

Avoiding Pitfalls in Doing Business with the Secretary of State

2012 Essentials of Business Law

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New Texas Business Filings

	<u>2010</u>	<u>2011</u>
For-Profit Corporations	24,801	24,123
LLCs	76,142	86,947
LPs	5,439	5,633
LLPs (new & renewal)	4,013	3,857

Active Entities as of May 1, 2012

For-Profit Corporations	366,671
Limited Liability Companies	454,675
Limited Partnerships	127,777
Limited Liability Partnerships	3850

Living in a BOC World

Should Governing Documents Be Amended or Restated?

- Section 402.005 of the BOC indicates that a domestic filing entity formed before January 1, 2006, must **conform** its certificate of formation when it next files an amendment to its certificate.
- Senate Bill 748 (*effective 09/01/11*) addressed certain concerns by amending chapter 402 of the BOC.

References to Prior Law

Legislative Clarification—New Section 402.0051

- Repeal does not affect prior operation of the statute or any action under that statute. Gov't Code § 311.031.
- Reference is historically accurate.
- BOC lists synonymous terms in § 1.006:
 - *articles of incorporation = certificate of formation*
 - *regulations = company agreement*
 - *certificate of authority = registration to transact business*
- BOC applies despite contrary references.

To Amend or Not to Amend

- Consider amending if documents do not conform in some substantive manner, i.e., name or registered agent, rather than to change references or terminology.
- If amending, consider a restated certificate of formation changing substance, references, and terminology.
 - Easier to make wholesale changes.
 - Supersedes original certificate of formation and prior amendments and is *effective certificate of formation*.

Restated Certificates of Formation

Common Errors to Avoid

- Omission of governing authority information
 - Organizer information may be omitted, but restated certificates **must** include the number, names and addresses of the entity's governing authority.
- Failure to identify amendments made
 - Section 3.059(d) requires an identification "by reference or description each added, altered, or deleted provision."
 - Full text of added/altered provisions is set forth in attached exhibit, but include brief description of amendments being made.

Restated Certificates of Formation

Statements Required by § 3.005(a)(7)

- Was entity formed pursuant to a plan of merger?
 - Restated certificate must include statement that entity was formed pursuant to plan of merger.
- Was entity formed pursuant to a plan of conversion?
 - Restated certificate must include:
 - ✓ Statement of its formation pursuant to plan of conversion, and:
 - ✓ Name, address, date of formation, prior form of organization and jurisdiction of formation of the converting entity.



Restated Certificates of Formation

- SOS Form 414—Restated Certificate With New Amendments
- SOS Form 415—Restated Certificate Without New Amendments
- Attached exhibit of Restated Certificate need not be signed.

Series LLCs

Establishing a Series LLC

- ❖ A company agreement may establish or provide for the establishment of one or more designed series of members, managers, membership interests or assets.
- ❖ Statement that a series LLC is being created not required in certificate of formation.
- ❖ Sec. 101.602(b)(3) BOC requires certificate of formation to include notice of limitations on liabilities of the series.

Notice of Limitations

Sec. 101.602(a) BOC requires notice to state:

- The debts, liabilities and obligations shall be enforceable against the assets of that series only and shall not be enforceable against the assets of the LLC or any other series.

- None of the debts, liabilities and obligations with respect to the LLC shall be enforceable against the assets of any series.

Notice of Limitations

Section 101.602(a) does not require the notice to reference a specific series.

How Popular Is the Texas Series LLC?

- ❖ There is no filing with the SOS when a series is actually established so SOS records do not reflect when and how many series have been created.
- ❖ SOS reviewed a representative sample of LLCs formed in 2011 to identify certificates of formation that included the notice of limitations.



SOS Sampling

Sample Size 659 Confidence Interval ± 5 Confidence Rate 99%

- ❖ Out of the 659 certificates of formation reviewed, there were five certificates that included the requisite notice of limitation of liability language, one that used *series LLC* in the entity name without the notice language, and one that stated in the text of the certificate that it was a series LLC but did not include the limitation of liability notice.
- ❖ Related to the larger population of 86,947 LLCs filed in 2012, approximately 660 of those were for series LLCs.

LLP Issues

LLP 2011 Legislative Changes

- SB 748, effective 9/01/2011, amended subchapter J of chapter 152 to:
- eliminate the \$100,000 insurance or financial responsibility requirements that were imposed on registration; and
- clarify when an obligation is incurred.

LLP 2011 Legislative Changes

Evanston Ins. Co. v. Dillard Dep't Stores, Inc., 602 F.3d 610 (5th Cir. 2010). Active LLP registration when cause of action arose, but no active LLP registration when judgment rendered. Individual partners personally liable.

- Amendments clarify that an obligation is incurred while partnership is an LLP if:
 - Obligation relates to an action or omission occurring while partnership is an LLP; or
 - Obligation arises under a contract or commitment entered while LLP.

LLP Renewals

Be vigilant about timely renewals!

- ❖ LLP provisions do not have a substantial compliance standard. Strict compliance with registration and renewal requirements is required to ensure liability protection. *Apcar Inv. Partners v. Gaus, 161 S.W.3rd 137 (Tex. App.- Eastland 2005, no pet.)*
- ❖ Failure of LLP to receive a notice of renewal does not extend duration of registration.
- ❖ *No grace period! If registration expires, new registration must be submitted.*

LLP Renewals and Franchise Tax

LLPs are taxable entities. If LLP is general partnership comprised solely of natural persons, registration lapse triggers final franchise tax report.

Registered Agent Provisions

Consent of Registered Agent

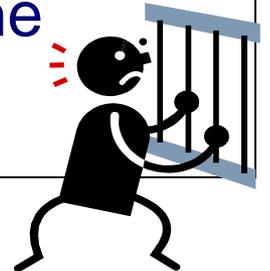
- A person appointed or named as a registered agent must have consented, in written or electronic form, to serve in that capacity.
- Designation or appointment of a registered agent by an organizer or managerial official in a registered agent filing is affirmation of consent.
- SOS developed Form 401-A for the consent.
 - Use of form is optional.
 - See 1 TAC § 79.29 if not using form.

Filing Consent of Registered Agent

- Filing with the SOS is ***not*** required.
- SOS recommends that the represented entity retain a copy of the consent in its own records.
- A statement of consent of registered agent will be maintained in the records of the SOS when:
 - submitted simultaneously with or as part of a registered agent filing; or
 - submitted separately with the appropriate filing fee.

Failure to Obtain Consent

- Sections 4.007 and 4.008 apply to false statement in registered agent filing naming a person without consent.
 - Section 4.007 provides for damages, court costs, and attorney's fees for a loss caused by a false statement of material fact in a filing instrument.
 - Section 4.008 provides criminal penalties if a person signs or directs the filing of an instrument that the person knows is materially false.



Rejection of Appointment

- A person named as registered agent without consent is *not* required to perform the duties of a registered agent and may refuse service of process.
- A person designated without consent may terminate the designation by filing a statement of rejection with SOS.
 - SOS developed Form 428 for rejection.
- SOS will notify entity of the necessity of filing a new registered agent and office.
- Failure to timely designate a new agent may result in involuntary termination of a domestic entity or revocation of registration of a foreign entity

Conversions

Conversion Pitfalls

- ◆ *Don't file the Certificate of Formation of the "converted" entity before the conversion!*
- ◆ A domestic entity created by a plan of conversion is formed by filing the Certificate of Conversion. Its existence is effective on the effectiveness of the conversion.

Conversion Pitfalls

- ◆ Don't use SOS certificates of formation for the formation document in a conversion unless the language required by §3.005(7) is added:
 - A statement that entity is formed under a plan of conversion; and
 - The name, address, date of formation, prior form of organization, and jurisdiction of formation of the converting entity.

Nonprofit Conversion Issues

- ◆ A domestic nonprofit corporation may not convert into a for-profit entity. §10.108
- ◆ SOS will accept a certificate of conversion that converts a Texas nonprofit corporation to a:
 - foreign nonprofit corporation;
 - nonprofit LLC; or
 - special nonprofit corporation formed under a code other than BOC.

Nonprofit Conversion Issues

- ◆ Chapter 10 of the BOC does not apply to an unincorporated nonprofit association. §252.017 BOC
- ◆ An unincorporated nonprofit association may not convert to a nonprofit corporation.

Conversion Effective Dates

The certificate of conversion and the certificate of formation filed as part of the conversion cannot have different effective dates.

Ex: Do not show an effective date of 12/31/2012 on the certificate of conversion and an effective date of 1/1/2013 on the formation.

§ 3.006 provides that the formation and existence of a domestic filing entity that is a converted entity in a conversion takes effect and commences on the effectiveness of the conversion.

Amendments to Foreign Registrations following a conversion or merger

- Sec. 9.009(a-1) permits a foreign filing entity to amend its application for registration to disclose a change resulting from:
 1. a conversion from one type of foreign entity to another type of foreign entity; or
 2. a merger into another foreign filing entity.
- Entity making the amendment succeeds to the registration of the original foreign filing entity.
- *See SOS Form 422.*

Name Availability

Entity Name Rules

The standards that the SOS applies when determining the availability of an entity name are included in Title 1, Part 4, Chapter 79, Subchapter C of the Texas Administrative Code.

There is a link to the rules on the *About the Corporations Section* tier page on SOS web site under *Points of Interest*.

Entity Name Issues

Some Words Require Pre-approval

Bank, Banc, Banque or Trust may not be used in an entity name without a “letter of no objection” from the Texas Department of Banking.

College, University, School of Medicine, Health Science Center, School of Law, Law Center, and words of similar meaning require prior approval of Texas Higher Education Coordinating Board.

Entity Name Issues

Some Words Require Pre-approval

Use of *Veteran, Legion, Foreign, Disabled, World War, or War* in a manner that might imply that the entity is a Veteran's organization requires the written approval of a Congressionally recognized Veteran's organization.

Use of *Olympic, Olympiad or Olympian* cannot be used without the written authorization of the United States Olympic Committee.

Entity Name Issues

Other Troublesome Words

- SOS notifies regulatory/examining boards when a document is filed using certain restricted or regulated terms.
 - ❑ An entity using *engineer, engineering, or engineered* in its name should be engaged in the practice of engineering and its engineering services performed by a licensed individual.
 - ❑ An entity using *architect or architecture* in its name should contact Texas Board of Architectural Examiners to determine whether use violates statutes applicable to architects.



Entity Name Issues

Common Drafting Error to Avoid

- Deceptive similarity between name of general partner and name of limited partnership to be formed.

ABC Realty LLC vs. ABC Realty, LP

- Differences in organizational identifiers not sufficient.
- Letter of consent not an option.

Unincorporated Nonprofit Associations

Unincorporated Associations are Taxable Entities

Under § 252.006 of the BOC, a nonprofit association is a legal entity separate from its members for the purposes of determining and enforcing rights, duties and liabilities in contract and tort.

Comptroller of Public Accounts is expecting that unincorporated associations will file franchise tax reports.

Useful Filing Options

Preclearance

- ✓ Recommended for complex or unusual transactions, especially mergers or conversions.
- ✓ Reduce risk of rejection on date of closing—submit draft for preclearance well before anticipated filing date.
- ✓ Identify submission as a preclearance request and submit \$50 fee.

Delayed Effectiveness Provisions

- ✓ Useful during peak filing periods or for multi-state filing transactions.
- ✓ Effectiveness may be delayed to a specific future date and time. Future date no later than 90th day after the date the instrument is signed.
- ✓ Future time cannot be specified as 12:00 am or 12:00 pm. Central Standard Time used by SOS.

Delayed Effectiveness Provisions

- ✓ Effectiveness may be delayed on the occurrence of a future event or fact, including the act of any person.
- ✓ If conditioned on future event or fact, must provide:
 - the manner in which the event or fact will cause the instrument to take effect; and
 - the date of the 90th day after the date of signing.
- ✓ Must file "Statement of Event or Fact" within 90 days of signing for instrument to be effective.

Delayed Effectiveness Provisions

- ✓ Although effectiveness of instrument may be delayed, SOS takes action and makes appropriate changes to its database at the time of filing.
- ✓ Example: A Texas filing entity that is a non-surviving party to a merger will have an inactive status of “merged” as of the date of filing.

Doing Business with the SOS

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Forms

http://www.sos.state.tx.us/corp/forms_option.shtml

Online Filing and Orders



Need Help?

Contact SOS by Email

Name availability & general entity information:

corpinfo@sos.state.tx.us

Request copies or certificates of fact:

corpcert@sos.state.tx.us

Legal questions relating to filing issues:

corphelp@sos.state.tx.us

SOSDirect assistance & issues:

sosdirect@sos.state.tx.us

Need Help?

Contact SOS by Email

Contact individual at SOS:

first initial last name@sos.state.tx.us

lwassdorf@sos.state.tx.us

Need Help?

Call (512) 463-5586



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