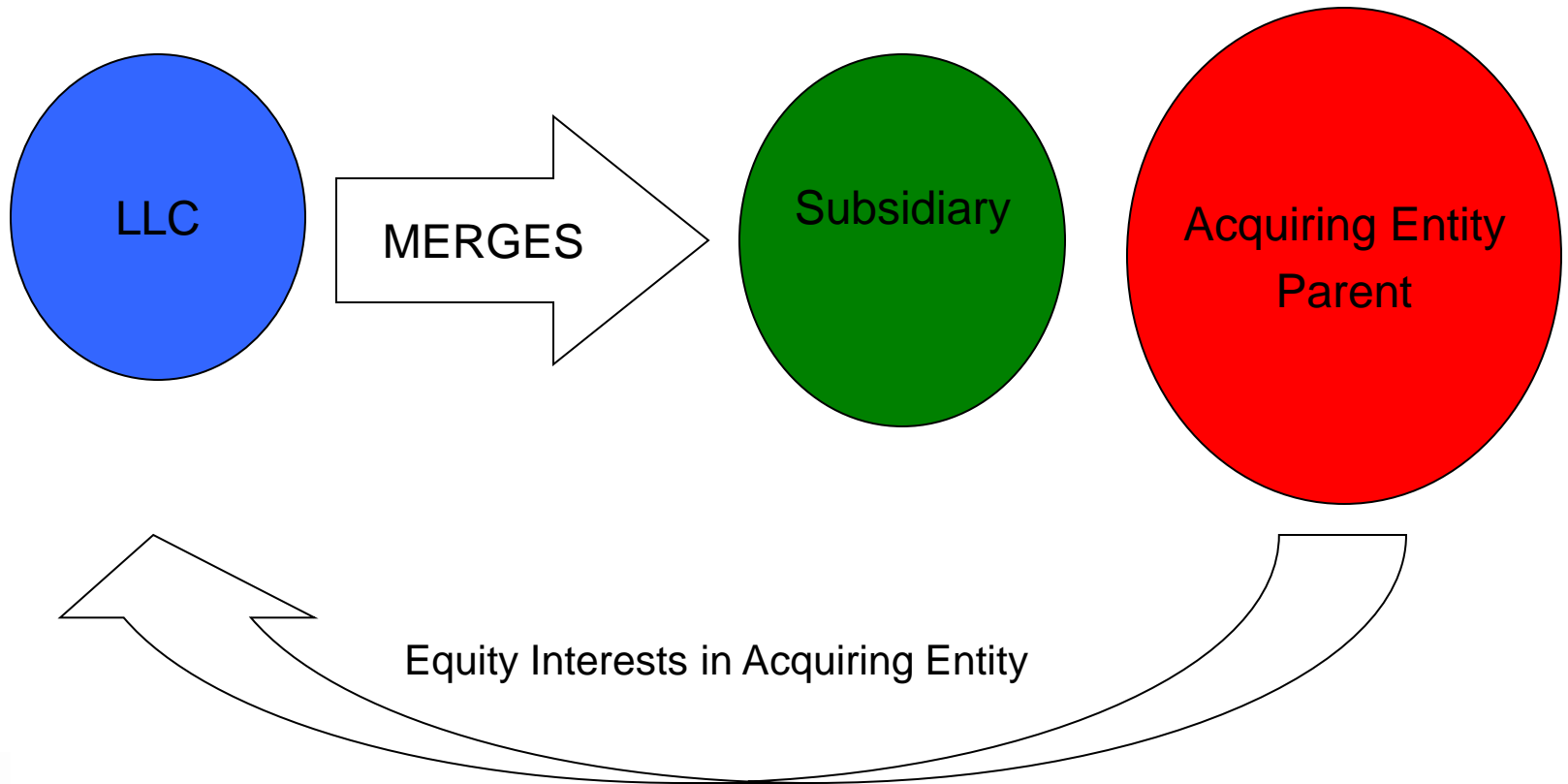
Forward Stock Merger



Forward Triangular Merger

- LLC merges into a subsidiary of acquiring entity
- Former members of the LLC receive equity interests in acquiring parent entity in exchange for their membership interests

Forward Triangular Merger

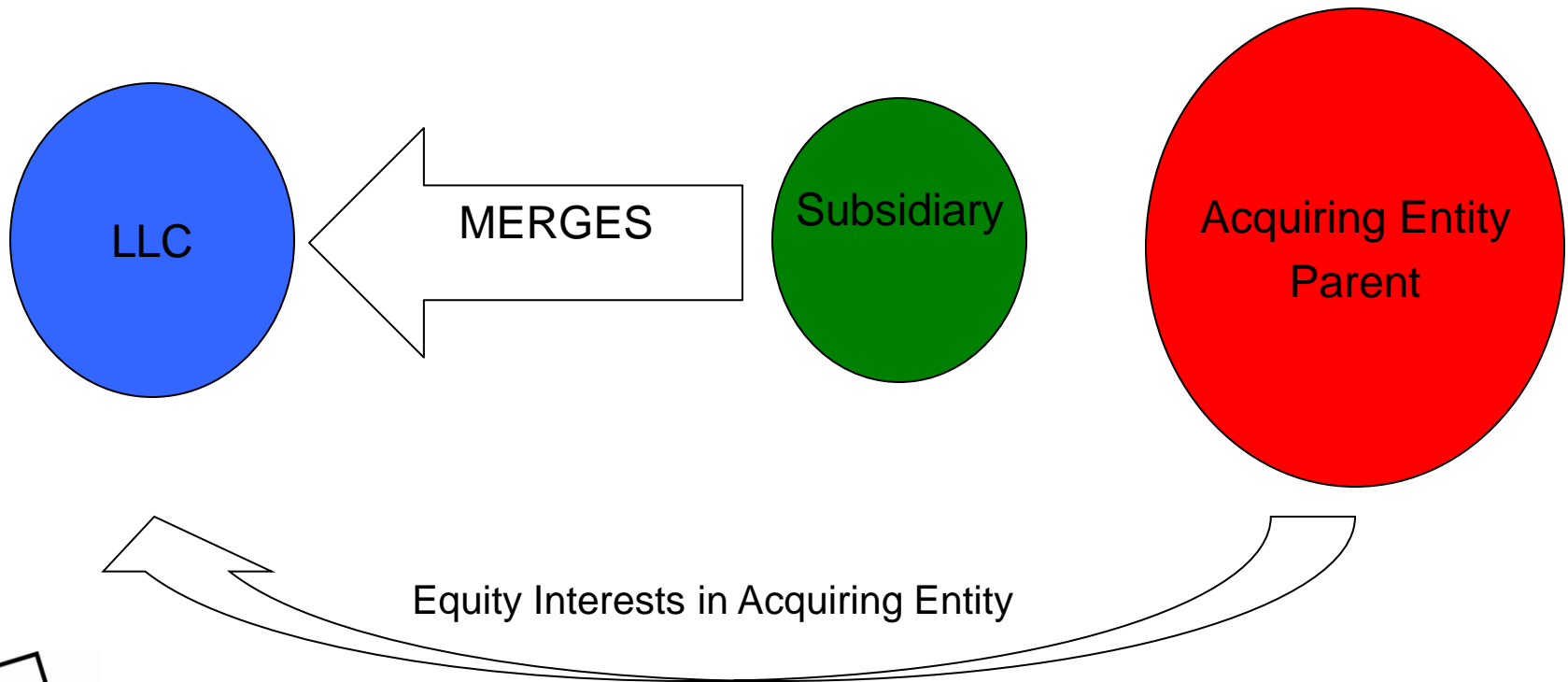


Reverse Triangular Merger

- Acquiring entity forms a subsidiary and the newly formed subsidiary merges into the LLC
- Former members of the LLC receive equity interests in the acquiring parent entity in exchange for their membership interests
- Parent becomes the owner of the LLC



Reverse Triangular Merger



SALE

1) Membership Interests/Units

- 1) Direct Sale
- 2) “B” Reorganization
- 3) Triangular “B” Reorganization

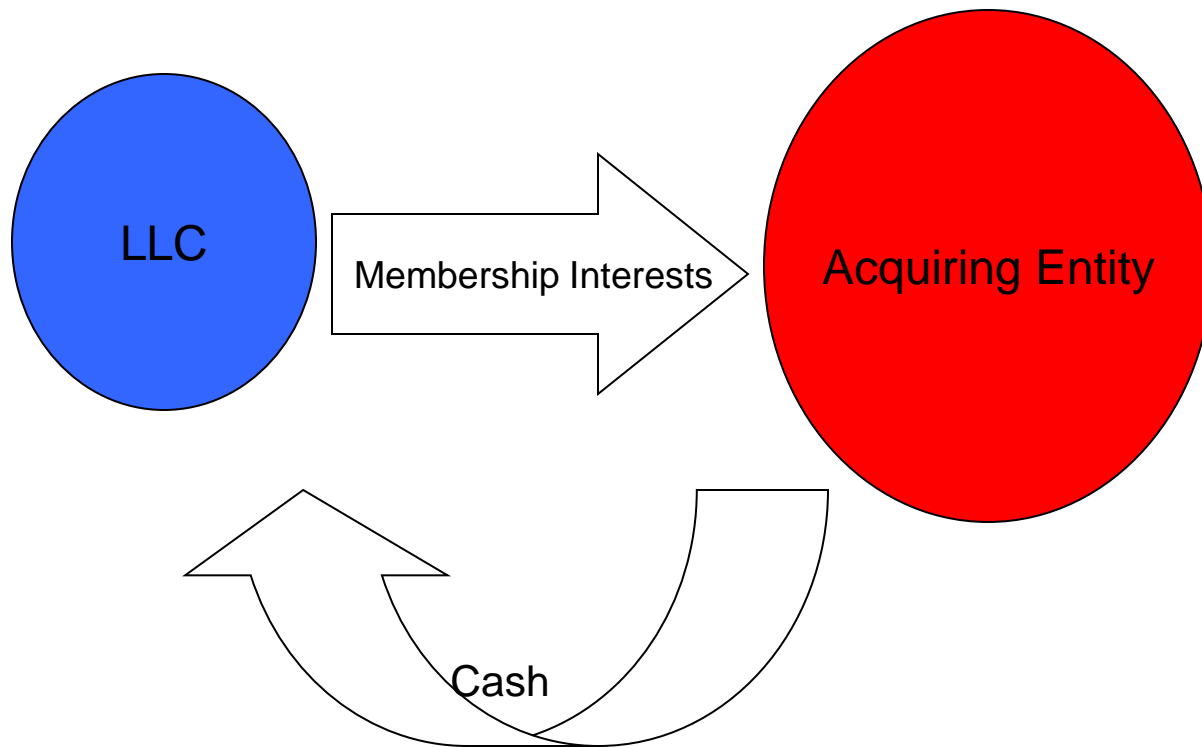
2) Assets

- 1) Direct Sale
- 2) “C” Reorganization
- 3) Triangular “C” Reorganization

Direct Unit Sale

- LLC members sell their membership interests to buyers for cash or other monetary consideration, such as a debt instrument

Direct Unit Sale

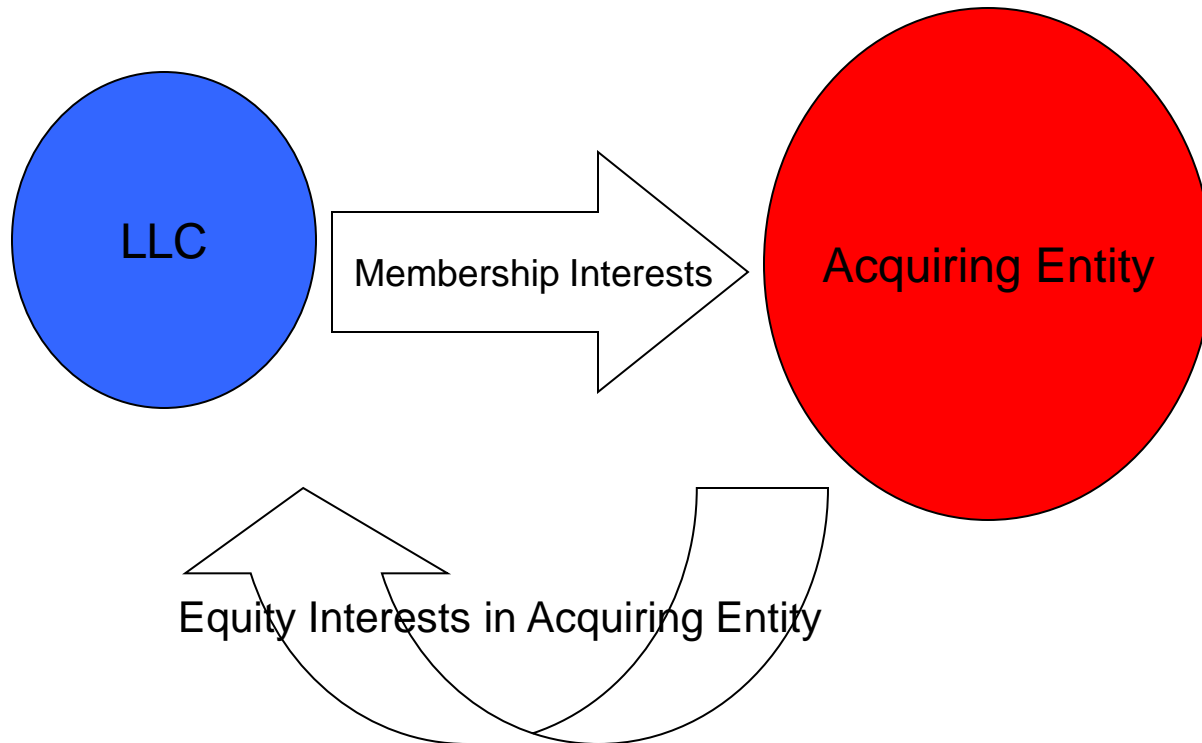


“B” Reorganization

- LLC members sell their membership interests to acquiring entity in exchange solely for equity interests in acquiring entity
- LLC becomes wholly-owned subsidiary of acquiring entity
- LLC members become owners of acquiring entity



“B” Reorganization

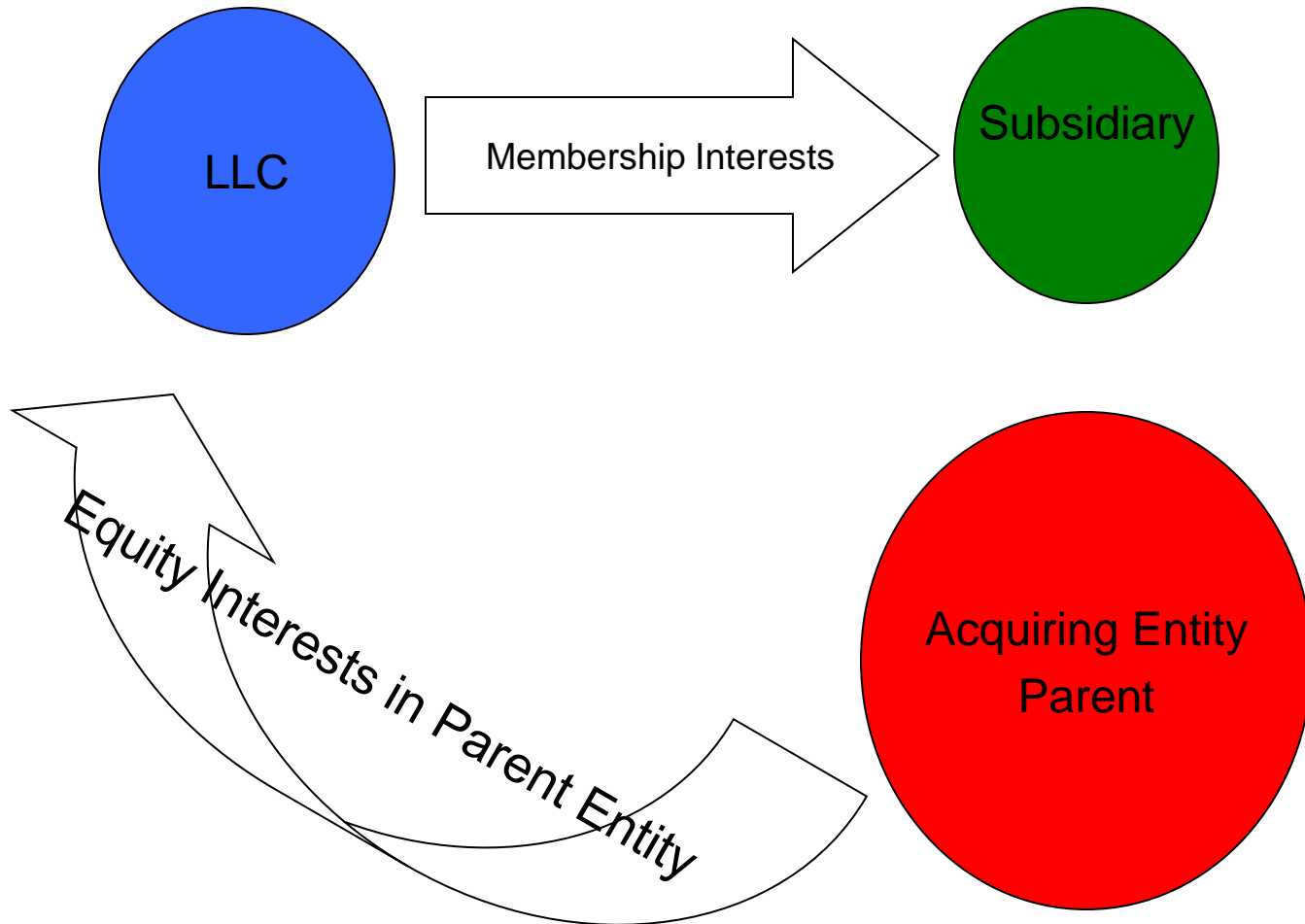


Triangular “B” Reorganization

- LLC members sell their membership interests to subsidiary of acquiring parent entity in exchange for equity interests in acquiring parent entity
- LLC members become owners of acquiring parent entity
- Typically, acquired LLC will be subsequently merged into subsidiary



Triangular “B” Reorganization

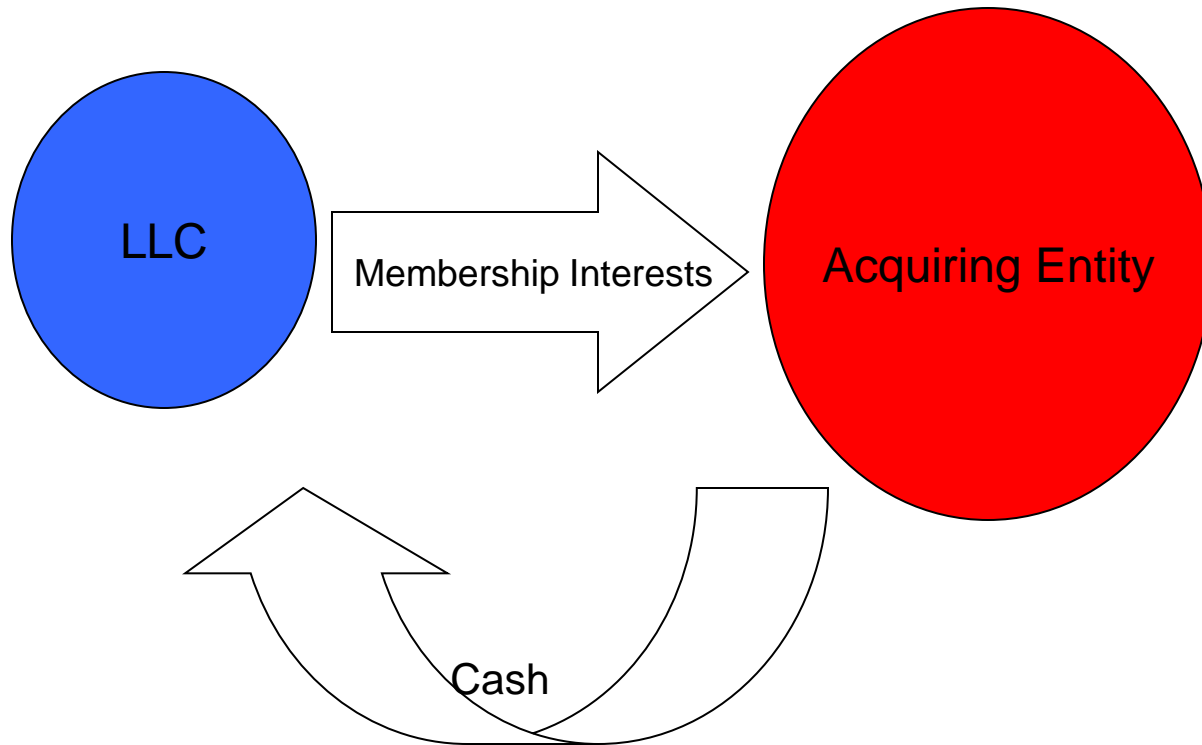


Direct Asset Sale

- LLC sells all or substantially all of its assets to buyers for cash or other monetary consideration, such as a debt instrument
- LLC then dissolves and distributes cash to members
- Buyer may or may not assume LLC's liabilities
- Buyer generally not considered successor of LLC



Direct Asset Sale

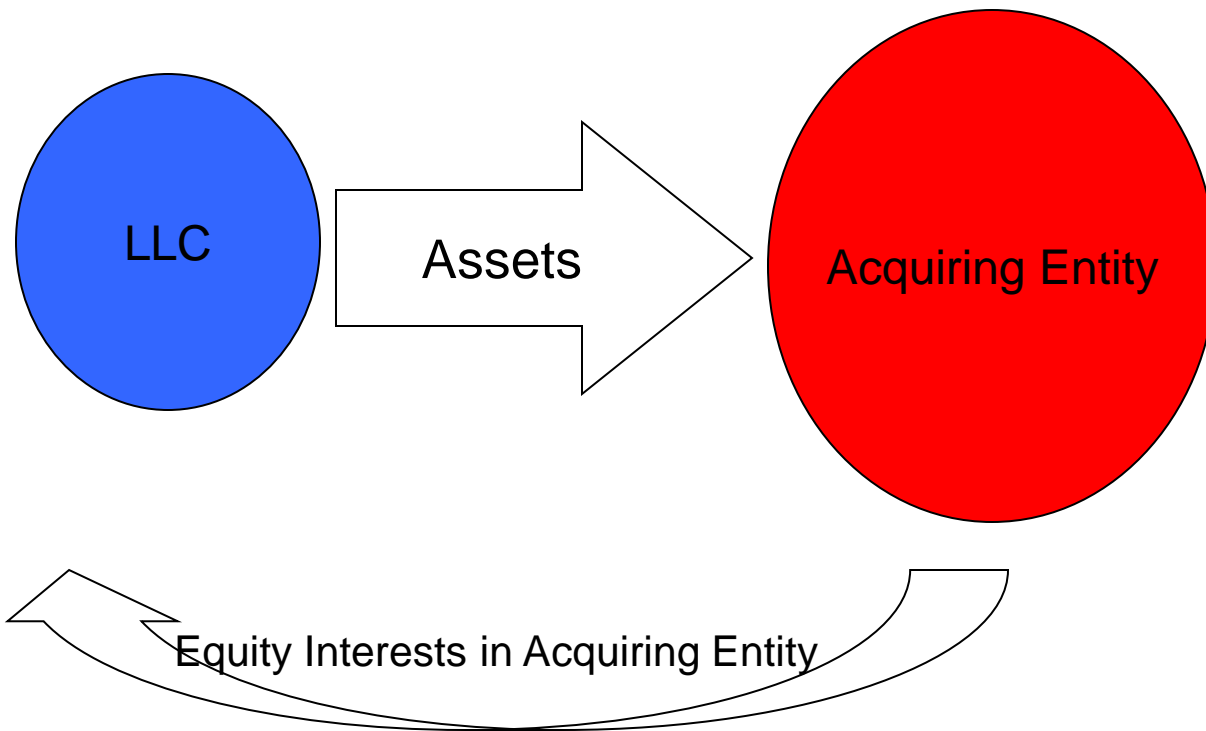


“C” Reorganization

- LLC sells all or substantially all of its assets to acquiring entity in exchange for equity interests in acquiring entity
- LLC then dissolves and distributes the equity interests (and any remaining LLC assets) to former LLC members
- LLC members become owners of acquiring entity



“C” Reorganization

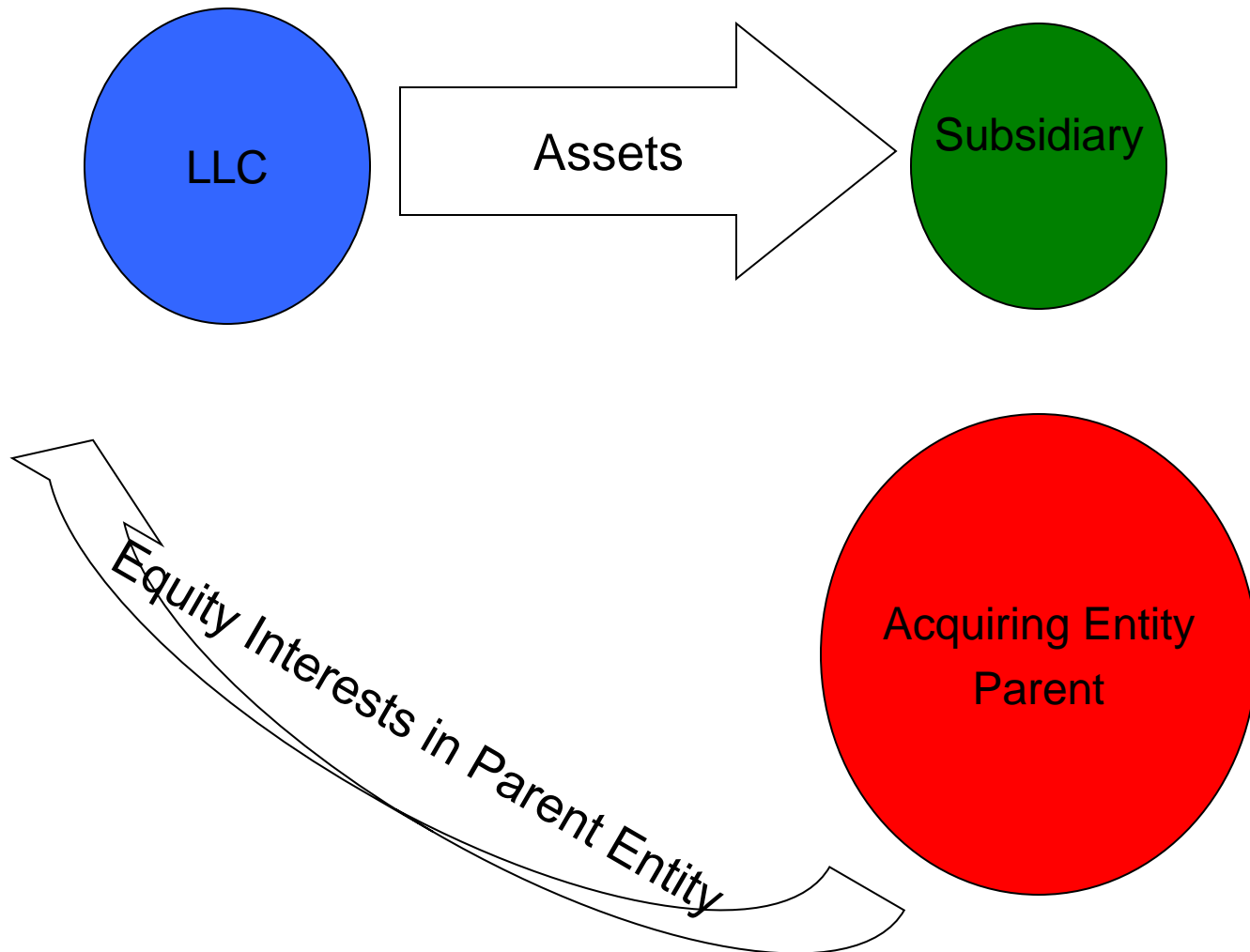


Triangular “C” Reorganization

- LLC sells all or substantially all of its assets to a subsidiary of the acquiring parent entity in exchange for equity interests in acquiring parent entity
- LLC then dissolves and distributes the equity interests (and any remaining LLC assets) to the former LLC members
- LLC members become owners of acquiring parent entity



Triangular “C” Reorganization



Checklist for Closing Your Business

- Legal
- Operations
- Facilities
- Human Resources
- Finance and Accounting
- Administration
- Marketing and Public Relations
- Owners

Closing Checklist

- Steps to Take to Close Your LLC

Step 1

- Vote to close the business following the procedures set out in LLC's Articles of Organization and Operating Agreement, and Alabama Limited Liability Act.
- Record the decision in resolution or minutes.

Step 2

- Officially dissolve the business
 - Obtain a tax clearance, if necessary (not required in Alabama)
 - File Articles of Dissolution

Step 3

- Cancel state, county and/or city permits and licenses, including seller's permits, business licenses, privilege licenses.

Step 4

- Terminate office and other premises leases
- Be sure to give landlord the required notice stated in the lease
- Terminate insurance policies applicable to leases



Step 5

- Collect outstanding accounts receivable
 - Before you notify customers that you are going out of business

Step 6

- Notify your employees
- Pay employees last paychecks and any accrued, unused personal leave or time-off, such as sick leave, vacation days.

Step 7

- Notify customers and fulfill any contractual obligations, if possible.
- Return any deposits or payments for goods not delivered or services not rendered.

Step 8

- If you have saleable inventory, consider a “going out of business sale.”
- Follow Alabama licensure and other requirements for such sales; see Ala. Code 1975, §§ 8-13-1 to -23.

Step 9

- Make your final federal and state payroll deposits.

Step 10

- Submit final sales and use tax forms/returns and payments due up to the closeout date.
- Alabama LLCs – Ala. Code 1975, § 40-23-25; sales and use tax return due within 30 days after the date of selling out business or inventory; purchaser of business required to withhold from purchase price unpaid sales and use taxes



Step 11

- Notify your creditors
 - Suppliers, lenders, service providers, and utilities

Step 12

- Comply with “bulk sales laws,” if required; not required in Alabama (Article 6 of Alabama’s UCC has been repealed).

Step 13

- Settle or pay all of your business debts
 - Money owed to landlord, bank, suppliers, utilities, and service providers.

Step 14

- Ask for letters indicating that your bills are paid in full as you pay off each creditor.

Step 15

- Cancel your business credit cards

Step 16

- Close your business bank accounts

Step 17

- File your final employment-related/payroll tax returns
 - Federal unemployment tax return (IRS Form 940)
 - Employer's federal tax return (IRS Form 941)
 - State tax withholding and wage reporting forms

Step 18

- File your final income tax returns, checking the box stating that this is your final return.

Step 19

- If you sell business assets, file IRS Form 4797, *Sales of Business Property*, or if you sell the bulk of your business assets to one buyer, file IRS Form 8594, *Asset Acquisition Statement*.

Step 20

- Leave contact information with former business contacts, colleagues, and employees

Questions?

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