

# **The Business Entity Transactions Act: What Kansas Business Lawyers Need to Know**

by

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## **I. Introduction:**

The Business Entity Transactions Act (BETA) is a new piece of legislation that is designed to fill a void in the Kansas statutory framework for what we can loosely refer to as cross-entity transactions.

- a. Several entity types:
  - i. corporations,
  - ii. limited liability companies,
  - iii. limited partnerships,
  - iv. partnerships,
  - v. and their other variants.
  
- b. BETA creates a statutory framework for the movement of the underlying interests in these entities into another entity type without requiring the dissolution and reorganization of the original entity as an interest exchange. Additionally, BETA includes provisions for the concept of domestications, and entity conversions.

## **II. Legislative history:**

Kansas Senate Bill 132 is the Business Entity Transactions Act, and on April 6, 2009 the governor approved the Bill,<sup>1</sup> without a single opposing vote having been cast in the Kansas House or Senate while the bill moved through each chamber.<sup>2</sup> It becomes law on July, 1, 2010.<sup>3</sup> Interestingly—and, as was the case in the regulation of securities—Kansas is one of the first to adopt an Entity Transactions Act.<sup>4</sup> As explained in testimony to the Senate Judiciary Committee, BETA is the result of a desire to "accomplish [cross-entity transactions] with appropriate approvals [and] without having to dissolve an entity and without extinguishing any obligations owed by preceding entities in the process."<sup>5</sup> Senate Bill 411 is presently pending in the legislature and adds some amendments to BETA which were apparently missed by Senate Bill 132 regarding limited partnerships.<sup>6</sup>

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<sup>1</sup> <http://www.kslegislature.org/bills/2010/132.pdf>.

<sup>2</sup> <http://www.kslegislature.org/legsrv-billtrack/searchBills.do?number=132>.

<sup>3</sup> Kansas Senate Bill 132, Sec. 52.

<sup>4</sup> Kansas and Idaho are the first two states to adapt the Model Entity Transactions Act first drafted by the National Conference of Commissioners on Uniform State Laws. But, the Model Act was introduced in the District of Columbia in 2010. [http://www.nccusl.org/Update/uniformact\\_factsheets/uniformacts-fs-menta.asp](http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-menta.asp). See also: <http://www.nccusl.org/Update/CommitteeSearchResults.aspx?committee=100>.

<sup>5</sup> Testimony of Edwin W. Hecker, Jr., to the Senate Judiciary Committee on SB 132, February 3, 2009.

<sup>6</sup> <http://www.kslegislature.org/bills/2010/441.pdf>.

### III. Pre-BETA Kansas Statutory Landscape:

Presently there are statutory frameworks for the creation, governance, and other activities of Corporations, Limited Liability Companies, Limited Partnerships, Partnerships, as can be depicted in this table:

Type of Entity or Transaction	Corporations <sup>7</sup>	Limited Liability Companies <sup>8</sup>	Limited Partnerships <sup>9</sup>	Partnerships <sup>10</sup>
Mergers with other entities of the same type?	Yes	Yes	Yes	Yes
Conversion into another entity type?	No	Yes, but not into a Corporation	Yes, but not into a Corporation	Yes, but not into a Corporation
Mixed Entity Merger <sup>11</sup> Provisions?	Yes (only applies to mergers)	Yes (only applies to mergers)	Yes (only applies to mergers)	Yes (only applies to mergers)
Interest Exchanges?	No	No	No	No
Domestications?	No	No	No	No

In the last three rows this table shows the areas where BETA most changes the existing statutory framework.

### IV. BETA ARTICLE 1.

Article 1<sup>12</sup> simply recites the definitions of the entity types to which BETA applies and excludes some particular entities: "Entities regulated under chapter 40 [(insurance companies)] of the Kansas Statutes Annotated; (b) banks and trust companies organized under chapter 9 of the Kansas Statutes Annotated; (c) credit unions organized under K.S.A. 17-2201 et seq., and amendments thereto; and (d) professional corporations formed under the Kansas professional corporation law or limited liability companies organized under the Kansas revised limited liability company act to render a professional service, as defined at K.S.A. 17-2707, and amendments thereto."<sup>13</sup>

BETA defines an "Entity" as follows:

#### a. Inclusions:

- i. A corporation;
- ii. a general partnership, including a limited liability partnership;
- iii. a limited partnership, including a limited liability limited partnership;
- iv. a limited liability company;
- v. a business trust or statutory trust entity;

<sup>7</sup> See Chapter 17 of the Kansas Statutes Annotated.

<sup>8</sup> See Chapter 17, Article 76 of the Kansas Statutes Annotated.

<sup>9</sup> See Chapter 56a of the Kansas Statutes Annotated.

<sup>10</sup> See Chapter 56, Article 1a of the Kansas Statutes Annotated.

<sup>11</sup> See Chapter 17, Article 77 of the Kansas Statutes Annotated (all sections repealed by SB 132).

<sup>12</sup> Kansas Senate Bill 132, Sec. 1-10.

<sup>13</sup> *Id.* at Sec. 10(a)-(d). Some practitioners may be interested to note that public utilities are apparently covered by BETA. Testimony of Edwin W. Hecker, Jr., to the Senate Judiciary Committee on SB 132, February 3, 2009.

- vi. a cooperative; or
- vii. any other person that has a separate legal existence or has the power to acquire an interest in real property in its own name.<sup>14</sup>

**b. Exclusions:**

- i. An individual;
- ii. a testamentary, inter vivos, or charitable trust, with the exception of a business trust, statutory trust entity or similar trust;
- iii. an association or relationship that is not a partnership solely by reason of subsection (c) of K.S.A. 56a-202 [(partnerships arising by operation of law under a share of profits type presumption)], and amendments thereto, or a similar provision of the law of any other jurisdiction;
- iv. a decedent's estate; or
- v. a government, a governmental subdivision, agency, or instrumentality or a quasi-governmental instrumentality.<sup>15</sup>

**c. Public Utilities:** entities governed by K.S.A. § 66-127 to 136 are included in BETA but "[w]here the provisions of this act are not inconsistent, they shall be construed as supplemental to chapter 66 of the Kansas Statutes Annotated and not in derogation or limitation thereof."<sup>16</sup>

**d. Noteworthy Alternatives:** "The fact that a transaction under this act produces a certain result does not preclude the same result from being accomplished in any other manner permitted by law other than this act."<sup>17</sup>

**e. Additional entity types who may not utilize the provisions of BETA:**

- i. Insurance Companies under K.S.A. Chapter 40.<sup>18</sup>
- ii. Banks under K.S.A. Chapter 9.<sup>19</sup>
- iii. Credit Unions under K.S.A. § 17-2201 et seq.<sup>20</sup>
- iv. Professional Corporations under K.S.A. § 17-2702.<sup>21</sup>

**V. BETA ARTICLE 2.**

Article 2<sup>22</sup> governs mergers and consequently starts by excluding mergers between two entities of the same type because those transactions are already provided for in the Kansas statutes—as depicted in row two of the previous table—and thus eliminates double coverage in the statutes. Article 2, then proceeds to re-define a process by which dissimilar

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<sup>14</sup> Kansas Senate Bill 132, Sec. 2(1)(1)-(7).

<sup>15</sup> Kansas Senate Bill 132, Sec. 2(1)(7)(A)-(E).

<sup>16</sup> Kansas Senate Bill 132, Sec. 3(d).

<sup>17</sup> Kansas Senate Bill 132, Sec. 6.

<sup>18</sup> Kansas Senate Bill 132, Sec. 10(a).

<sup>19</sup> Kansas Senate Bill 132, Sec. 10(b).

<sup>20</sup> Kansas Senate Bill 132, Sec. 10(c).

<sup>21</sup> Kansas Senate Bill 132, Sec. 10(d).

<sup>22</sup> Kansas Senate Bill 132, Sec. 11-16.

entities types can merge as the entirety of Chapter 17, Article 77—" MERGER OR CONSOLIDATION; CONSTITUENT ENTITY" is repealed by BETA.<sup>23</sup>

**Details:** Article 2 also provides for the following mechanics of post-BETA Mergers.

- a. The content of an Agreement of Merger.<sup>24</sup>
- b. The requirements for an effective Agreement of Merger.<sup>25</sup>
- c. The means by which an Agreement of Merger may be amended.<sup>26</sup>
- d. The filing of the certificate of merger with the Secretary of State.<sup>27</sup>

*The Secretary of State's office Deputy Assistant Secretary of State Legal Counsel has assured the author that the necessary filing infrastructure will be available as of July 1, 2010, the effective date of BETA.*

- e. The effective date of a merger.<sup>28</sup>

## VI. BETA ARTICLE 3.

Article 3<sup>29</sup> is where BETA starts to significantly change Kansas Business Law. Article 3 of BETA creates the new concept of an "interest exchange" and reduces any need to execute a reverse triangular merger<sup>30</sup> when an acquiring entity wishes to acquire and hold another entity as a subsidiary.<sup>31</sup> An interest exchange is essentially defined as when:

(1) A domestic entity may acquire all of one or more classes or series of interests of another domestic or foreign entity in exchange for interests, securities, obligations, rights to acquire interests or securities, cash, or other property, or any combination of the foregoing; or

(2) all of one or more classes or series of interests of a domestic entity may be acquired by another domestic or foreign entity in exchange for interests, securities, obligations, rights to acquire interests or securities, cash, or other property, or any combination of the foregoing.<sup>32</sup>

### **A transition issue:**

(c) If a protected agreement contains a provision that applies to a merger of a domestic entity but does not refer to an interest exchange, the provision applies to an interest exchange in which the domestic entity is the acquired entity as if the

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<sup>23</sup> Kansas Senate Bill 132, Preamble.

<sup>24</sup> Kansas Senate Bill 132, Sec. 12.

<sup>25</sup> Kansas Senate Bill 132, Sec. 13.

<sup>26</sup> Kansas Senate Bill 132, Sec. 14.

<sup>27</sup> Kansas Senate Bill 132, Sec. 15.

<sup>28</sup> Kansas Senate Bill 132, Sec. 16.

<sup>29</sup> Kansas Senate Bill 132, Sec. 17-22.

<sup>30</sup> "When the subsidiary of the acquiring corporation merges with the target firm. In this case, the subsidiary's equity merges with the target firm's stock. As a result of the merger, the target would become a wholly-owned subsidiary of the acquirer and shareholders of the target would get shares of the acquirer."

<http://www.investopedia.com/terms/r/rtm.asp>.

<sup>31</sup> Testimony of Edwin W. Hecker, Jr., to the Senate Judiciary Committee on SB 132, February 3, 2009.

<sup>32</sup> Kansas Senate Bill 132, Sec. 17(a)(1)-(2).

interest exchange were a merger until the provision is amended after the effective date of this act.<sup>33</sup>

Further, the article provides for a means by which a certificate of interest exchange shall be filed with the Secretary of State.<sup>34</sup>

**Practice Point:** should the entity-governing documents you draft for your clients contain explicit approval requirements for "interest exchanges?" Most entities require majority or super-majority approval for merger activity as is provided for in Article 2, but it may be best practice to include the term "interest exchange" explicitly in the provisions regarding the approval of transactions by the entity in any documents you prepare if only to eliminate confusion going forward. This might be particularly important in a Manager-Managed LLC Operating Agreement that carefully delineates the powers of the LLC Manager.

**Details:** Article 3 also provides for the following mechanics of Interest exchanges.

- a. Approval of an Interest Exchange.<sup>35</sup>
- b. The requirements for an effective Interest Exchange.<sup>36</sup>
- c. The means by which an Interest Exchange may be amended.<sup>37</sup>
- d. The filing of the certificate of interest exchange with the Secretary of State.<sup>38</sup>
- e. The effective date of an Interest Exchange.<sup>39</sup>

## VII. BETA ARTICLE 4.

Article 4<sup>40</sup> creates a single-entity conversion framework, and for the purposes of this writing, an important point to note is that upon the conversion of an entity into another entity type:

all property of the converting entity continues to be vested in the converted entity without assignment, reversion or impairment; (3) all liabilities of the converting entity continue as liabilities of the converted entity; (4) except as provided by law other than this act or the agreement of conversion, all of the rights, privileges, immunities, powers and purposes of the converting entity remain in the converted entity;<sup>41</sup>

Consequently, as a matter of statute, entities will not be able to convert as a mean of escaping their obligations.

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<sup>33</sup> Kansas Senate Bill 132, Sec. 17(c).

<sup>34</sup> Kansas Senate Bill 132, Sec. 21(a).

<sup>35</sup> Kansas Senate Bill 132, Sec. 18.

<sup>36</sup> Kansas Senate Bill 132, Sec. 19.

<sup>37</sup> Kansas Senate Bill 132, Sec. 20.

<sup>38</sup> Kansas Senate Bill 132, Sec. 21.

<sup>39</sup> Kansas Senate Bill 132, Sec. 22.

<sup>40</sup> Kansas Senate Bill 132, Sec. 23-28.

<sup>41</sup> Kansas Senate Bill 132, Sec. 28(a)(2)-(4).

**Practice Point:** Practitioners should consult with their tax partners as to how such conversion will be viewed by the IRS. For instance, the IRS could construe a state-law conversion as a taxable liquidating event depending upon the entity type being converted and its underlying assets. It is presently unclear how the IRS might construe certain scenarios. These questions and others should be thoroughly examined before embarking on an entity conversion.

**Details:** Article 4 also provides for the following mechanics of Conversions.

- a. General Conversion provisions.<sup>42</sup>
- b. Approval of a Conversion.<sup>43</sup>
- c. The requirements for an effective Conversion.<sup>44</sup>
- d. The means by which a Conversion may be amended.<sup>45</sup>
- e. The filing of the certificate of Conversion with the Secretary of State.<sup>46</sup>
- f. The effective date of a Conversion.<sup>47</sup>

## VIII. BETA ARTICLE 5.

Article 5<sup>48</sup> sets up the domestication framework by which a Kansas entity could domesticate in a foreign jurisdiction or a foreign entity could domesticate in Kansas (at this writing apparently only Idaho entities would have the necessary state law). Prior to Article 5, Kansas had no domestication framework (although we allow the foreign registration of entities domiciled in other states), thus it is entirely new law for Kansas. Nonetheless, its significance may be limited to the occasion where an entity wishes to domesticate in another jurisdiction.

**Details:** Article 5 also provides for the following mechanics of Domestications.

- a. General Domestication provisions.<sup>49</sup>
- b. Approval of a Domestication.<sup>50</sup>
- c. The means by which a Domestication may be amended.<sup>51</sup>
- d. The filing of the certificate of domestication with the Secretary of State.<sup>52</sup>
- e. The effective date of a Domestication.<sup>53</sup>

Lastly, Article 6<sup>54</sup> primarily conducts the house cleaning needed in the Kansas Statutes to and by the Kansas Secretary of State's Office to implement the provisions of BETA.

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<sup>42</sup> Kansas Senate Bill 132, Sec. 23.

<sup>43</sup> Kansas Senate Bill 132, Sec. 24.

<sup>44</sup> Kansas Senate Bill 132, Sec. 25.

<sup>45</sup> Kansas Senate Bill 132, Sec. 26.

<sup>46</sup> Kansas Senate Bill 132, Sec. 27.

<sup>47</sup> Kansas Senate Bill 132, Sec. 28.

<sup>48</sup> Kansas Senate Bill 132, Sec. 29-34.

<sup>49</sup> Kansas Senate Bill 132, Sec. 29-30.

<sup>50</sup> Kansas Senate Bill 132, Sec. 31.

<sup>51</sup> Kansas Senate Bill 132, Sec. 32.

<sup>52</sup> Kansas Senate Bill 132, Sec. 52.

<sup>53</sup> Kansas Senate Bill 132, Sec. 34.

<sup>54</sup> Kansas Senate Bill 132, Sec. 35-52.

## IX. CONCLUSION:

Let's re-examine our table in a post-BETA Kansas:

Type of Entity or Transaction	Corporations <sup>55</sup>	Limited Liability Companies <sup>56</sup>	Limited Partnerships <sup>57</sup>	Partnerships <sup>58</sup>
Mergers with other entities of the same type?	Yes	Yes	Yes	Yes
Conversion into another entity type?	Yes	Yes	Yes	Yes
Mixed-Entity Mergers? <sup>59</sup>	Yes	Yes	Yes	Yes
Interest Exchanges?	Yes	Yes	Yes	Yes
Domestications?	Yes	Yes	Yes	Yes

Upon initial examination, BETA shows promise in simplifying certain transaction types between entities and providing the necessary framework at the Secretary of State's office. Nonetheless, when the statutes expand, practitioners must be cautious to account for the differences in their day-to-day practices.

Before pulling the trigger on a BETA transaction for a compelling state law reason, just remember that the IRS is not bound to follow the National Conference of Commissioners on Uniform State Law's views when construing the tax effect of a particular "interest exchange" or conversion. Additionally, for good measure add the terms "interest exchange", "conversion" and "domestication" to your entity governing documents in the provisions dealing with approval and governance. If you have thoughts about this outline, wish to point out my errors, or hear of issues surrounding the use of BETA's provisions in the years to come, please contact me.

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<sup>55</sup> See Chapter 17 of the Kansas Statutes Annotated.

<sup>56</sup> See Chapter 17, Article 76 of the Kansas Statutes Annotated.

<sup>57</sup> See Chapter 56a of the Kansas Statutes Annotated.

<sup>58</sup> See Chapter 56, Article 1a of the Kansas Statutes Annotated.

<sup>59</sup> These are now provided for in BETA.