Administrative Dissolution and Reinstatement of Business Entities
ADMINISTRATIVE DISSOLUTION AND REINSTATEMENT OF BUSINESS ENTITIES

Administrative dissolution is an action taken by the Secretary of State that results in the loss of a business entity's rights, powers and authority. Reinstatement is the action taken that restores an administratively dissolved business entity’s rights, powers and authority. This White Paper discusses how administrative dissolution can occur, what problems it can cause for the entity and its officials, and how reinstatement can solve many (but not all) of these problems.

INTRODUCTION

Administrative dissolution is the process by which the state administrator overseeing business entities takes away the rights, powers and authority of a corporation, LLC or other business entity, due to the entity’s failure to comply with certain obligations of the business entity statute.

Administrative dissolution is one of the worst things that can happen to a business entity and should be avoided at all costs. Nevertheless, it happens to tens of thousands of business entities each year. Adding to the misery, in many cases the people running the business have no idea the administrative dissolution took place and continue conducting business as usual.
Eventually, the business entity’s principals will realize that administrative dissolution has occurred. This can happen when they try to file documents with the filing office, bring a lawsuit, enter into a merger or asset sale, find investors, or provide proof that the business entity validly exists. At that point, the entity’s principals are likely to seek the advice of a lawyer familiar with the compliance obligations of state business entity laws, who can advise them as to how the entity’s powers, can be reinstated. The principals will also need to understand the consequences of their conducting business while their entity lacked the power to do so.

This White Paper will address these issues as it explores the topics of administrative dissolution and reinstatement. (It should be noted that, although this White Paper will use the common and generic terms of “administrative dissolution” and “reinstatement,” some statutes use other terms when referring to the taking away and restoring of an entity’s powers such as “forfeiture,” “cancellation,” “revival” and “renewal”.)

INADVERTENT ADMINISTRATIVE DISSOLUTION CAN HAPPEN FAIRLY EASILY AND TO BUSINESS ENTITIES LARGE AND SMALL.

ADMINISTRATIVE DISSOLUTION IN GENERAL

A business entity may be administratively dissolved for a variety of reasons. The exact grounds are set forth in state business entity statutes. The three most common grounds are:

1. Failing to pay franchise, or privilege, taxes within a specified period of time after they were due.

2. Failing to file an annual report within a specified period of time of the due date.

3. Failing to maintain a registered agent or registered office for a specified period of time.

The failure to comply with one of these obligations may be intentional or unintentional. In some cases, the noncompliance occurs because the entity is abandoned by its owners. However, more often the noncompliance is inadvertent.

Inadvertent dissolution. Inadvertent administrative dissolution can happen fairly easily and to business entities large and small. For example, the sole owner of a small LLC may believe that because the LLC did not have to pay state income tax, it did not have to pay franchise taxes either. Or, an overburdened corporate secretary, responsible for the annual report filings of hundreds of subsidiaries, may have allowed some to fall between the cracks.
Dissolution procedure. The state administrator, who is most often the secretary of state, must follow a statutory procedure before dissolving a business entity. The procedure generally requires that notice be given to the business entity, along with a grace period in which it may correct each violation. If the violations are not corrected within this grace period, then the entity eventually will be administratively dissolved.

CONSEQUENCES OF ADMINISTRATIVE DISSOLUTION

At common law, and under the early statutes, a business entity ceased to exist as an entity upon the effective date of its dissolution. However, today an administratively dissolved business entity continues to exist—but only for the limited purpose of winding up its affairs. In some states, a dissolved entity exists until the state’s “survival statute” expires. A survival statute is like a statute of limitations. It gives a dissolved business entity a certain period of time (often two or three years) to prosecute and defend suits and take the actions necessary to wind up.

Practice Pointer: The survival period for administratively dissolved entities may be different than the one that applies to voluntarily or judicially dissolved entities. The differences can involve not only the length of the time period, but legal rights and remedies of the entity, its owners or its officers.

Perils of doing business after administrative dissolution. Despite the prohibition, it is not unusual to see an administratively dissolved business entity continuing to operate as a going concern, usually because the people who are acting on its behalf are unaware that it has been dissolved.

When an administratively dissolved business entity continues doing business, it (and its owners and officers) can run into a variety of serious legal problems, including:

- the people who act on its behalf may be held personally liable for debts or obligations incurred while dissolved
- it may be unable to bring a lawsuit or proceeding
- actions it takes, other than those done to wind up its affairs, may be considered void or voidable
In many cases, shielding individuals from personal liability is one of the main reasons for deciding to form an entity. Administrative dissolution can destroy that protection and leave the owners and officers exposed to claims arising from the business.

Recent case law on dissolution. The following cases provide examples of what can happen if an administratively dissolved entity continues doing business.

- Pension fund trustees brought an ERISA action to recover nearly $145,000 in contributions due from an administratively dissolved New Jersey corporation. The federal district court held the corporation’s shareholder personally liable for any contributions the corporation failed to make in connection with any work performed after the date it was administratively dissolved. The shareholder was liable because he continued to operate the business after its charter was revoked, in violation of New Jersey law. (Trustees of Local 7 Tile Industry Welfare Fund v. Giacomelli Tile, No. 11 Civ. 01846 (WJM), 2012 U.S. Dist. LEXIS 1013 (D.N.J. Jan. 5, 2011))

- A shareholder who entered into an agreement on behalf of a corporation while it was administratively dissolved was held personally liable for money due on the agreement. The court stated that the general rule shielding officers, directors and shareholders from personal liability for a corporation’s debts does not provide protection when a corporation is administratively dissolved. (Martin v. Pack’s Inc., No. 2010-CA-001048-MR, 2011 Ky. App LEXIS 187 (July 29, 2011))

These are only two of numerous cases where operating a business after administrative dissolution placed the owners at risk. Administrative dissolution can also prevent a business entity from asserting claims on its own behalf, as the following case illustrates.

- A lawsuit was filed in New York on behalf of a Delaware corporation that had been administratively dissolved for failing to maintain a registered agent. The court dismissed the action, noting that under the Delaware General Corporation Law, the corporation lost the capacity to sue and be sued. The court also rejected the plaintiffs’ argument that they could sue because the corporation filed an application for authority in New York. The court noted that the New York Business Corporation Law provides that a foreign corporation has authority to do business only so long as it retains that authority in its state of incorporation. (Manney v. Intergroove Tontrager Vertriebs GmbH, 10 CV 4493 (E.D.N.Y. 2011))
Practice Pointer: The interpretation of the administrative dissolution statutes is exceptionally intricate. The administrative dissolution survival statutes can be in conflict with other provisions in the business entity statutes. For example, the survival period may be two years, while the reinstatement period may be five years. This inconsistency can be treacherous.

Also, the precedent for statutory interpretation is highly unsettled and complex. It is extremely difficult to predict the full impact of an administrative dissolution. The old adage, “the best defense is a good offense,” should be taken to heart: Make sure your clients are fully informed of their ongoing administrative obligations and the consequences that can follow from neglecting them.

REINSTATEMENT OF ADMINISTRATIVELY DISSOLVED BUSINESS ENTITIES

One of the first steps a lawyer will take on behalf of an administratively dissolved client is to seek reinstatement. This is a statutory procedure that restores an administratively dissolved business entity’s rights, powers and authority, thereby allowing it to resume doing business as before dissolution. In most states, reinstatement is only available for a certain number of years after dissolution. The period varies from state to state but is generally not less than two or more than five years.

There are generally two parts to the reinstatement process:

- curing the grounds that caused the dissolution, and
- filing an application for reinstatement with the state administrator

Loss of name. In many states, administration dissolution means the entity’s name will become available for use by another business entity. (States may offer some limited period of name protection, but this period is usually for only a few months.) If, during the period of administrative dissolution, another business entity forms, qualifies or changes its name to the dissolved business entity’s name, reinstatement will generally not give the business entity the right to get its name back. It will instead have to choose another name in order to be reinstated.
IMPACT OF REINSTATEMENT — “RELATION-BACK” PROVISIONS

State statutes generally provide that when reinstatement is effective, it relates back to, and takes effect as of, the date of dissolution. This creates a legal fiction that the administrative dissolution never occurred. By creating this fiction, many of the problems that arise due to the dissolution, such as personal liability for debts created during the period of dissolution, the voiding of actions taken, and the loss of the capacity to sue, may be eliminated.

Recent case law on reinstatement. The following cases illustrate that, in certain circumstances, the relation-back provision can protect the owners or managers and enable the entity to pursue legal remedies.

- A Nevada LLC that was administratively dissolved for failing to make an annual filing continued doing business and filed a suit to recover money allegedly owed on a construction job. The trial court refused to grant the LLC a stay to give it time to reinstate its charter, and eventually dismissed the action. The LLC was then reinstated, but the trial court refused to vacate the dismissal. The Nevada Supreme Court reversed. The court stated that dismissal was too harsh a penalty for the LLC’s failure to complete its annual filing and that the trial court should have granted the stay to allow it to reinstate. The court then granted the LLC’s motion to vacate, noting that the LLC’s reinstatement retroactively restored its right to litigate the suit to conclusion. (AA Primo Builders, LLC v. Washington, 245 P.3d 1190 (Nev. 2010))

- The plaintiff, who entered into a lease agreement with an administratively dissolved LLC, filed an action for breach of the lease, seeking to hold the LLC’s sole member liable. The LLC was administratively dissolved at the time the lease was executed, but while the suit was pending it was reinstated. The appellate court affirmed the trial court’s ruling in favor of the member. The court noted that reinstatement operates as if dissolution never occurred; therefore, it naturally follows that the LLC’s members are not individually liable for actions undertaken on the LLC’s behalf during its dissolution. (Pannell v. Shannon, No. 2010 – CA – 01172, 2011 Ky. App. Unpub. LEXIS 627 (Aug. 26, 2011))
• While a Maryland corporation was administratively dissolved, petitions it filed for immigrant visas for an employee were denied. After the corporation was reinstated, an administrative appeals office upheld the denials. A federal district court reversed, holding that the corporation’s reinstatement restored its powers and authority as if they had not been lost and validated its actions in respect to the visa petitions. (Rahman v. Napolitano, No. C09-1269 RSM, 2011 U.S. Dist. LEXIS 142157 (W.D. Wash. Dec. 9, 2011))

Although in many cases reinstatement extinguishes personal liability or restores a business entity’s capacity to sue and validates other actions, this is not always so — as these decisions illustrate.

• An Illinois corporation was administratively dissolved for failing to file an annual report, but its president and sole shareholder continued operating the business. The corporation ordered merchandise, and the seller filed a suit. Although the corporation was reinstated, the court held the president liable for the corporation’s debt. The court interpreted Illinois law as providing that an officer may be held personally liable for debts incurred during a period of dissolution, even if the corporation is subsequently reinstated, if there is evidence the officer knew or should have known about the dissolution. Here the court found it hard to believe that the president, who was responsible for filing the annual reports and who had filed them for 15 years, had no idea that the corporation was administratively dissolved for failure to file an annual report. (Benetton U.S.A. Corp. v. Kostopulos, No. 10CV 106, 2011 U.S. Dist. LEXIS 121187 (N.D. Ill. Oct. 19, 2011))

• An administratively dissolved Georgia corporation brought a lawsuit after the two-year survival period had run, but before the five-year reinstatement period had run. While the suit was pending, the corporation was reinstated. Nevertheless, the court dismissed the suit because at the time the case was filed, the Georgia survival statute—which gives a dissolved corporation two years to file a suit—had run. The corporation argued that the relation-back period provided by statute upon its reinstatement validated the lawsuit. However, that argument was rejected. The court stated that the lawsuit was a nullity when filed and therefore there was no lawsuit to validate. (GC Quality Lubricants, Inc. v. Doherty, Duggan & Rouse Insurors, 697 S.E. 2d 871 (Ga. App. 2010))
CONCLUSION

The right to do business as a corporation, LLC or other statutory business entity—and all the benefits that brings—is granted by state law. In return for granting that right, the states impose certain obligations. If the business entity fails to comply, the state may take away its rights through a process called administrative dissolution.

Administrative dissolution is not an uncommon occurrence and can be a devastating one. However, the states do not want to see viable business entities dissolving, so most have a statutory reinstatement process that can restore the business entity’s rights and powers.

Consequently, lawyers with business entity clients should be aware of the statutes and case law governing administrative dissolution and reinstatement for the states in which their clients are organized. And, of course, these clients must be kept informed as well.