



Weekly Information Sheet 13

# DISSOLUTION

## 1. Dissolution and Termination

### Generally:

Most Corporations are formed for perpetual existence. As a result, most corporations need never cease to exist. A corporation can however, have its existence terminated either voluntarily or involuntarily. Such process is known as corporate dissolution, whereby the company is dissolved and its assets are distributed.

### Definitions:

**Dissolution Defined:** Black's law dictionary defines the term dissolution as:

***"The termination of a corporation's legal existence by expiration of its charter, by legislative act, by bankruptcy or by other means, which brings about the liquidation or winding up process"***

### Corporate Dissolutions:

**Voluntary Dissolution:** A corporation's desired termination by the board of directors and approved by the shareholders.

**Involuntary Dissolution:** The termination of a corporation administratively (for failure to file required reports or pay taxes), judicially (for abuse of corporate authority, management deadlock or failure to pay creditors), or through involuntary bankruptcy.

**Dissolution Generally:** Dissolution is the ultimate fundamental change. Although dissolution results in the death of the corporation, it does not necessarily mean the death of the business. Because of its going-concern value, the business (its assets) usually will be sold intact. Dissolution simply redistributes the assets to an outside party (or shareholder faction). The shareholders then share pro rata in the proceeds of the sale.

### Dissolution Terminology:

Dissolution is the formal extinguishment of the corporation's legal life. *Liquidation* is the process of reducing the corporation's assets to cash or liquid assets, after which the corporation becomes a holding shell. *Winding up* is the whole process of liquidating the assets, paying off creditors, and distributing what remains to shareholders.

### Process:

**Accomplished First By the Board of Directors:** Typically, voluntary dissolution must be initiated by the board of directors and followed by shareholder approval, though in some states all shareholders can consent to dissolve the corporation without board action. Dissolution, like a charter amendment, is subject to majority rule.

# DISSOLUTION CONTINUED

## 1. Dissolution and Termination Continued

### Process Continued:

**Shareholders Get A Vote After the Board:** Absent oppression or deadlock, minority shareholders generally cannot dissolve the corporation. Likewise, minority shareholders cannot force the corporation's continuance.

**Two Step Dance:** Voluntary dissolution is subject to only two levels of protection: (1) initial approval by the board of directors, and (2) subsequent approval by shareholders.

**New York Business Corporation Law:** Article 10 of the Business Corporation Law governs voluntary dissolutions. Article 11 governs involuntary dissolutions by means of a petition to the state supreme court. Once a dissolution is approved, the corporation may conduct no other business than to wind up its affairs.

### Process of Winding Up:

**Creditors Protected:** Corporate law protects creditors in a dissolution. In the winding-up process, the corporation must pay all known claims. The corporation must send notice to known claimants for them to submit their claims. Under the Business Corporation Law, unknown claims (such as contingent tort claims) may be brought against the dissolved corporation.

**Wage Claims:** If the corporation does not retain sufficient assets after the distribution, the Business Corporation Law (section 630) permits employees and labors to get priority in payment, and thereafter, to seek satisfaction from the ten largest former shareholders.

**Successor Liability:** If creditors cannot satisfy their claims against the dissolved corporation or its former shareholders, they may be afforded the opportunity to assert their claims against the entity that acquired the business's assets under the successor liability doctrine. Further, if the board approves the distribution of assets to shareholders without the corporation first satisfying known claimants, the directors can be liable to the creditors, with contribution (recoupment) available from shareholders who knew the distribution was illegal.

**Judicial Oversight:** To shield directors from liability, the corporation can apply to have the supreme court to oversee the dissolution and determine how much security the corporation should set aside to satisfy anticipated claims.

### Process of Liquidation:

**Purpose:** The purpose of liquidating a corporation is to distribute all of the company's assets to those individuals and businesses that have claims against the corporation.

**Priority:** Priority is an important issue when it comes to liquidating corporate assets. Priority, means the order in which a person at he or she has the right to receive payment before others.

**Shareholders:** Shareholders are entitled to whatever corporate assets are left over after corporate creditors have been paid.

**After Liquidation:** Upon liquidation, the corporation no longer has any assets.

**Definitions:** Liquidation and winding up are two terms closely intertwined. Liquidation refers to the process of divesting all corporate assets, while winding up refers to the process of concluding all corporate business.

# DISSOLUTION CONTINUED

## 2. Corporate Property

### Definitions:

#### **Corporate Property Defined:**

*“Corporations are separate legal entities from the persons (which may include individuals or other corporations) that own them. Although the corporation will be owned by other persons (shareholders), such persons do not actually own the property of the corporation, as it belongs to the corporation itself, which has the characteristic of being able to legally own property, as an artificial person under the law.”*

#### **Corporate Property During Dissolutions:**

**Winding Up:** In accordance with section 1005 of the Business Corporation Law, a corporation that is dissolving shall proceed to wind up its affairs, with power to:

- **Fulfill or discharge its contracts;**
- **Collect its assets;**
- **Sell its assets for cash at public or private sale;**
- **Discharge or pay its liabilities, and**
- **Do all other acts appropriate to liquidate its business.**

### **Liquidation and Shareholder Distribution of Corporate Property:**

#### **Liquidation of Assets:**

When a corporation is dissolved, it must liquidate its assets. Liquidation refers to the process of sale or auction of the company's non-cash assets. Only those assets your company owns can be liquidated. Thus, a corporation cannot liquidate assets that are used as collateral for loans. Assets used as security for loans must be given to the bank or creditor that extended the loan, or it must pay off the loan before selling such assets.

#### **Shareholder Distribution:**

The final step of dissolution involves distributing the company's remaining assets among its shareholders. Such assets may include the money kept in bank accounts or obtained from selling or otherwise disposing of the company's non-cash assets. The payment to company shareholders is done on a pro-rata basis, i.e., in the ratio of their share ownership percentages. This distribution is only done after all other liabilities of the corporation have been satisfied. If the corporation is solvent (meaning it has more assets than liabilities), it will have cash and assets after repaying its taxes and liabilities to distribute to shareholders. In such cases, the leftover amount is totaled and divided between shareholders on the basis of their ownership stake. In exchange for getting back their investment (in full or part), the shareholders return their shares to the company, which are then canceled.

## 3. Issues in Dissolution

### Generally:

**Perpetual Existence:** Most Corporations are formed for perpetual existence. As a result, most corporations need never cease to exist. In these situations, corporations do not exist for a set time period, and instead, can exist for centuries, long outliving the individuals who created them.

**Decision to Dissolve:** A corporation can however, have its existence terminated either voluntarily or involuntarily. Such process is known as corporate dissolution, whereby the company is dissolved and its assets are distributed.

**Why Dissolution:** Businesses terminate for a wide variety of reasons, but when a corporation seeks to end its legal existence, there are special rules with which it must comply.

# DISSOLUTION CONTINUED

## 3. Issues in Dissolution Continued

### Generally Continued:

**Effect of Dissolution:** Dissolution terminates the Corporation's existence. When the corporation does cease to exist, the corporate charter, the articles of incorporation, and any other document related to the corporation's existence cease to have any legal significance.

**Dissolution Can Take Time:** Dissolving a corporation can take months or even years. During this time, all of the corporation's business will be concluded (wound up) and its assets will be distributed to creditors and shareholders.

**Shareholders must Agree to Dissolution:** In a voluntary dissolution, shareholders must agree, usually by simple majority vote, to dissolve the corporation.

**Notification of Creditors:** When a corporation is considering dissolution, it must notify its creditors of its intention.

**Priority of Creditors:** The Business Corporation Law requires that creditors receive higher priority than corporate shareholders when it comes to distributing assets. In fact, only after all corporate creditors are paid will shareholders be entitled to receive any remaining corporate assets.

**Where Dissolution Takes Place:** When a corporation functions in several different states, the state which has authority to dissolve the corporate structure is the state in which the corporation is domiciled (i.e. where they filed their Articles of Incorporation).

# BANKRUPTCY

## 1. Bankruptcy

### The Nature of Bankruptcy:

Bankruptcy is an action brought under Federal Law (the United States Bankruptcy Code – Title 11 of the United States Code).

Federal Jurisdiction for Bankruptcy is conferred by the Constitution (Article 1, Section 8, Clause 4) which authorizes Congress to enact "uniform Laws on the subject of Bankruptcies throughout the United States.

The first federal bankruptcy law was enacted in 1801. Prior to that insolvency and debtors were dealt with pursuant to Common Law.

### Fundamentals:

There are two parties involved in bankruptcy.

Each party can be a natural person or a corporation. Such parties are debtors and creditors.

There is also the trustee and the federal government who will administer the bankruptcy proceeding.

The term "Bankruptcy" is defined by Black's Law dictionary to mean:

***"A statutory procedure by which a (usually insolvent) debtor obtains financial relief and undergoes a judicially supervised reorganization or liquidation of the debtor's assets for the benefit of creditors".***

# **BANKRUPTCY CONTINUED**

## **1. Bankruptcy Continued**

### **History:**

The word bankrupt is actually of ancient origin, and traces its roots to medieval Italy.

There, as a symbol of your financial failure, and your inability to pay your debts, creditors were legally empowered to break the bench from which the merchant operated their business.

From the Italian “banka” – meaning “bench” and “rotta” – meaning “break” derives the word “bankrupt”.

### **How Bankruptcy is Declared and Processed:**

Jurisdiction over bankruptcy cases is in U.S. district courts, which may refer all cases and related proceedings to adjunct bankruptcy courts. These are federal cases pursuant to federal statute (Title 11 of the US Code – The Bankruptcy Code).

An action is commenced by the filing of a petition.

This can be **voluntary** (filed by the debtor – natural person or the corporation that owes the money); or

**Involuntary** (by not less than 3 creditors – the corporations or people to whom the money is owed).

The debtor(s) and the creditor(s) are the parties in Bankruptcy.

### **Five bankruptcy proceedings are available:**

- **Chapter 7 (Liquidation);**
- **Chapter 9 (Municipalities)**
- **Chapter 11 (Business reorganization);**
- **Chapter 12 (Family Farms and Fishermen); and**
- **Chapter 13 (Individual Consumer Debt Adjustment).**

### **What the Parties Want:**

In a bankruptcy case the Debtor wants a discharge of his debts and to preserve his assets.

What the Creditor(s) and Trustee want is to maximize the distribution to creditors, to keep the Debtor “honest”, to discharge only dischargeable debts, and to keep no non-exempt assets.

What the Bankruptcy Court wants is a “fresh start” for honest debtors, a return to productivity free from unmanageable debt, to promote best interests of Creditors, and an equitable distribution of estate, from debtor’s non-exempt assets.

### **Debtors Prison:**

Prior to the enactment of modern Bankruptcy laws, a merchant who did not pay their debt through no fault of their own, could be imprisoned in Debtors Prison.