THE UNIFIED BUSINESS ORGANIZATIONS CODE: THE NEXT GENERATION

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ABSTRACT

The current proliferation of the number of business forms has become a source of increasing confusion. The situation is worsened by virtue of the significant differences among state business organization statutes. Uniform and Model Acts have generally been drawn up on a form-by-form basis, and attempts at promulgation have resulted in spotty and non-uniform adoption by the states, resulting in possible traps for the unwary.

In response to this problem, this article proposes a unified business code that would harmonize in a "hub" administration portions of various business organization statutes, while maintaining essential distinctive elements of the various forms in "spoke" sections.

Despite the many difficulties involved, including a necessary high degree of cooperation between the National Conference of Commissioners on Uniform State Laws, the American and state bar associations, and state and tax officials, the author concludes that the goal of a unified business organizations code is a worthy pursuit.

I. INTRODUCTION

The Delaware Code Annotated contains statutory provisions governing ten types of for-profit business organizations and several types of nonprofit organizations. The for-profit organizations can be categorized as follows: (1) corporations, including general corporations, close corporations, professional service corporations, and cooperatives; (2) sole proprietorships, which are by far the most numerous form of business in Delaware and elsewhere, are not included in this list because they have no specific statutes regulating their organization or governance.

1President and Dean, William Mitchell College of Law. This article is derived from the Francis G. Pileggi Distinguished Lecture in Law delivered by the author in Wilmington, Delaware on April 11, 2003.
2Sole proprietorships, which are by far the most numerous form of business in Delaware and elsewhere, are not included in this list because they have no specific statutes regulating their organization or governance.
4Id. §§ 341-356.
5Id. §§ 601-619.
partnerships, including general partnerships, \(^6\) limited liability partnerships, \(^7\) limited partnerships, \(^8\) limited liability limited partnerships, \(^9\) and limited liability companies; \(^10\) and (3) special purpose organizations, namely, registered business trusts. \(^11\) Nonprofit organizations can be organized in a corporate, \(^12\) partnership, \(^13\) or limited liability company \(^14\) format. In addition, Delaware has adopted the Uniform Unincorporated Nonprofit Association Act, \(^15\) which provides limited liability protection \(^16\) to all nonprofit organizations that are neither corporations nor partnerships.

Many of these organizational forms, for example, limited liability partnerships (LLPs), limited liability limited partnerships (LLLPs), and limited liability companies (LLCs) did not even exist fifteen years ago, while others, which many commentators thought were obsolete, have significantly increased in number in recent years. The number of Delaware Registered Business Trusts, for example, has increased from 3,424 in 1997 to 9,237 in 2003. \(^17\)

The most dramatic change in Delaware has been the increase in the number of LLCs. At the end of 1997 there were 39,244 Delaware LLCs. As of March 2003 there were 205,210 Delaware LLCs, a fivefold increase in merely seven years. \(^18\) The number of LLCs formed in Delaware actually exceeded the number of corporations formed in Delaware in both 2001 and 2002. \(^19\) Apparently, LLCs have now become the business entity of choice in Delaware, at least concerning businesses that are not publicly traded.

The proliferation of business forms in Delaware is fairly typical. The most significant development in other states during the past decade has

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\(^7\) Id. §§ 15-1001 to -1003.

\(^8\) Id. §§ 17-101 to -1109.


\(^12\) Del. Code Ann. tit 8, § 101(b) (2000).

\(^13\) See Del. Code Ann. tit. 6, § 15-202(a) (1999) (general partnerships); id. § 17-106(a) (limited partnerships).

\(^14\) Id. § 18-106(a).


\(^16\) Id. § 1906.

\(^17\) Statistics provided by the Delaware Secretary of State, Corporate Division (Mar. 20, 2003) (on file with the Delaware Journal of Corporate Law).

\(^18\) Id.

\(^19\) Id. As of March 20, 2003, there were fewer Delaware Corporations (282,207) than there were at the end of 1997 (291,511). Interestingly, the number of Delaware Limited Partnerships, predicted by many to be made obsolete by LLCs, have increased sixty percent since 1997 from 28,944 to 47,962. Id.
also been the dramatic increase in the number of LLCs. In 1990 only two states had statutes authorizing LLCs.20 By the end of 1996, all fifty states and the District of Columbia had LLC statutes.21 In 2000, thirty percent of all new businesses were formed as LLCs22 and in 2001, thirty-three percent were formed as LLCs.23 In 2002, forty percent of all new businesses in the United States were formed as LLCs24 and in at least twenty-eight states more LLCs than corporations were formed.25 In the period between 2000 and 2002, the number of new businesses formed as corporations declined from fifty-nine percent in 2000 to forty-eight percent in 2002.26

The increase in the number of business forms is bewildering to practicing lawyers, judges, law professors, and legislators.27 Almost every

21Id.
23Id.
24International Association of Commercial Administrators, 2003 Annual Report of the Jurisdictions (2003), at http://www.iaca.org/?article=40507fb2c5c30&title=Documents and Forms&pagetype=doc. The figures reported are a composite of the reported statistics. No filing date for 2002 was reported for six states: Illinois, Kentucky, Mississippi, New Mexico, Oklahoma, and South Carolina. This appears to be about the average number of states that do not report, although the names of the nonreporting states changes each year.
25Id. The list consists of large and small states throughout the United States: Alabama, Alaska, Arizona, Colorado, Connecticut, Delaware, Hawaii, Idaho, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Michigan, New Hampshire, New Jersey, Ohio, Oregon, Rhode Island, Tennessee, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. In four of these states, more than twice as many LLCs versus corporations were formed in 2002: Louisiana (16,593 LLCs vs. 6,267 corporations), New Hampshire (5,046 LLCs vs. 1,679 corporations), West Virginia (3,085 LLCs vs. 1,432 corporations), and Wisconsin (18,132 LLCs vs. 5,752 corporations), and Arizona (21,923 LLCs vs. 11,515 corporations) had almost twice as many LLCs as corporations formed in 2002. Id. Kentucky and Oklahoma, non-reporting states in 2002, both had more LLCs than corporations formed in 2001. 2002 IACA Report of the Jurisdictions, supra note 22.
262003 IACA Report of the Jurisdictions, supra note 22. The other twelve percent consisted of nonprofit corporations (seven percent), limited partnerships (four percent) and limited liability partnerships (one percent). Id.
27See generally William H. Clark, Jr., Rationalizing Entity Laws, 58 BUS. L. LAW. 1005, 1006-07 (2003) (arguing that the list of new and old entity forms, when combined with tax considerations, creates an increasingly complex landscape for the business lawyer to navigate); Jack B. Jacobs, Entity Rationalization: A Judge's Perspective, 58 BUS. L. LAW. 1043, 1044 (2003) (explaining that the number of different entity alternatives has resulted in the proliferation of litigation regarding the new forms, as well as judicial difficulty in determining the proper doctrines to resolve the disputes); Oesterle & Gazur, supra note 20, at 104 (stating that lawyers and clients who need to choose among alternative entity forms suffer inconvenience and confusion due to an excess of business forms).
year, a new type of entity or a major revision to an existing business organization statute is promulgated or enacted. Frequently, the cause of the statutory modifications have been precipitated by changes in federal tax law. LLC legislation in the 1990s is an example. A 1988 Revenue Ruling that allowed an LLC to be taxed as a partnership rather than as a corporation led to the adoption of first-generation LLC statutes across the nation. In 1996 the IRS approved the so-called check-the-box regulations which eliminated many of the prior requirements necessary for partnership taxation. This change was followed by another nationwide flurry of LLC statutory amendments.

The differences between the various state business organization statutes are significant and the problems resulting from these differences are growing. In many respects, Delaware is ahead of most states in trying to maintain reasonable consistency between the statutory provisions that govern each type of organizational format. When a change is made in one business entity statute, the practice in Delaware is to enact parallel statutory language in all the other business entity statutes that have similar provisions. This is not an easy task because the various statutory provisions are currently in four separate titles of the Delaware Code.

The Model Business Corporation Act (MBCA) (1984), which also includes special supplements for close corporations and professional corporations, has been amended extensively in the past twenty years to take into account developments in corporate law. Approximately twenty-four states have adopted all or substantially all of the MBCA (1984). Most of

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29 Treas. Reg. §§ 301.7701-3 (1996). These regulations automatically grant pass-through federal tax status for all business entities that are not formed as corporations, unless the business affirmatively elects to be taxed as a corporation (this is why they are called the "check-the-box" rules). These regulations also authorize pass-through tax status for one-member LLCs. See Carter G. Bishop & Daniel S. Kleinberger, Limited Liability Companies—Tax and Business Law ¶ 2.02[4] (2003).
31 Compare 74 Del. Laws ch. 85, § 14 (2003) (conversion of LLCs) with id. ch. 103, § 11 (conversion of a general partnership) and id. Ch. 104, § 17 (conversion of a limited partnership).
32 Three states—Kansas, Oklahoma, and Nevada—have corporation statutes based on the Delaware General Corporation Law (DGCL). Puerto Rico has also adopted the DGCL. Because Delaware is the state of incorporation for such a large number of publicly held corporations, its influence is far greater than might otherwise be inferred by the few number of states that have corporation statutes patterned on the DGCL. The major differences between the MBCA and the DGCL are explored in Michael P. Dooley & Michael D. Goldman, Some Comparisons Between
the Model Act States have not, however, adopted all the various amendments to the Model Act approved by the ABA Committee on Corporate Laws. Twenty-nine states adopted the 1964 version of the Model Nonprofit Corporation Act but only two states have adopted the 1987 Revised Model Nonprofit Corporation Act.

The National Conference of Commissioners on Uniform State Laws, which has traditionally drafted uniform acts governing unincorporated organizations, has promulgated new versions of the Uniform Partnership Act and the Uniform Limited Partnership Act and has approved two new uniform unincorporated organizations acts in the past decade. The Revised Uniform Partnership Act was originally promulgated in 1994. The latest version, which contains special provisions for limited liability partnerships, was approved in 1997. It has been adopted in thirty states including Delaware, the District of Columbia, Puerto Rico, and the Virgin Islands, but the remaining states still have the 1914 version of the Uniform Partnership Act. The Uniform Limited Partnership Act,

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33See Bryn Vaaler, Scrap the Minnesota Business Corporation Act, 28 WM. MITCHELL L. REV. 1365 (2002). After examining the Minnesota Business Corporation Act (MBCA), the author states:

Today, I believe that the best advice Minnesota lawyers can give their clients, whether their businesses are to be closely or publicly held, is to avoid incorporating in Minnesota.

Minnesota deserves better than this. The MBCA should be scrapped in its entirety. Years of inattention, fuzzy thinking, sloppy drafting and bad choices have resulted in a statute that is really beyond patchwork repair even by an informed and interested legislature acting under the advice and close direction of an expert and active corporate bar. Instead, Minnesota should do what nearly half the states in the United States have done: adopt the Model Act as it exists today in its entirety and commit to a disciplined program of prompt consideration of, and action on, future amendments and improvements to the Model Act with a view toward keeping Minnesota in the mainstream of corporate statutory law.

Id. at 1371. See also Thomas F. Blackwell, The Revolution Is Here: The Promise of a Unified Business Entity Code, 24 J. CORP. L. 333, 367-68 (1999) (discussing the varying rates of adoption of the Model and Uniform Acts by states); William J. Carney, The Production of Corporate Law, 71 S. CAL. L. REV. 715, 742-44 (1998) (discussing the Revised Model Act's rate of adoption by states); Oesterle & Gazur, supra note 20, at 121-22 (discussing the aging of close corporation statutes, which largely have not been updated or modernized at the same rate as general corporate codes).

34Blackwell, supra note 33, at 368.
originally promulgated in 1916\textsuperscript{39} was revised in 1976 and again in 1985,\textsuperscript{40} and was extensively revised and re-approved in 2001.\textsuperscript{41} It contains specific provisions authorizing limited liability limited partnerships.\textsuperscript{42} Most states, however, still have the 1985 version of the ULPA.\textsuperscript{43} The two new uniform acts governing unincorporated organizations are the Uniform Limited Liability Company Act (1996),\textsuperscript{44} adopted in eight states,\textsuperscript{45} and the Uniform Unincorporated Nonprofit Association Act (1996),\textsuperscript{46} adopted in ten states.\textsuperscript{47}

The Model Entity Transactions Act (META) is in the final stages of development.\textsuperscript{48} As presently drafted, it will allow all types of corporate and unincorporated organizations to engage in mergers, interest exchanges, conversions and domestication transactions. The ABA Committee on Corporate Laws and the Partnership and Unincorporated Associations Committee have recently approved and published for comment the Model Inter-Entity Transactions Act (MITA).\textsuperscript{49} MITA authorizes the same inter-entity transactions covered by META.\textsuperscript{50}

Not only has the enactment of the recently promulgated uniform unincorporated organization acts been spotty, but these acts also contain material differences in wording for similar provisions. Some of the states that have enacted them have made significant non-uniform amendments, many of which may have unintended adverse consequences that can create traps for the unwary.\textsuperscript{51}

\textsuperscript{42}UNIF. LTD. P'SHIP ACT §§ 102, 201(a)(4), 404(c), 6A U.L.A. 12-14, 33, 57 (2003).
\textsuperscript{48}The most recent draft of META is posted on the National Conference of Commissioners on Uniform State Laws website at http://www.law.upenn.edu/bil/uic/ueta/feb2004mtg.pdf.
\textsuperscript{50}If META is approved by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the ABA, MITA will be withdrawn. See infra note 79.
The lack of uniformity in style, format and substance is particularly acute with respect to limited liability company legislation. In many cases, amendments that fundamentally change the basic rights of the LLC members have been enacted at the insistence of a small group of lawyers. Several states, for example, have amended their statutes at the request of estate planning lawyers to provide that a member cannot sell or dispose of his or her interest unless the operating agreement otherwise provides.\(^5\) This will supposedly reduce the valuation of ownership interests with resulting favorable tax consequences for inter-family transfers of LLC ownership interests.\(^5\) The Uniform Limited Liability Company Act, however, which uses the Uniform Partnership Act as its model, provides that a member can dispose of his or her economic interest (but not the governance rights) unless otherwise agreed in the operating agreement.\(^5\) In states that have adopted the no-exit default rule, a serious trap for the unwary lawyer who might assume that because LLC statutes are based on a partnership model the partnership exit rights,\(^5\) or something similar, can exist. The lock-in created by this change in the default exit rule can lead to the same problems that have faced minority shareholders in closely held corporations who have no market for their shares.\(^5\) Most corporate codes, however, now contain involuntary dissolution provisions and buy-out rights that provide reasonable remedies from arbitrary and oppressive action by the minority shareholders.\(^5\) Members of LLCs in states that have the no-exit default rule may not, however, have these same exit rights, unless the lawyer representing the members is astute enough to draft them in the operating agreement.\(^5\)

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\(^5\)See Keatinge, supra note 30, at 52-64; Oesterle & Mazur, supra note 20, at 132-41.


\(^5\)Under the Uniform Partnership Act (1997), unless otherwise provided in the partnership agreement, a partner can always withdraw from the partnership and upon withdrawal receive the value of his or her interest in the partnership in the form of a liquidating or non-liquidating distribution, subject to an offset for damages in the case of a wrongful withdrawal. See UNIF. P'SHIP ACT §§ 601-03, 701-03, 801-07 (1997), 6 U.L.A. (pt.1) 163-86, 189-211 (2001).

\(^5\)F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 1.14 (3d ed. 2002).


\(^5\)See Banoff, supra note 51, at 75-80.
A 1996 law review article by John H. Matheson, the S. Walter Richey Professor of Corporate Law at the University of Minnesota Law School, and Brent A. Olson, a member of the Minnesota Bar, describes the present state of business organization statutes and case law as follows: "The law of business organizations has thus become a hodge-podge of unwieldy, illogical, and even irrational legislation and decisions bristling with incoherence and inconsistencies. Bursting at the seams, the fabric of business organizational law currently blanketing the nation has become a variegated quilt of legal passwords."59

I concur in this assessment. If anything, the situation is worse today than it was in 1996. I also concur with the authors' conclusion that "[f]undamental reform of business organization law is both imperative and inevitable."60 My suggestion for reform is to create a unified business organizations code.

II. A Unified Business Organizations Code

The idea of a unified business organizations code is not new. The perplexing question has always been what such a code would look like. At one extreme are hub-and-spoke proposals that would attempt to eliminate all the non-essential differences between the various organizational forms leaving a single formulation for each major element, for example, the fiduciary duties of equity owners. The end result would presumably be a business organizations code having a large core that applied to all the various forms and separate rather short chapters for each of the different forms that continue to exist. This seems to be the approach incorporated in legislation introduced in the Pennsylvania legislature several years ago,61 revised portions of which have been recently under consideration by the ABA Business Law Section Partnership and Unincorporated Associations Ad Hoc Committee on Entity Rationalization.62 Another type of hub-and-spoke proposal seeks to harmonize and compile all of the common basically administrative provisions in the various organizational statutes such as definitions, filing of documents, and other formalities of formation, permissible names, purposes and powers, required records and inspection rights, registered agents and registered offices, service of process,

60 Id. at 3.
61 See Clark, supra note 27, at 1020.
indemnification, registration of foreign entities and the administrative powers of the Secretary of State in one article of the unified code and then have separate articles for each of the organizational forms.\textsuperscript{63} These articles would be basically the same as before consolidation into a single code, except for the omission of definitions and other provisions that would be moved to the general provisions article. The end result would look something like the Uniform Commercial Code.\textsuperscript{64} This is the approach taken in the Texas Business Organizations Code, enacted in 2003.\textsuperscript{65} The basic difference between these two hub-and-spoke proposals is in the amount and scope of material that is in the hub.

Other proposals for a unified code have focused on eliminating some of the existing forms. These proposals generally advocate retaining the traditional corporate code designed for large, publicly held corporations, and a separate code for small or closely held businesses with limited liability for the equity owners, broad contractual flexibility for matters


\textsuperscript{64}See 1 & 2 U.L.A. (2002).

\textsuperscript{65}H.B. 1156, 78th Sess. (Tex. 2003), available at http://www.tlc.state.tx.us/legal/bocode. The enactment in 2003 was the culmination of a ten-year effort spearheaded by the Texas State Bar Business Law Section and the Texas Secretary of State. The new Code is effective for business organizations formed on or after January 1, 2006. It does not apply to businesses formed before January 1, 2006 until January 1, 2010, but these business organizations can elect to have the new Code apply to them after January 1, 2010. H.B. 1156 is over 800 pages in length. A summary is available at http://www.tlc.tx.us/legal/bocode/revisions report.html. See also Daryl B. Robertson, et al., Introduction to the Texas Business Organizations Code, 38 Tex. J. Bus. L. 57 (2002) (providing an overview of the new code). For the most part, the Texas Business Organizations Code is a re-codification of existing statutes. Title 1 of the Code contains definitions (of which there are 89) and other general provisions common to all the acts. The various subchapters in Title 1 deal with issues such as purposes and powers, formation and filings and filing fees, meetings and voting rights, recordkeeping, entity names, service of process, indemnifications and insurance, registration of foreign business organizations, mergers, interest exchanges, conversions and sales of assets, winding up and terminations, and administrative process. Title 1 is thus the "hub." The remaining titles, with the exception of Title 8 which contains miscellaneous and transition provisions, deal with the various types of organizations covered by the Code. These are the "spokes." Title 2 covers corporations. It contains special provisions that apply to standard corporations, close corporations, investment companies, nonprofit corporations, church benefit boards, business development corporations, and grand lodges. Title 3 contains the provisions governing limited liability companies. Title 4 covers partnerships, including general partnerships, limited liability partnerships, limited partnerships and limited liability limited partnerships. Title 5 deals with real estate investment trusts. Title 6 contains the spoke provisions for cooperatives and unincorporated nonprofit associations. Title 7 governs professional entities, including professional corporations and professional limited liability companies. Tex. Bus. Org. Code Ann. §§ 1.001-402.014 (Vernon 2003).
relating to the owners rights *inter se*, and pass-through tax consequences.  

This idea of combining both corporate and partnership concepts in a single business form for closely held businesses was first proposed thirty-five years ago by Professor Robert Kessler of Fordham University in an article entitled "With Limited Liability For All: Why Not A Partnership Corporation?" Section 1 of Professor Kessler's proposed statute is remarkably straightforward and easy to understand: "A Partnership Corporation is a corporation with the internal structure of a partnership formed by one or more natural persons under the provisions of § 2 [filing of a certificate]. The members as such shall not be bound by the obligations of the partnership corporation."

The plethora of new business entity forms in recent years has spawned renewed interest in this approach. In their 1996 law review article, Matheson and Olson advocated a business organization scheme with only two types of entities: the traditional corporation and a second type of entity called a Standard Business Organization (SBO), which would replace all types of business organizations other than a corporation. The SBO would have limited liability, free transferability of interests, perpetual existence and pass-through taxation. The statute authorizing the SBO would have default rules similar to those in partnership statutes for governance matters, which could be modified in a comprehensive document called an Owner Control Agreement that would be similar to a partnership agreement.

A somewhat similar proposal was made by Professors Dale A. Oesterle and Wayne M. Gazur in a 1997 article published in the *Wake Forest Law Review*. They proposed one set of rules for a publicly-traded firm and a second set of rules for a privately-held firm which would be known as limited liability entity or "LLE." The provisions governing privately-held firms would have three divisions with somewhat different

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70Id. at 37-48.

71Id. at 40-41.

default rules. A business where all the equity owners are active in the business would be in the first group or division. A business where some of the equity owners are passive and therefore need exit rights and other protection from arbitrary action by the owners holding a majority of the equity would be in the second division. The third group would be for businesses with a substantial number of sophisticated passive equity investors. All three would have limited liability, perpetual existence and pass through tax treatment.\textsuperscript{73}

In my opinion, the most immediate need is to try to achieve a higher degree of modernization and internal consistency and coherence in the existing organizational statutes before any attempt is made to undertake a project designed to reduce the number of organizational forms. I envision a four stage process. The first stage involves obtaining more widespread adoption of the existing model and uniform business organization acts and the various amendments to these acts. The second stage is to expand the number of model and uniform business organization acts for special purpose organizational forms. The third stage is to undertake a hub-and-spoke project similar to the Texas Business Organizations Code described earlier.\textsuperscript{74} Only if this project is successful and the hub-and-spoke code is widely adopted, should a project designed to consolidate and possibly eliminate one or more organizational forms be undertaken.

\textbf{A. Wider Adoption of Existing Model and Uniform Acts}

The acts on my list are: Model Business Corporation Act (1984);\textsuperscript{75}

\textsuperscript{73}Id. at 129-31, 141-48.

\textsuperscript{74}See supra note 67 and accompanying text.

\textsuperscript{75}See American Bar Association Section of Business Law, Model Business Corporation Act - Official Text with Official Comments and Statutory Cross-References Revised through 2002 (2002). The Model Business Corporation Act (1984) (MBCA) was selected rather than the Delaware General Corporation Law (DGCL) for two reasons. First, the MBCA has been adopted in whole or in part in approximately one-half the states, whereas the DGCL has only been adopted in three states. See supra note 32 and accompanying text. Second, the format and structure of the DGCL and the case law interpreting the DGCL have created a hospitable climate and level of comfort for large, publicly held corporations. That is why so many large corporations incorporate or re-incorporate in Delaware. See Dooley & Goldman, supra note 32, at 737-39, 764-66. Although the DGCL contains a chapter designed for use by closely held corporations (see \textit{Del. Code Ann.} tit. 8, §§ 341-56 (2001)), these provisions are not widely used and the amount of case law involving Delaware close corporations is not nearly as well developed as the case law involving large, publicly held corporations. The MBCA, on the other hand, not only has the Statutory Close Corporation Supplement which has been adopted in approximately eighteen states, but also contains other provisions that are designed for close corporations that do not elect to become statutory close corporations. See, e.g., MBCA § 14.34 (discussing share purchase rights in the event of deadlock or alleged oppression). The MBCA also contains the Professional
Revised Uniform Partnership Act (1977), \(^6\) which contains provisions authorizing both general partnership and limited liability general partnerships; Revised Uniform Limited Partnership Act (2001), \(^7\) which contains provisions authorizing both limited partnerships and limited liability limited partnerships; Uniform Limited Liability Company Act; \(^7\) Model Entity Transactions Act; \(^7\) Model Nonprofit Corporation Act, \(^8\) and

Corporation Supplement. The extensive Official Comments accompanying each section of the MBCA, although not part of the codified statute, provide guidance to practitioners and judges in interpreting the MBCA. The Model Business Corporation Act Annotated (3d ed. 2002) also contains case law citations for each section. The Official Comments and the annotations are particularly helpful in states that do not have extensive corporate case law.


\(^7\) 6A U.L.A. 1 (2003). Although almost all states currently have the prior version, the Uniform Limited Partnership Act (1976 with 1985 Amendments), ULP A (2001) is expected to be widely adopted in the next several years. One major problem with ULP A (1976 with 1985 Amendments) is that is it linked to the Uniform Partnership Act (1914); yet UPA (1914) is repealed by UPA (1997). The linkage between the general and limited partnership acts has always been problematic. See generally Larry E. Ribstein, Linking Statutory Forms, 58 Law & Contemp. Probs. 187 (1995) (arguing that the linkage between business organization statutes creates confusion, necessitating a reevaluation of linkage). The linkage issue and the gap created by the repeal of UPA (1914) by UPA (1997) does not exist under ULP A (2001), because it is a self-contained act.

\(^8\) 6A U.L.A. 553 (2003). The current Uniform Limited Liability Company Act (1996) (ULLCA) has only been adopted in eight states. The National Conference of Commissioners on Uniform State Laws in 2003 appointed a Drafting Committee to revise ULLCA. The earliest the revised act can be approved under the National Conference's rules is the summer of 2005 and the first state legislative session in which it can be introduced is 2006. Because ULLCA (1996) has not been widely adopted, is clearly now outdated, and the revision is only three years or so from completion, priority should be given to state adoptions of the other Model and Uniform Acts discussed in the text until the revised ULLCA is promulgated.

The ABA Business Law Section Partnership and Unincorporated Associations Committee recently approved an LLC Prototype Act project. See Clark, supra note 27, at 1007. Although state enactment of the Prototype proposals is not a stated purpose of this project, many states adopted provisions from the initial LLC Prototype Act project that was undertaken in the early 1990s. At some point the possibility of combining the LLC uniform act project and the LLC prototype project should be seriously explored.

\(^9\) The current draft of this act can be found at http://www.law.upenn.edu/bll/uvc/ueta/feb2004mtgdraft.htm. It is scheduled for approval in final form by the National Conference of Commissioners on Uniform State Laws in the summer of 2004. It was previously known as the Uniform Entity Transactions Act (UEnTA). See http://www.law.upenn.edu/bll/uvc/ueta/ann-meet-draft03.htm. The Model Inter-Entity Transactions Act (MITA), drafted by the ABA Committee on Corporate Laws and the Ad Hoc Committee on Entity Rationalization is also pending. See supra notes 49-50 and accompanying text. The ABA Business Law Section and the National Conference have agreed to meld UEnTA and MITA into what is now called META. Assuming the molding process is successful and that, as expected, META is approved by NCCUSL and by appropriate ABA entities, it will be ready for adoption by states in the 2005 legislative session. If META is approved by both NCCUSL and the ABA, MITA will be abandoned. Widespread adoption of this act is vitally important to the success of the hub-and-spoke project. It will allow both inter- and intra-entity restructuring transactions between corporate and noncorporate businesses and therefore will be a key component of the "hub" portion of the proposed unified
Uniform Unincorporated Nonprofit Associations Act (1996). 81

This is a long list and it will take many years and a great deal of effort to achieve the goal of widespread national enactment. 82 Nevertheless, this is an important goal because broader adoption of these acts will provide a reasonable amount of consistency and uniformity between the basic business organization statutes of all the states, which will make the hub-and-spoke stage easier to achieve.

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81 Although only two states have adopted the Revised Model Nonprofit Corporation Act (1987), twenty-nine states and the District of Columbia have adopted the Model Nonprofit Corporation Act (1964). See Blackwell, supra note 33, at 368. The ABA Business Law Section Committee on Nonprofit Corporations is undertaking a revision of the 1987 Act. See Clark, supra note 27, at 1007. It is unclear when the new revision will be completed. An alternative in the Unified Code would be to follow the Delaware approach to having a few special provisions that apply specifically to nonprofit corporations but applying the DGCL in all other respects. See, e.g., DEL. CODE ANN. tit. 8, §§ 102(a)(3) (purpose), 255-58 (mergers), 276 (dissolution) (2001).

The stand-alone ABA Model Nonprofit Corporations Act, however, is the predominate format among the states and there is no indication that the current revision committee will abandon that approach in favor of the Delaware approach.

The inclusion of nonprofit corporations in the proposed Unified Business Organizations Code raises special issues concerning religious and other charitable organizations that are already included in state's nonprofit corporation acts. These organizations should continue to be included in the state's nonprofit corporation act relating to the state attorney general's oversight functions, regulation of charitable solicitations and the like should be placed in a separate part of the state's code. The nonprofit corporation spoke in the Unified Code should, however, contain a provision that special statutes or rules regulating a particular type of nonprofit corporation would apply. The comments (or annotations) in the Unified Code should contain appropriate cross-references to the other applicable regulations.

This same scheme would also work well with respect to the professional association spoke in the Unified Code. Many existing state professional corporation acts contain what are essentially regulatory provisions for particular professions (e.g., lawyers) These types of provisions should be placed in other parts of the state's code or administrative regulations rather than in the proposed Unified Code. See Thomas E. Rutledge, The Place (If Any) of the Professional Structure in Entity Rationalization, 58 BUS. LAW. 1413, 1423-24 (2003); Keatinge, supra note 30, at 32, 77.

82A U.L.A. 651 (2003). Although this act has only a few sections and does not have the same breadth of coverage as the other uniform and model acts, it fills a necessary gap in state statutory law by providing limited liability protection for members, the right to sue and to be sued, and the right to hold and to transfer title to property in the organization's name for the thousands of nonprofits, such as churches, trade associations, and little league teams, that are not incorporated or formed as another entity which provides similar rights.

83Many states, for what are to them legitimate reasons, will not choose to adopt all of the acts on this list. Delaware, for example, is not likely to adopt the MBCA to replace the DGCL. Delaware will also probably never enact the Uniform Entity Transactions Act because it has already incorporated the main provisions in UEnTA in its existing business entity statutes.
Two prominent examples of special purpose organizational forms are business trusts and cooperatives. Both are widely used and generate billions of dollars of revenue and yet, for the most part, the state statutes that govern them are archaic and incomplete in several important respects.

Business trusts are contract-based organizations with flow-through tax treatment that are widely used for mutual funds, pension funds and asset securitization financing where assets such as accounts receivable or real estate mortgages are transferred to a business trust that functions as a vehicle to protect the transferred assets from creditors of the transferee. REMICs (Real Estate Mortgage Investment Conduits), and FASITs (Financial Asset Investment Securitization Trusts) are examples of such business trusts. Many REITs (Real Estate Investment Trusts) are also formed as business trusts. Other specialized areas where business trusts are used are Oil and Gas Royalty Trusts and various types of regulatory compliance trusts such as Nuclear Decommissioning Trusts and Environmental Remediation Trusts for environmental cleanup purposes. This format is also suitable for land conservation trusts. Approximately thirty-four states have some form of business trust statute and most of these are very incomplete and inconsistent. One example of the shortcomings of some business trust statutes is that they vary widely with respect to the provisions specifying the liability protection that exists. Some statutes state that both the holders of beneficial interests and the trustees have limited

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83 Statistics provided by the Delaware Secretary of State, Corporate Division (Mar. 26, 2002) (on file with the Delaware Journal of Corporate law), indicate that as of March 20, 2003 there were 9,237 business trusts filed in Delaware. At the end of 1997 there were 3,424 business trusts. I was unable to locate statistics on the business trust filings in other states. Business trusts are not included in the compilation of business entity filings collected by the International Association of Commercial Administrators, see 2003 IACA Report of the jurisdictions, supra note 24.


liability equivalent to a corporation.88 Others explicitly allow limited liability for holders of beneficial interests but are silent on the liability of trustees.89 Most, however, fail to cover the liability issue in any respect.90

The most complete act is the Delaware Business Trust Act,91 enacted in 1988 and amended periodically. It has been the model for recently adopted business trust statutes in Nevada,92 New Hampshire,93 and Virginia94 and it could easily be used as a model for a uniform act.95 Widespread adoption of such an act would make it easier for business trusts formed in one state to transact business in other states without fear that the limitation of liability and other terms of the trust instrument would not be enforceable in the other states.

The most prevalent type of cooperative is a farm product marketing association. Perhaps the best known cooperatives of this type are Land O' Lakes and Sunkist. In recent years farm cooperatives have expanded into product processing, e.g., a cooperative that processes corn into ethanol as well as other ventures.96 While virtually all states have farm cooperatives statutes, most have not been substantially changed in the last fifty years. These statutes do not, for the most part, allow business diversification,

89See, e.g., IND. CODE ANN. §§ 23-5-1-8 (Michie 1999); WASH. CODE ANN. § 23.90.020 (West 1994).
90See, e.g., FLA. STAT. ANN. §§ 609.01 to -.08 (West 2001 & Supp. 2004); UTAH CODE ANN. §§ 16-15-101 to -110 (2001). The liability exposure of trustees and beneficiaries of business trusts is also not clear under caselaw. See Chermside, supra note 84, at 722-25, 728-29; Jones et al., supra note 84, at 433, 439-43. See also Tmar Frankel, The Delaware Business Trust Act Failure as the New Corporate Law; 23 CARDOZO L. REV. 325, 344 (2001) (discussing the limited benefit of the trust form to businesses that operate nationally due to conflicting state liability laws).
95The National Conference of Commissioners on Uniform State Laws recently approved a Uniform Business Trust Act drafting project. The Drafting Committee is expected to hold its first meeting in the fall of 2003. A uniform laws drafting project takes a minimum of two years to complete.
96See Doekke Faber & Lee Egerstrom, New Generation Cooperatives in the New Millennium ch. 11 in A COOPERATIVE APPROACH TO LOCAL ECONOMIC DEVELOPMENT 167, 174 (Christopher D. Merrett & Norman Walzer eds., 2001); Mark J. Hanson, A New Cooperative Structure for the 21st Century: The Wyoming Processing Cooperative Law, COOPERATIVE ACCT. 3, 4-5 (Summer 2001).
access to capital markets, or tax or structural flexibility. A comprehensive, modern model or uniform cooperative statute would definitely enhance the use of cooperatives as a business form.

C. The Hub-and-Spoke Unified Business Organizations Code

As previously stated, in concept utilizing the Unified Business Organizations Code, the emphasis should be on harmonizing in the hub those administrative portions of the various business organization statutes that are common to all the forms and leaving largely intact the substantive provisions of each form. All of the organizational forms discussed in Sections A and B should be included in this code. Additionally, the essential elements that are distinctive to a particular form, and the types of businesses where it has been most widely used should be preserved in the spokes. This focus will help to deflect the tendency to try to make every form fit every imaginable type of business. This tendency has most recently manifested itself in LLC amendments in several states that are designed to make an LLC look like a limited partnership for purposes of family estate planning valuation purposes. Several states have also amended their LLC statutes to include corporate-style provisions for voting

97 Most cooperatives are classified for state purposes as corporations (see, e.g., DEL. CODE ANN. tit. 3, § 8505 (2001) (stating that for most purposes the DGCL applies to cooperatives)) and are taxed on a modified mandatory dividend flow-through theory under subchapter T of the Internal Revenue Code. In June 2001, the IRS issued a Private Letter Ruling allowing cooperatives to be taxed as limited liability companies, which are unincorporated associations. See Priv. Ltr. Rul. 200123033 (Mar. 7, 2003).

98 The National Conference of Commissioners on Uniform State Laws in 2003 approved a drafting project for a Uniform Cooperative Act. The Drafting Committee is expected to hold its first meeting in the fall of 2003.

99 It is unclear whether the proposed Uniform Cooperative Act will be limited to farming operations or will include other forms of cooperatives. Many states, for example, have electric cooperative statutes. See, e.g., ARIZ. REV. STAT. §§ 10-2051 to -2083 (2003); 15 PA. CONS. STAT. §§ 7301-7359 (2003). Europe has a wide variety of cooperatives that do not currently exist in the United States. Two examples are so-called Finlandia cooperatives for professional and service businesses such as architects, and worker-owned Mondragon Cooperatives for assembly of appliances and electronic equipment. See Faber & Egerstrom, supra note 96, at 182-84.

100 See Robert R. Keatinge, Plumbing and Other Transitional Issues, 58 BUS. LAW. 1051 (2003); Keatinge, supra note 30, at 81-84. This is essentially the strategy incorporated in the newly adopted Texas Business Organizations Code, discussed supra note 65 and accompanying text.

101 The MBCA statutory close corporation and professional corporation supplements should probably also be included because many states have already adopted them or have similar statutes. See MODEL BUS. CORP. ACT ANN. (2002), CC-1 to 90 (STATUTORY CLOSE CORP. SUPP.), PC-1 to 57 (PROFESSIONAL CORP. SUPP.).

102 See Keatinge, supra note 30, at 56-62; Oesterle & Gazur, supra note 20, at 132-46.
rights, meetings of members and managers and the like. The ostensible purpose of these amendments is to make an LLC look more like a corporation and therefore more acceptable to lawyers (and perhaps their clients) who are comfortable with the corporate form and the statutory formulations used in corporate statutes.\textsuperscript{103} As was pointed out in the Introduction, this type of statutory conflation can create serious problems and adverse unintended consequences.\textsuperscript{104}

Rather than trying to universalize every type of organizational form, the proposed reform would instead act as a purification of each form. An example is the newly promulgated Uniform Limited Partnership Act (2001). The Prefatory Note to the Act states:

The new Act has been drafted for a world in which limited liability partnerships and limited liability companies can meet many of the needs formerly met by limited partnerships. This Act therefore targets two types of enterprises that seem largely beyond the scope of LLPs and LLCs: (i) sophisticated, manager-entrenched commercial deals whose participants commit for the long term, and (ii) estate planning arrangements (family limited partnerships). This Act accordingly assumes that, more often than not, people utilizing it will want: strong centralized management, strongly entrenched, and passive investors with little control over or right to exit the entity. The Act's rules, and particularly its default rules, have been designed to reflect these assumptions.\textsuperscript{105}

Under the proposed hub-and-spoke Unified Business Organizations Code, it would be easy to determine that certain desired estate planning tax objectives for a family business can be achieved under the limited

\textsuperscript{103}Recently a group of lawyers in Maryland who represented one or more venture capital companies introduced legislation in the Maryland Legislature that would in essence incorporate into the Maryland LLC statute all the provisions in the Maryland Corporate Code that venture capitalists were used to seeing. H.D. 1512, 2004 Leg., 418th Sess. (Md. 2004). This is admittedly an extreme case. The bill was withdrawn after a hearing in the Maryland House of Representatives.

\textsuperscript{104}See supra notes 52-58 and related text. See also Richard A. Booth, \textit{Form and Function in Business Organizations}, 58 BUS. LAW. 1433, 1446-48 (2003) (arguing that while entity rationalization eliminates unintentional conflicts between forms, simplification of the business forms can create confusion and therefore additional risks for business persons).

partnership spoke in the Code.\textsuperscript{106} Therefore, there would be no need to amend the state's limited liability company spoke to create the same result. Moreover, because the hub of the proposed Unified Business Organizations Code will allow inter-entity conversions, there is no legal downside to forming a family business as a limited partnership and then later converting it to a limited liability company (or some other type of organizational form) if circumstances justify the change.\textsuperscript{107}

Another important task that can be undertaken in the hub-and-spoke project is to eliminate the differences in wording for similar provisions in different organizational forms that are intended to have identical meaning. This is potentially a serious problem with the uniform acts governing unincorporated organizations. These acts were drafted over a long period of time by different drafting committees. The language allowing modification of the default rules in these statutes, for example, should be the same unless the differences are intentional. If they are, the rationale for the difference should be set forth in the Official Comments.

There is no reason why the hub-and-spoke project could not be undertaken at the same time as the drafting and enactment efforts described in Sections A and B are underway. Because the Unified Business Organizations Code will include the Model Business Corporation Act, the Model Nonprofit Corporation Act, and the various uniform unincorporated association acts, close coordination between the ABA Business Law Section, which oversees the Model Acts, and the National Conference of Commissioners on Uniform State Laws (NCCUSL), which oversees the uniform acts, will be necessary, at least concerning the drafting of the common provisions in the hub. Ideally a joint ABA/NCCUSL Drafting Committee will be appointed for the Unified Code project, which, as the experience with such similar legislation in Pennsylvania and Texas shows, will undoubtedly take several years to develop. NCCUSL has taken an initial step by approving at the 2002 Annual Meeting a resolution creating:

[A] study committee . . . to consider[] establishing a


drafting project for an omnibus business organization code, including both profit and non-profit, and corporate and non-corporate business organizations, and to perform a survey of business organization forms, statutes, and regulations in this and other countries.\footnote{Robert R. Keatinge, From the Chair, PUBOGRAM (Am. Bar Ass'n, P'ship and Unincorporated Bus. Org. Comm.), Nov. 2002, at 2.}

When the Unified Business Organizations Code is completed and ready for state adoption, two additional steps will be necessary to insure its success. The first is to mobilize an effective team of individuals from the ABA and NCCUSL to promote the enactment of the Code on a nationwide basis. This effort needs to be the same magnitude as the effort that has been made beginning in the 1960s to get the Uniform Commercial Code enacted.\footnote{See, e.g., William A. Schnader, Permanent Editorial Board for the Uniform Commercial Code—Can it Accomplish its Objective, 3 AM. BUS. L.J. 137 (1963) (discussing the UCC's sponsors' actions in forming a permanent editorial board whose purpose was to persuade states to adopt the code as promulgated). The effort to gain widespread adoption of Revised UCC Article 9, promulgated in 1999 is the most recent example. Every state had adopted this act by 2003. See NAT'L CONF. OF COMM'RS ON UNIF. STATE LAWS 2003-04 REFERENCE BOOK 121 (2002).} The second step, which also draws on the Uniform Commercial Code experience, is to establish a Permanent Editorial Board (PEB), similar to the PEB for the Uniform Commercial Code,\footnote{The original agreement creating the Permanent Editorial Board (PEB) for the Uniform Commercial Code was signed in August 1961 and has been amended several times, most recently in January 1998. The agreement is between the National Conference of Commissioners on Uniform State Laws and the American Law Institute. Both the ABA and the ALI appoint an equal number of representatives to the PEB. The agreement states:}

\begin{quote}
\begin{itemize}
\item The function of the PEB is to assist in attaining and maintaining uniformity in state statutes governing commercial transactions by (1) discouraging non-uniform amendments to the Code by the states, and (2) approving and promulgating amendments to the Code when experience has demonstrated a provision is unworkable or otherwise requires amendment; when court decisions have rendered the correct interpretation of a provision doubtful; when new practices have rendered a provision obsolete or new provisions desirable; and when amendments would lead to wider acceptance of the Code.
\item If the PEB recommends UUC amendments or the addition of new articles, a joint NCCUSL/ALI drafting committee is established. The amendments and additions have to be approved by both organizations, but if they are unable to agree, "each body is free to promulgate its own draft as an alternate amendment to the Code with notation as to the unilateral source, or, if appropriate, as an act outside the Code." Schnader, supra note 109, at 139. To the best of my knowledge, the current Agreement for the PEB has not been published in any treatise, book, or periodical and is not available on-line, but a copy is available from NCCUSL's headquarters in Chicago, Illinois.
\item Although there have been disagreements from time-to-time between NCCUSL and the ALI, most recently over revised Article 2 of the UCC (the disagreements have been resolved and}
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\end{quote}
duty to monitor and to evaluate all amendments made by the states and the authority to recommend changes and additions to the Unified Business Organizations Code. The PEB will provide an effective way of making sure that the Code is current and accommodates new legal and tax developments. A concerted effort to obtain enactment of all the approved amendments will also be necessary.

D. Consolidation—A Second Generation Business Organizations Code

This project would have as one of its objectives the possibility of eliminating one or more of the existing organizational forms. Because a statute designed specifically for the traditional general business corporation should probably be retained, the focus should be on eliminating one or more of the unincorporated forms.111

The various forms of partnerships and limited liability company acts are really variations on a theme, that theme being limited liability and the ability to modify the default rules governing the relations among the owners. It should be possible, then, to collapse those forms into one of the existing types of unincorporated entities. The argument in favor of this form of consolidation would be:

Limited partnerships were invented about a hundred years ago as a means of obtaining corporate style limited liability for the limited partners. Limited liability companies evolved in the 1990s as a vehicle to provide the same level of limited liability as exists in a corporation, partnership planning flexibility, and the ability to be taxed as a partnership under Subchapter K of the Internal Revenue Code, instead of the double tax scheme under Subchapter C or the less than desirable pass-through taxation

111 One commentator has suggested the possibility of having a single business organizational form that might be designated as the Universal Contractual Organization (UNICORN), Universal Business Organization (UBO), or Limited Liability Entity (LLE), but ultimately concluded that some distinctions should be retained where those distinctions have support. See Keatinge, supra note 30, at 81-84.

An unresolved issue is how to treat closely held corporations in the consolidation code. See infra notes 119-21 and accompanying text.
of a corporation taxed under Subchapter S of the Internal Revenue Code. The LLC partnership/corporation model in turn accelerated the development of both the limited liability partnership (LLP), which provides corporate style limited liability for all general partners in most states, and the limited liability limited partnership (LLLP), which gives corporate style limited liability to the general as well as the limited partners in a limited partnership. If the LLP had been the first form to have been developed, the others would probably have been unnecessary. Hence, LLPs should be retained and the other types of partnerships and LLCs should be eliminated.

LLC adherents would argue, however, that if only one type of unincorporated entity is to remain, it should be the LLC. At least two reasons would be given for this choice: (1) the growing popularity of LLCs, which proves it is the vehicle of choice for new closely held business, and (2) the ability under current tax law to have one-member LLCs with flow-through tax consequences, which makes LLCs available for sole proprietors and for wholly owned subsidiaries of an existing business whereas a partnership must have at least two partners.

Partnership devotees, on the other hand, will point out that LLCs are quite new and largely untested by the courts and that choosing the LLC over the partnership with its long history and considerable caselaw would be a real loss from a legal standpoint. Partnership devotees will also point out that sole proprietors can already incorporate and get basic pass-through taxation under Subchapter S of the Internal Revenue Code. They may be so bold as to say that a "new" partnership act could be drafted so that a partnership could exist with only one partner. Finally, the partnership adherents would ask the following questions, among others: What happens to all of the existing partnerships if partnerships are no longer considered a separate form of business? Will they be forced to convert to the new surviving form even if the conversion would adversely affect the financial and governance arrangements in the partnership.

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114 See supra notes 17-26 and accompanying text.

115 BISHOP & KLEINBERGER, supra note 29, § 2.02[4].

116 This same argument could be made with respect to the elimination of any of the existing forms. See Ribstein, supra note 63, at 1027-29.

agreement? What remedies would the adversely affected partners have? Would the partnership agreement automatically qualify as an LLC operating agreement? LLC adherents would immediately counter with the same arguments regarding existing LLCs if they were not included in the unified code. The best response to this problem may be to allow all existing LLCs (or LLPs, depending on who wins) to continue to operate under the prior statute, unless they voluntarily convert into a form authorized by the new code. The code would thus affect only businesses formed after the effective date of the new unified statute.  

There are also other difficult transition issues. Most proponents of the consolidation concept think that there should be one form designed for publicly held corporations and one form for small, closely held businesses. One advantage of this dichotomy is that the new corporate code could be redesigned or purified to focus solely on the needs of largely publicly held businesses. This might result in the repeal of several provisions, such as involuntary dissolution provisions based on oppression, unfairly prejudicial conduct or frustration of reasonable expectations, that have been added to corporate codes in recent years as an accommodation.

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A possible middle ground is to provide that existing business forms eliminated by the consolidation will have several years to convert to whatever other form is available. The New Texas Business Organizations Code, for example, applies to new businesses formed after January 1, 2006 but does not apply to existing businesses until January 1, 2010, four years later. TEX. BUS. ORG. CODE ANN. §§ 402.001, 402.005 (Vernon 2003). See also supra note 65. While four years to transition into a new form may appear to be sufficient, this conclusion would have to be based on the assumption that all of the affected businesses would have consulted competent legal counsel before the end of four years (and seven years after enactment of the Code). Many businesses, however, do not have in-house or regular outside counsel and may not have actual knowledge of the implications of the new consolidated code. What happens to these businesses after the consolidated code is effective as to them? One possibility would be to have a special set of default rules that would apply, e.g., the filings in the secretary of state's office are not deleted, limited liability protection still exists (assuming it previously existed), etc. Drafting these default rules will be difficult and make the consolidated code even more complicated to navigate.

See supra notes 69-73 and accompanying text. See also Lowenstein, supra note 66, at 456, 465 (suggesting consolidation efforts that would result in two distinct business entities: the corporation and a flexible, limited liability entity).

The vast majority of businesses, whether corporate or noncorporate in form can be properly classified as small or closely held. According to one respected treatise, ninety percent or more of all corporations are closely held enterprises. See O'NEAL & THOMPSON, supra note 56, § 1.19, at 108. Another indication of the prominence of small businesses is reflected in federal tax returns. A report on 1999 Federal Tax Business Returns showed that more than one half of all corporate returns were S corporations, which can have no more than seventy-five shareholders. Sheldon I. Banoff & Richard M. Lipton, What's More Popular: Partnerships, LLC's or S Corporations?, 98 J. TAXN 126 (2003). The same report showed that there were an average of four partners per general partnership return, an average of five partners per LLP return, an average of four members per LLC return, and an average of twenty-five partners per limited partnership return. Id.
to the needs of close corporation minority shareholders. These types of provisions are highly problematic with respect to publicly held corporations where an involuntary dissolution suit by a disaffected shareholder owning only a few shares could cause havoc and possible serious damage to the corporation's share value. If these provisions are repealed, what would happen to all the closely held corporations in existence before the effective date of the consolidated code? Will they be allowed to continue in existence, or will they be required to convert into the new small business form?

Conversion may not, however, be desirable from a tax perspective. While it is possible to convert from one type of unincorporated format to another unincorporated form or from an unincorporated form to a corporate form on essentially a tax free basis, a conversion of a corporation into an unincorporated entity is currently treated as a taxable liquidation of the corporation. Again, the answer to this question may have to be that existing closely held corporations, whether they were formed under the state's general corporation law or under a special close corporation statute such as the Model Business Corporation Act Statutory Close Corporation Supplement, be allowed to continue to operate under the corporate statute in existence before the new consolidated code was adopted.

These complex transition problems will also exist if, instead of eliminating one or more business forms by consolidating them, one or more new forms were created and all the previously existing forms were required to convert. The impracticality of forcing all the existing businesses to convert to the new form means that all that is accomplished is the creation of yet another organizational form thus exacerbating the proliferation of

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120 See, e.g., MODEL BUS. CORP. ACT § 14.30(2)(ii) (1984); Close Corp. Supp. §§ 40(a)(1), 42(a) (1997). See also O'NEAL & THOMPSON, supra note 56, § 1.16; Haynsworth, supra note 57 (discussing the use of involuntary dissolution suits to remedy dissenion in close corporations). Not everyone agrees that these minority shareholder protection provisions are a positive development. See, e.g., Dennis L. Karjala, An Analysis of Close Corporation Legislation in the United States, 21 ARIZ. ST. L.J. 663, 702-03 (1989) (arguing that special close corporation legislation is both fundamentally arbitrary and obsolete); Dennis L. Karjala, A Second Look at Close Corporation Legislation, 58 TEX. L. REV. 1207 (1980) (contending that special legislation is unnecessary because the problem has been solved by flexible modern corporate statutes).


122 See Treas. Reg. § 301.7701-3(g)(1)(i) (2003); BITTKER & EUSTICE, supra note 112, § 2.02[3][b].

123 See 4 MODEL BUS. CORP. ACT ANN. CC1-CC90 (2002). Approximately eighteen states have adopted the Statutory Close Corporation Supplement or a special chapter or set of provisions for close corporations.

124 See supra notes 69-73 and accompanying text.
forms problem.\textsuperscript{125}

A legitimate question that might be asked is: if all existing businesses can continue to operate under the statutes governing them before the new consolidated code was adopted, what positive purpose does the new code serve? The most logical response is that the new code will govern all new businesses established after it is enacted, and if it truly meets their needs, most, if not all, of the existing businesses will, over a period of time, convert to the new form or forms. This conversion process, however, could take innumerable years.

A counter argument is that a great deal of convergence of the various forms has already taken place and the consolidation code will speed up a process that is well underway.\textsuperscript{126} Therefore, the conversion and transition issues may not be that difficult to resolve. The proponents of this line of reasoning will point to the many cases where courts have applied partnership fiduciary duty principles to close corporations on the basis that they are really partnerships in a corporate form.\textsuperscript{127} Many state corporate codes also specifically authorize shareholder management agreements that can allow shareholders in a close corporation to eliminate the board of directors and have a management system similar to a partnership.\textsuperscript{128} Moreover, many partnership and limited liability company acts increasingly contain provisions formerly found only in corporate codes.\textsuperscript{129}

The convergence that has taken place, however, is not necessarily a good thing. For example, the attempt to apply partnership fiduciary duties to close corporations has not been universally praised as a positive development.\textsuperscript{130} More importantly, convergence does not necessarily lead to consolidation. In short, convergence may occur while leaving all the various business forms intact.

A more telling argument against eliminating one or more of the

\textsuperscript{125}See Clark, supra note 27, at 1018.
\textsuperscript{126}Id. at 1011-14.
\textsuperscript{127}Donahue v. Rodd Electrolyte Co. of New England, Inc., 328 N.E.2d 505, 515 (Mass. 1975) is considered the seminal case. See generally F. Hodge O'Neal & Robert B. Thompson, O'Neal's Oppression of Minority Shareholders §§ 7:03-7:05 (2d ed. 1991) (discussing enhanced fiduciary duties of those in control of close corporations due to partnership-like qualities of close corporations).
\textsuperscript{129}See Clark, supra note 27, at 1011-14.
existing organizational forms is the fact that the business organization marketplace provides empirical evidence of the demand for each of the existing forms. The number of limited partnerships, for instance, continues to increase despite the growing popularity of limited liability companies.\textsuperscript{131} Although the number of limited liability partnerships is not great,\textsuperscript{132} they continue to be formed in every state at a rate that indicates reasonably wide acceptance, particularly with respect to professional service firms. A recent survey of law firms, for example, showed that among firms of fifty or more lawyers there were significantly more limited liability partnerships than general partnerships, limited liability companies, or professional corporations.\textsuperscript{133} Moreover, corporations, including close corporations, continue to be formed at a somewhat reduced but nevertheless brisk rate.\textsuperscript{134} In addition, the recent increase in the number of business trusts and the renewed interest in cooperatives indicates that there is a market for these more specialized business forms.\textsuperscript{135}

Another argument against undertaking a business organizations code with the objective of elimination of some of the existing organizational formats is the role federal tax policy has played in the development of the various types of business organizations. The rapid development of limited liability companies after the publication of a 1988 revenue ruling\textsuperscript{136} authorizing limited liability companies to be taxed as partnerships is only the most recent example.

The adoption of Subchapter S in 1958 played an important role in the development and popularity of close corporations. More than one-half of all corporations are Subchapter S corporations.\textsuperscript{137} The number of new businesses being formed as Subchapter S corporations each year, however, is probably decreasing, due to the emergence of limited liability companies, which are generally considered to be a preferable format from both a structural and tax perspective.\textsuperscript{138}

\begin{footnotesize}
\textsuperscript{131}More than 63,000 new limited partnerships were formed in 2002. See 2003 IACA Report of the Jurisdictions, \textit{supra} note 22.

\textsuperscript{132}Approximately 12,000 LLPs were formed in 2002. \textit{Id.}


\textsuperscript{134}In 2002, more than 845,000 new corporations were formed as compared to approximately 947,000 in 2000. 2003 IACA Report of the Jurisdictions, \textit{supra} note 22.

\textsuperscript{135}See \textit{supra} notes 83-99 and accompanying text.


\textsuperscript{137}See Banoff & Lipton, \textit{supra} note 119, at 126.

\end{footnotesize}
Another example was the popularity in the late 1960s and early 1970s of so-called tax shelter limited partnerships that purportedly allowed limited partners to use tax deductions and tax credits far in excess of their basis in the limited partnership to offset income from other sources. The Tax Reform Act of 1976, which added the "at risk" limitations in Section 465 of the Internal Revenue Code as well as other tax legislation, effectively curtailed the use of limited partnerships for abusive tax shelter deductions.

A final example is the rapid development of professional associations as a separate form of business for professionals after the Internal Revenue Service in 1969 reluctantly agreed that professional associations could be taxed as corporations rather than partnerships.\(^{139}\) This enabled professional associations (or professional corporations as they are now more commonly called) to take advantage of fringe benefits and more generous retirement plans that were available for shareholders of corporations but not the partners of partnerships.\(^{140}\) The Tax Equity and Fiscal Responsibility Act of 1982 and subsequent tax legislation has to some degree decreased these corporate tax advantages.\(^{141}\) Moreover, limited liability companies and limited liability partnership statutes provide essentially the same liability protection for professionals that is possible in a professional association.\(^{142}\) As a result, professional associations are less popular today than they were before the advent of limited liability companies and limited liability partnerships.\(^{143}\) In short, tax changes in the

\(^{139}\) See Rev. Rul. 70-101, 1970-1 C.B. 278, amplified in Rev. Rul. 70-455, 1970-2 C.B. 297; Rev. Rul. 72-468, 1972-2 C.B. 647. Ironically, the tax classification regulations, known as the Kintner regulations, were intentionally drafted to tax professional associations as partnerships. This attempt failed but the partnership bias in the classification regulations was not substantially changed. This bias then became the focus of the battle with the Internal Revenue Service over the tax classification of limited liability companies. The IRS initially wanted limited liability companies to be taxed as corporations but was unsuccessful because the initial limited liability company statutes were carefully crafted to comply with the partnership bias in the classification regulations. The IRS ultimately realized that the complexities of trying to draft the classification regulations to achieve a particular tax result was very costly and counterproductive. This led to the check-the-box regulations, Treas. Reg. §§ 301.7701-1 to -4 (1996), which allow unincorporated businesses to choose whether they want to be taxed as a partnership or a corporation. See Rutledge, supra note 80, at 1413-19.


\(^{142}\) See Bishop, supra note 113, at 125-38; Rutledge, supra note 80, at 1414-23.

\(^{143}\) Existing professional corporations that might want to convert to an LLC or LLP status may not be able to do so as a practical matter because of adverse tax consequences. See Laurence J. Lee, Disincorporation Problems, 42 N.Y.U. INST. ON FED. TAX’N 44.01 (1984). See also Hillman, supra note 133, at 1397-1402 (discussing the tax implications and difficulties of
past have significantly impacted the choice of business form decisions. In all likelihood future tax changes will also make some forms more popular and others less popular or maybe lead to the creation of an entirely new organizational form.

Finally, statutes and regulations other than tax law also impact on the choice of business form decision. Some states prohibit certain types of businesses from operating in a particular form. In Oklahoma, for example, it is not permissible for a liquor store to operate as an LLC. Moreover, regulations of professional firms in many states may make one type of organizational format either more or less desirable than other possible forms. There are many other state and federal statutes that can have major impact on which organization form best fits the needs of a particular business. The elimination of one or more forms could have the unintended consequence of causing significant adverse regulatory problems for existing businesses that have been organized in a format that complies with (or successfully avoids) these regulations.

III. CONCLUSION

The hub-and-spoke Unified Business Organizations Code is, at the present time, a much more realistic model for entity rationalization than a Consolidation Business Organizations Code aimed at eliminating one or more of the existing organizational forms. Resolving the transitional problems for entities organized under statutory forms that would be eliminated in a consolidation code will be an enormous and perhaps impossible task. The end result may well be that all the existing forms must be retained; and the new form or forms created to replace them will simply be additional forms.

The hub-and-spoke approach avoids the transitional problems inherent in the consolidation approach. More importantly, the hub-and-spoke approach will preserve and enhance the utility of all the existing forms (and new ones that may be developed before the new Code is escaping current contract obligations).


145 See Bishop, supra note 113.

146 See Oesterle & Gazur, supra note 20, at 108-14; Ribstein, supra note 138, at 431-32.

finished) and will eliminate many of the troubling filing and other regulatory inconsistencies between the various organizational forms that currently exist.

Drafting a hub-and-spoke Unified Business Organizations Code will be a monumental multi-year task. The adoption of the Code on a widespread basis will also take several years. Neither goal can be accomplished without an extraordinary degree of cooperation between the National Conference of Commissioners on Uniform State Laws, the American Bar Association, state bar association sections that have oversight responsibility for business entity laws, and the Secretary of State offices and tax officials in all the states. Nevertheless, achieving the goal of a widely adopted hub-and-spoke Unified Business Organization Code is a worthy albeit challenging pursuit.

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149 Robert R. Keatinge, one of the leading proponents of entity rationalization, refers to these as "plumbing" issues. See Keatinge, supra note 100, at 1054-57.

150 The newly adopted Texas Business Organizations Code is based on the hub-and-spoke model and was a ten year project. See supra note 65.

151 As was pointed out in the text, the effort necessary to achieve widespread adoption will be similar to the effort to get the UCC adopted by the states. See supra note 109 and accompanying text. Modifying the Unified Business Organizations Code to accommodate new tax and legal developments and having a system in place to oversee the adoption of the modifications by the states will be another challenge that must be met if this undertaking is to be successful. See supra note 110 and accompanying text.