

D R A F T

FOR DISCUSSION ONLY

MODEL ENTITY TRANSACTIONS ACT

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

AMERICAN BAR ASSOCIATION

Partial Draft for April 9, 2005, Committee Meeting
(Containing Article 6)

WITH PARTIAL COMMENTS

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HARRY J. HAYNSWORTH, IV, 14866 Old Marine Tr. N, Marine on St. Croix, MN 55047, *Chair*
K. KING BURNETT, P.O. Box 910, Salisbury, MD 21803-0910
RONALD W. DEL SESTO, Del Sesto-Hall's Building, 49 Weybosset St., Providence, RI 02903
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CULLEN M. GODFREY, 100 Congress, Suite 1100, Austin, TX 78701
HENRY M. KITTLESON, P.O. Box 32092, 92 Lake Wire Dr., Lakeland, FL 33802-2092
LEON M. McCORKLE, JR., P.O. 256, 4288 W. Dublin-Granville Rd., Dublin, OH 43017-0387
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ANN CONAWAY ANKER, Widener University, School of Law, 4601 Concord Pike, Wilmington,
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Committee on Partnerships and Unincorporated Business Organizations
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Laws*

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Vermillion, SD 57069-2390

ROBERT R. KEATINGE, Suite 3200, 555 17th Street, Denver, CO 80202-3979

CAROL G. KROCH, RR 1 E College Rd E, P.O. Box 2316, Princeton, NJ 08543

BARRY B. NEKRITZ, 8000 Sears Tower, 233 S. Wacker Dr., Chicago, IL 60606

SECTION ON TAX LAW

ROBERT R. CASEY, 8555 United Plaza Blvd, Suite 500, Baton Rouge, LA 70809

OBSERVERS

CARTER G. BISHOP, Suffolk University Law School, 120 Tremont St., Boston, MA
02108-4977

DANIEL S. KLEINBERGER, William Mitchell College of Law, 875 Summit Ave., St. Paul,
MN 55105

MELISSA WANGEMANN, Kansas Secretary of State, 120 SW 10th Ave., Topeka, KS
66612-1594

Copies of this Act may be obtained from:

**NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS**

211 E. Ontario Street, Suite 1300,
Chicago, Illinois 60611
312/915-0195
www.nccusl.org

**AMERICAN BAR ASSOCIATION
SECTION ON BUSINESS LAW**

321 N. Clark St.
Chicago, Illinois 60610
312/988-6244
www.abanet.org

MODEL ENTITY TRANSACTIONS ACT

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1 **MODEL ENTITY TRANSACTIONS ACT**

2

3 **SECTION 102. DEFINITIONS.** In this [act]:

4 (6.1) “Dividing entity” means the domestic entity that approves a plan of division
5 pursuant to Section 603 or the foreign entity that approves a division pursuant to the law of its
6 jurisdiction of organization.

7 (6.2) “Division” means a transaction of the kind authorized by [Article 6].

8 (32.1) “Resulting entity” means an entity that continues in existence after or is
9 created by a division.

10

11 **[ARTICLE] 6**

12 **DIVISION**

13

14 **SECTION 601. DIVISION AUTHORIZED.**

15 (a) Except as otherwise provided in this section, by complying with this [article], a
16 domestic entity may divide into:

17 (1) the dividing entity and one or more new entities, whether domestic or
18 foreign; or

19 (2) two or more new entities, whether domestic or foreign.

20 (b) A foreign entity may be created by the division of a domestic entity only if the
21 division is authorized by the laws of the foreign entity’s jurisdiction of organization.

22 (c) Except as otherwise provided in this section, if the division is authorized by

1 the laws of the foreign entity's jurisdiction of organization, one or more of the resulting entities
2 created in a division of a foreign entity may be a domestic entity.

3 (d) If a protected agreement contains a provisions that applies to a merger of a
4 domestic entity but does not refer to a division, the provision applies to a division of the entity
5 until the provision is amended after the effective date of this [act].

6 [(e) The following entities may not divide or be created in a division under this
7 [article]:

8 (1)

9 (2)]

10 **Comments**

11
12 **1. In General** – The division transaction authorized by this article is the reverse of a
13 merger. Instead of two or more entities being merged into one entity, in a division one existing
14 entity is divided into two or more resulting entities. The dividing entity may or may not survive
15 the division, and one or more of the resulting entities may be foreign entities if the laws of the
16 foreign entity's jurisdiction of organization permit the division. As part of the division, the
17 assets and liabilities of the dividing entity are allocated to the resulting entities as provided in the
18 plan of division to the extent permitted by this article.

19
20 Restructurings that divide a business into more than one entity have become increasingly
21 popular in recent years. One prominent example is the transaction in which, as part of a
22 settlement of antitrust litigation, the telephone assets of AT&T were divided among the seven so-
23 called "Baby Bells" and the stock of the Baby Bells was distributed to the AT&T shareholders in
24 what is known as a spin-off division. Another example is the split-off by General Motors of one
25 of its major subsidiaries, Electronic Data Systems, where GM distributed EDS stock to the
26 holders of its Class E stock. A third type of division, known as a split-up, is sometimes used in
27 closely held businesses to resolve protracted dissension between the equity owners. For
28 example, if the entity operates two distinct businesses, it may be possible to resolve dissension
29 among two groups of owners by distributing the equity interests in one to one faction and the
30 equity interests in the second to the other faction. As a result, unlike spin-off and split-off
31 divisions where the distributing entity continues in existence, there will be two new entities and
32 the distributing entity ceases to exist.

33
34 In addition to being a non judicial remedy for resolving dissension, there are many other

business reasons for using divisions, including: separating conflicting businesses or businesses having different capital requirements or operating characteristics, freeing a parent company of underperforming businesses, unlocking value in a portion of the business operations that is expected to have greater market value operating as a separate business, and disposing of an unwanted business to facilitate a buy-out of the rest of the business enterprise.

2. Nonstatutory Divisions – This [Article] also does not apply to a division in which an existing subsidiary is distributed to the dividing entity’s equity holders, unless the assets and liabilities of the existing subsidiary are to be changed in preparation for the division transaction, in which case this [Article] may be useful. See Sections 602(a)(4)(ii) and 606(a)(4).

3. Coordination with Other Division Statutes – It is expected that some adopting states will add provisions authorizing divisions to their organic laws. On the other hand, there will be some types of entities where it is unlikely that division provisions will be added to the organic law, for example, unincorporated nonprofit associations. In cases where an organic law provides for a division in which the dividing entity and the resulting entities are all of the same type, there is no need for this Act; but in cases where an organic law does not provide for divisions, this Act will serve the important function of authorizing divisions just involving entities of that type. If one or more organic laws in a particular state authorize the division of entities organized under them, a subsection should be added to this section analogous to Sections 201(c) and 301(c)(d) providing that:

This [article] does not apply to a division under:

- (1)
- (2)

4. Tax Considerations – This [Article] authorizes a division for state law purposes. Federal law and other state law will independently determine how a division transaction will be taxed.

5. Protection of Creditors and Other Persons – Because the assets and liabilities of a dividing entity are allocated among the resulting entities in a division transaction governed by this [Article], there is a legitimate concern that the rights of creditors and equity owners of the dividing entity are not illegally curtailed by the division. Since this Act only deals with the types of transactions within its scope and the procedures for approval and the effect of these transactions, law other than this Act will govern any potential illegal allocation in a division. See Section 103. This other law includes: fraudulent conveyance and bankruptcy law, fiduciary duty principles, illegal distribution statutes, oppression law, securities laws and other federal and state regulatory law (e.g., regulation of transactions by charitable organizations). See Richard M. Cieri, Lyle G. Ganke and Heather Lennox, “Breaking Up Is Hard To Do: Avoiding the Solvency-Related Pitfalls in Spinoff Transactions,” 54 Bus. Law 533 (1999); Edward S. Adams and Arijit Mukherji, “Spin-offs, Fiduciary Duty and the Law,” 68 Ford. L. Rev. 15 (1999); F. Hodge O’Neal and Robert B. Thompson, O’Neal and Thompson’s Oppression of Minority

1 Shareholders and LLC Members, Sections 5:28-5:32 and 7:1-7:43 (2nd Rev. Ed. 2004). Section
2 355 of the Internal Code also serves as a deterrent to abusive corporate divisions because a
3 division can only qualify as a nontaxable dividend distribution if the division has an
4 “independent business purpose,” which requires that there must be a real and substantial non
5 federal tax purpose germane to the business of the entities. See Adams and Mukherji, supra at
6 20-26.

7
8 **6. Section 601(e)** – Section 601(e) is an optional provision that may be used to exclude
9 certain types of entities from the scope of this article. It is limited to domestic entities because a
10 restriction on the power of a foreign entity to engage in a division is more properly placed in the
11 organic law of the foreign entity. A provision that excludes certain types of entities from the Act
12 generally is set forth in section 107.
13

14 **SECTION 602. PLAN OF DIVISION.**

15 (a) A domestic entity may divide under this [article] by approving a plan of
16 division. The plan of division must be in a record and contain:

17 (1) the name and type of the dividing entity;
18 (2) a statement whether the dividing entity will continue after the division;
19 (3) the name, jurisdiction of organization, and type of each new resulting
20 entity;

21 (4) the manner of:
22 (i) converting the interests of the dividing entity into interests,
23 securities, obligations, rights to acquire interests or securities, cash, or other property, or any
24 combination of the foregoing;

25 (ii) allocating between or among only certain of the resulting
26 entities those assets of the dividing entity that are not to be owned by all of the resulting entities
27 as tenants in common pursuant to section 606(a)(4) and those liabilities of the dividing entity as
28 to which all of the resulting entities are not to be liable jointly and severally pursuant to section

1 **[606(a)(6)(ii)(B)] [607(a)(2)(ii)]; and**

2 (iii) distributing the interests of the resulting entities created in the
3 division;

4 (5) the proposed public organic document, if any, of each new resulting
5 entity and the full text of its private organic rules that are proposed to be in a record;

6 (6) if the dividing entity will continue after the division, any proposed
7 amendments to its public organic document or private organic rules that are proposed to be in a
8 record;

9 (7) the other terms and conditions of the division; and

10 (8) any other provision required by the laws of this state or the organic
11 rules of the dividing entity.

12 (b) A plan of division may contain any other provision not prohibited by law.

13 **Comments**

14
15 1. **Section 602(a)** - The requirements for the approval of a plan of division are set forth
16 in Section 603.

17
18 2. **Section 602(a)(4)** – [Explain options under paragraph (iii) for disposing of interests in
19 the resulting entities.]

20
21 3. **Section 602(a)(5) and (6)** – Section 602(a)(5) and (6) provides the interest holders of
22 the dividing entity with the text of the public organic documents, if any, and the private organic
23 rules of the resulting entities and any amendments to the public organic documents or private
24 organic rules of the dividing entity that are proposed to be in a record.

25
26 4. **Section 602(b)** – Section 602(b) provides the statutory authority for the dividing entity
27 to include information in a plan of division that is not specifically listed in section 602(a). One
28 such possibility is that of appraisal rights. Few state statutes provide for appraisal rights for
29 minority dissenting owners of unincorporated entities. A dividing entity, could, however,
30 provide for appraisal rights in section 602(b).
31

1 **SECTION 603. APPROVAL OF DIVISION.**

2 (a) A plan of division is not effective unless it has been approved:

3 (1) by a domestic dividing entity:

4 (A) in accordance with the requirements, if any, in its organic rules
5 for approval of a division;

6 (B) if its organic rules do not provide for approval of a division, in
7 accordance with the requirements, if any, for approval of a merger in its organic law and organic
8 rules as if the division were a merger; or

9 (C) if neither its organic law nor organic rules provide for approval
10 of a division or a merger, by all of the interest holders of the entity entitled to vote on or consent
11 to any matter; and

12 (2) in a record, by each interest holder of a domestic dividing entity that
13 will have interest holder liability with respect to a resulting entity for liabilities that arise after the
14 division becomes effective, unless:

15 (A) the organic rules of the entity provide in a record for the
16 approval of a division in which some or all of its interest holders become subject to interest
17 holder liability by the vote or consent of fewer than all of the interest holders; and

18 (B) the interest holder voted for or consented in a record to that
19 provision of the organic rules or became an interest holder after the adoption of that provision.

20 (b) A division of a foreign entity in which one or more of the resulting entities is a
21 domestic entity is not effective unless it is approved by the foreign entity in accordance with the
22 law of the foreign entity's jurisdiction of organization.

Comments

1. **In general.** – Approval under Section 603 is intended to include whatever actions by the governors and interest holders of a dividing entity are required by either its organic law or organic rules to effectuate the division. For example, if the organic rules of an entity prescribe a procedure for the proposal, adoption and/or approval of a division, the term “approval” includes conformance to all of those rules. See the definition of “approval” in Article 1. If the organic law and organic rules require only approval by the requisite vote of interest holders, then section 603 mandates only that required by the organic rules, nothing more. “Approval” also contemplates any additional requirements attendant to the proposal, adoption and approval of an action by the entity approving the division. This approval process will include, in the case of some incorporated entities, rules applicable to voting and records that apply to shareholder votes. On the other hand, Section 603 is not intended to impose any greater requirements for effecting a division than those required by the applicable organic rules or organic law of the entity.

2. **Section 603(a)** - Section 603(a) provides the substantive rule applicable to the approval of divisions by domestic dividing entities under the Act. Subsection (a) sets out an alternative three-part test:

1. Approval of a division must be in accordance with any procedures in the organic rules of the entity.
2. If the organic rules are silent with respect to procedures for approval of a division, then the entity will follow the procedures for approval of a plan of merger in its organic law or organic rules.
3. If the organic law and the entity’s organic rules are silent with respect to procedures for approval of a division or a merger, then approval by all of the interest holders entitled to vote on any matter is required.

The incorporation into this article of the merger procedures in the organic law of the dividing entity should be construed broadly to include not only express statutory procedures, but also applicable common law principles such as fiduciary duty standards for governors and majority interest holders. Statutory provisions on voting by classes or voting groups will also be applicable.

Statutory provisions on “short-form” mergers will not be applicable. [Explain.]

3. **Section 603(a)(2)** – Subsection (c) is patterned generally after § 1110 of ULPA (2001). Section 603(a)(2) will be applicable, for example, to shareholders of a dividing corporation where one of the resulting entities is a general partnership that is not a limited liability partnership if the shareholders become general partners of the general partnership. If such a shareholder were to exercise appraisal rights, however, the shareholder would not become

1 subject to owner liability because one effect of exercising appraisal rights is that the shareholder
2 would not become a general partner in the resulting entity; and, in that case, the consent of that
3 shareholder would not be required.
4

5 The consent of an interest holder required by subsection (a)(2)(B) may be given either by
6 (i) signing or agreeing generally to the terms of organic rules that includes the required provision
7 permitting less than unanimous approval of a division in which interest holders become subject
8 to owner liability, or (ii) voting for or consenting to an amendment to add such a provision.
9

10 4. **Section 603(b)** – Where a foreign entity is the dividing entity, subsection (b) defers to
11 the laws of the foreign entity’s jurisdiction of organization for the requirements for approval of
12 the division by the foreign entity. Those laws will include the organic law of the foreign entity
13 and other applicable laws, such as this Act (or any applicable regulatory law) if it has been
14 adopted in the foreign jurisdiction. The laws of the foreign jurisdiction will also control the
15 application of any special approval requirements found in the organic rules of the foreign entity.
16

17 **SECTION 604. AMENDMENT OR ABANDONMENT OF PLAN OF DIVISION.**

18 (a) A plan of division of a domestic dividing entity may be amended:

19 (1) in the same manner as the plan was approved, if the plan does not
20 provide for the manner in which it may be amended; or

21 (2) by the governors or interest holders of the entity in the manner
22 provided in the plan, but an interest holder that was entitled to vote on or consent to approval of
23 the division is entitled to vote on or consent to any amendment of the plan that will change:

24 (A) the amount or kind of interests, securities, obligations, rights to
25 acquire interests or securities, cash, or other property, or any combination of the foregoing to be
26 received by any of the interest holders of the dividing entity under the plan:

27 (B) the public organic document or private organic rules of any of
28 the resulting entities that will be in effect immediately after the division becomes effective,
29 except for changes that do not require the approval of the interest holders of the resulting entity

1 under its organic law or organic rules; or

2 (C) any of the other terms or conditions of the plan, if the change
3 would adversely affect the interest holder in any material respect.

4 (b) After a plan of division has been approved by a domestic dividing entity and
5 before a statement of division becomes effective, the plan may be abandoned:

6 (1) as provided in the plan; or

7 (2) unless prohibited by the plan, in the same manner as the plan was
8 approved.

9 (c) If a plan of division is abandoned after a statement of division has been filed
10 with the [Secretary of State] and before the filing becomes effective, a statement of
11 abandonment, signed on behalf of the entity, must be filed with the [Secretary of State] before the
12 time the statement of division becomes effective. The statement of abandonment takes effect
13 upon filing, and the division is abandoned and does not become effective. The statement of
14 abandonment must contain:

15 (1) the name of the dividing entity;

16 (2) the date on which the statement of division was filed; and

17 (3) a statement that the division has been abandoned in accordance with
18 this section.

19 **Comments**

20 The manner in which a division may be abandoned under this section will be determined
21 by the entity's organic law and organic rules. Absent some special provision, abandonment may
22 be authorized in the same manner as any other action. The plan of division may also provide for
23 the manner in which the governors may abandon the division.
24

1 **SECTION 605. STATEMENT OF DIVISION; EFFECTIVE DATE.**

2 (a) A statement of division must be signed on behalf of the dividing entity and
3 filed with the [Secretary of State].

4 (b) A statement of division must contain:

5 (1) The name, jurisdiction of organization, and type of the dividing entity.

6 (2) If the dividing entity is a domestic entity, whether the dividing entity
7 will survive the division.

8 (3) The name, jurisdiction of organization, and type of each resulting
9 entity created in the division.

10 (4) If the statement of division is not to be effective upon filing, a date or
11 time certain specified in the statement or plan of division, which is not more than 90 days after
12 the statement or plan is delivered for filing to the [Secretary of State], on which it will become
13 effective.

14 (5) If the dividing entity is a domestic entity, a statement that the plan of
15 division was approved in accordance with this [article] or, if the dividing entity is a foreign
16 entity, a statement that the division was approved by the foreign dividing entity in accordance
17 with the law of its jurisdiction of organization.

18 (6) If the dividing entity is a domestic filing entity and survives the
19 division, any amendments to its public organic document approved as part of the plan of
20 division.

21 (7) With respect to each domestic resulting entity created by the division, a
22 copy of its public organic document, if any.

1 (8) A description of any real property allocated to a resulting entity other
2 than the dividing entity in sufficient detail to provide constructive notice of the location of the
3 property.

4 (c) In addition to the requirements of subsection (b), a statement of division may
5 contain any other provision not prohibited by law.

6 (d) If a resulting entity created in the division is a domestic entity, its name must
7 satisfy the requirements of the law of this state.

8 (e) A plan of division that is signed on behalf of a domestic dividing entity and
9 meets all of the requirements of subsection (b) may be filed with the [Secretary of State] instead
10 of a statement of division and upon filing has the same effect. If a plan of division is filed as
11 provided in this subsection, references in this [act] to a statement of division refer to the plan of
12 division filed under this subsection.

13 (f) A statement of division becomes effective upon the date and time of filing or
14 the later date and time specified in the statement of division.

15 **Comments**

16
17 1. **Section 605(a)** - The filing of a statement of division makes the transaction a matter of
18 public record. The filing requirements and filing fee for a statement of division are set forth in
19 sections 105 and 106.

20
21 2. **Section 605(b)(5)** – The statement in subsection (b)(5) as to how the plan of division
22 was approved by the dividing entity necessarily presupposes that the plan was approved in
23 accordance with any valid, special requirements in the organic rules of the entity.

24
25 4. **Section 605(f)** - The effective time of the statement is the effective time of its filing,
26 unless otherwise specified. A statement may specify a delayed effective time and date, and if it
27 does so the statement becomes effective at the time and date specified.
28

1 **SECTION 606. EFFECT OF DIVISION.**

2 (a) When a division becomes effective:

3 (1) If the dividing entity is to survive the division, the dividing entity
4 continues to exist.

5 (2) If the dividing entity is not to survive the division, the dividing entity
6 ceases to exist.

7 (3) The resulting entities created in the division come into existence.

8 (4) All property of the dividing entity:
9 (i) is allocated to and vests in the resulting entities created in the
10 division, or remains vested in the dividing entity, in each case without reversion or impairment,
11 to the extent specified in the plan of division;

12 (ii) not allocated by the plan of division remains vested in the
13 dividing entity if the dividing entity survives the division; and

14 (iii) not allocated by the plan of division is allocated to and vests
15 equally in the resulting entities as tenants in common without reversion or impairment if the
16 dividing entity does not survive the division.

17 (5) The name of a resulting entity to which a cause of action is allocated as
18 provided in paragraph (4) may be substituted or added in any pending action or proceeding to
19 which the dividing entity is a party at the effective time of the division.

20 **{Drafting Option 1:**

21 *(6) The liabilities of the dividing entity are allocated between or among*
22 *the resulting entities as provided in section 607.}*

{Drafting Option 2:

(6) The liabilities of the dividing entity are allocated between or among the resulting entities as follows:

(i) Each resulting entity is responsible, as a separate and distinct entity, only for:

(A) those liabilities that the resulting entity undertakes or incurs in its own name subsequent to the division; and

(B) the liabilities of the dividing entity to the extent provided in this paragraph (6).

(ii) The liabilities of the dividing entity:

(A) subject to subparagraph (iii), are allocated to and become the liabilities of the resulting entities created in the division, or remain the liabilities of the dividing entity, to the extent specified in the plan of division; and

(B) to the extent not allocated in the plan of division, or as to which any of the tests in subparagraph (iii) are not satisfied, are allocated to and become the joint and several liabilities of the resulting entities.

(iii) One or more, but less than all, of the resulting entities will be free of a particular liability of the dividing entity to the extent, if any, provided in subparagraph

(ii)(A) only if:

(A) the division does not materially increase the risk of nonpayment to a creditor or the risk of nonperformance to a person owed performance; and

(B) the allocation of assets and liabilities in the division is

1 *not ineffective or voidable under law other than this act.}*

2 (7) Each resulting entity created in the division holds any property
3 allocated to it as the successor to the dividing entity, and the property is not deemed to have been
4 assigned to the resulting entity in any manner, whether directly or indirectly, or by operation of
5 law.

6 (8) If the dividing entity survives the division, its public organic document,
7 if any, and its private organic rules are amended to the extent provided in the plan of division and
8 remain binding on its interest holders.

9 (9) The public organic document, if any, and the organic rules of each
10 resulting entity created by the division become effective and are binding upon the interest holders
11 of the resulting entity.

12 (10) The interests in the dividing entity that are to be converted in the
13 division are converted, and the interest holders of those interests are entitled only to the rights
14 provided to them under the plan of division and to any appraisal rights they may have under
15 section 108.

16 **{Include the following if Drafting Option 2 is used:**

17 (11) *Liens, security interests, and other charges upon the property of the*
18 *dividing entity shall not be impaired by the division, notwithstanding any otherwise enforceable*
19 *allocation of liabilities of the dividing entity.*

20 (12) *If the dividing entity is bound by a security agreement governed by*
21 *[Article 9 of the Uniform Commercial Code] and the security agreement provides that the*
22 *security interest attaches to after-acquired collateral pursuant to [UCC § 9-204(a)], each*

1 *resulting entity is also bound by the security agreement.*}

2 (b) A person that becomes subject to interest holder liability with respect to a
3 domestic resulting entity as a result of a division has interest holder liability only to the extent
4 provided by the organic law of this [State] and only for those liabilities that arise after the
5 division becomes effective.

6 (c) The effect of a division on the interest holder liability of an interest holder of
7 the domestic dividing entity that is incurred before the division becomes effective is as follows:

8 (1) The division does not discharge any interest holder liability under the
9 organic laws of the domestic dividing entity's jurisdiction of organization in which the person
10 was an interest holder to the extent the interest holder liability was incurred before the division
11 becomes effective.

12 (2) The person does not have interest holder liability under the laws of the
13 domestic dividing entity's jurisdiction of organization in which the person was in interest holder
14 before the division becomes effective.

15 (3) The laws of the domestic dividing entity's jurisdiction of organization
16 continue to apply to the collection or discharge of any interest holder liability preserved by
17 paragraph (1) as if the division had not occurred.

18 (4) The person has whatever rights of contribution from any other person
19 as are provided by the laws of the domestic dividing entity's jurisdiction of organization or the
20 entity's private organic rules with respect to any interest holder liability preserved by paragraph
21 (1) as if the division had not occurred.

22 (d) If the dividing entity is a qualified foreign entity and does not survive the

1 division, its certificate of authority or other foreign qualification is canceled when the division
2 becomes effective.

3 **Comments**

4
5 **1. Section 606(a)(1) – (3)** - Subsection (a)(1) – (3) state the general rules that a division
6 results in the division of a single entity into two or more new or existing entities. The filing of a
7 statement of division may either terminate the dividing entity and create two or more new entities
8 or continue the existence of the dividing entity and recognize the new existence of one or more
9 other entities.

10
11 **2. Section 606(a)(4)** - The property, causes of action, and contract rights of the dividing
12 entity may be allocated to the surviving entities without reversion or impairment in any manner
13 stated in the plan. If the plan is silent as to the allocation of these assets, the dividing entity
14 retains the assets if it survives the division; otherwise the surviving entities take the assets as
15 tenants in common. The allocation is, of course, subject to the challenge on the basis of fraud or
16 other violation of law.

17
18 **3. Section 606(a)(6)** –The term “liabilities” is defined very broadly in section 102.

19
20 **4. Section 606(a)(7)** – The allocation of assets and liabilities in a division occurs without
21 an assignment by operation of law. As with a merger, a division should not trigger “assignment”
22 clauses.

23
24 **5. Section 606(a)(12)** – Where a dividing entity has granted a security interest in after-
25 acquired property, the effect of subsection (d) is that the resulting entities will have the status of
26 “new debtors” under UCC Article 9.

27
28 **6. Section 606(b)** - Subsection (b) sets forth the general rule that an owner in a resulting
29 entity will be personally liable only for the liabilities of the resulting entity that arise after the
30 effective date of a division. When a liability arises will be determined by other applicable law.
31 The concept of “liabilities” is defined very expansively in section 102.

32
33 **6. Section 606(c)** - Subsection (c) has four parts:

34
35 (1) An interest holder in a dividing entity who had interest holder liability for the
36 liabilities of the dividing entity under the entity’s organic law is not discharged from
37 those liabilities if they arose before the effective date of the division.

38
39 (2) An interest holder in a dividing entity does not have interest holder liability for
40 the liabilities of a resulting entity if those liabilities arose after the effective date of the
41 division.

1 (3) The organic law governing the dividing entity continues in effect for the
2 purpose of preserving the interest holder liability described in paragraph (1) despite the
3 nonexistence of the dividing entity after the merger.
4

5 (4) The organic law of the dividing entity continues to apply for the purpose of
6 any contribution rights that may exist with respect to liabilities described in paragraph (1),
7 again notwithstanding the nonexistence of the dividing entity after the division.
8

9 7. **Sections 606(b) and (c)** – The effects of subsections (b) and (c) will depend to a
10 certain extent on how a contractual liability is worded. For example, a lease that provides that
11 the entire rent is due when the lease is signed, but permits that rent to be paid in future
12 installments, will be treated differently from a lease that does not provide that the entire rent is
13 earned upon signing.
14

15 Under section 603(a)(2), a division cannot have the effect of making any interest holder
16 of a domestic dividing entity subject to interest holder liability for the obligations or liabilities of
17 any other person or entity unless each such interest holder has executed a separate written
18 consent to become subject to such liability or previously agreed to the effectuation of a
19 transaction having that effect without the interest holder's consent.
20

21 **{Drafting Option 1 continued. The following section will be retained only if**
22 **Drafting Option 2 for Section 606(a) is not used.**
23

24 **SECTION 607. ALLOCATION OF LIABILITIES IN A DIVISION.**

25 (a) When a division becomes effective, the liabilities of the dividing entity are
26 allocated between or among the resulting entities as follows:

27 (1) Each resulting entity is responsible as a separate and distinct entity
28 only for:

29 (i) those liabilities that the resulting entity undertakes or incurs in
30 its own name subsequent to the division; and

31 (ii) the liabilities of the dividing entity to the extent provided in
32 this section.

33 (2) The liabilities of the dividing entity:

1 (i) subject to paragraph (3), are allocated to and become the
2 liabilities of the resulting entities created in the division, or remain the liabilities of the dividing
3 entity, to the extent specified in the plan of division; and

4 (ii) not allocated by the plan of division, or as to which any of the
5 tests in paragraph (3) is not satisfied, are allocated to and become the joint and several liabilities
6 of the resulting entities.

7 (3) One or more, but less than all, of the resulting entities shall be free of a
8 particular liability of the dividing entity to the extent, if any, provided in paragraph (2) if:

9 (i) the division does not materially increase the risk of nonpayment
10 to a creditor on the liability or the risk of nonperformance to a person owed performance of the
11 liability;

12 (ii) the division was not undertaken with actual intent to hinder,
13 delay, or defraud a creditor on the liability;

14 (iii) immediately after the effectiveness of the division, the assets
15 of the resulting entity that retains or is allocated the liability are not unreasonably small in
16 relation to its business or performance of the liability.

17 (b) Liens, security interests, and other charges upon the property of the dividing
18 entity shall not be impaired by the division, notwithstanding any otherwise enforceable allocation
19 of liabilities of the dividing entity.

20 (c) If the dividing entity is bound by a security agreement governed by [Article 9
21 of the Uniform Commercial Code] and the security agreement provides that the security interest
22 attaches to after-acquired collateral pursuant to [UCC § 9-204(a)], each resulting entity is also

1 bound by the security agreement.

2 **Comments**

3
4 1. A dividing entity can always contract with a creditor for a different result than is
5 provided in this section.

6
7 2. Where a dividing entity has granted a security interest in after-acquired property, the
8 effect of subsection (d) is that the resulting entities will have the status of “new debtors” under
9 UCC Article 9.