THE 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 article 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.

Administrative dissolution is the taking away of the rights, powers, and authority of a domestic corporation, LLC, or other statutory business entity by the state administrator overseeing business entities, 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 is that in many cases, the people running the business have no idea the administrative dissolution happened and continue conducting business as usual.

Eventually, the business entity’s principals will learn what happened. This may be when they try to file documents with the filing office, bring a lawsuit, enter into a merger or asset sale, find investors, or another event occurs where proof that the business entity validly exists is required. At that point the entity’s principals will want to find out which obligations of the state business entity law they failed to comply with, how their entity’s powers can be reinstated, and what the consequences are of their conducting business while their entity lacked the power to do so.

This article will address these issues and more as it explores the topics of administrative dissolution and reinstatement. (It should be noted that although the common and generic terms of “administrative dissolution” and “reinstatement” will be used, 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.”)

ADMINISTRATIVE DISSOLUTION IN GENERAL

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

- Failure to pay franchise taxes within a specified period of time after they were due
- Failure to deliver an annual report within a specified period of time of the due date
- Failure to maintain a registered agent or registered office for a specified period of time

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**Inadvertent administrative dissolution**

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

Inadvertent administrative dissolution can happen fairly easily and to business entities large and small. For example, the sole owner of a small LLC may have thought 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**

Before dissolving a business entity, the administrator — often the Secretary of State — must follow a statutory procedure. 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, the entity will eventually 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 — generally until it winds up its affairs or the “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.

**Perils of doing business after administrative dissolution**

Once a business entity is administratively dissolved, it is prohibited by statute from engaging in any activities other than those necessary to liquidate its assets and wind up its affairs.

But despite this prohibition, it is not unusual to see an administratively dissolved business entity continuing to operate as a going concern, because the people who are acting on its behalf are unaware that it has been dissolved.

If an administratively dissolved business entity continues doing business, the entity — and its owners and managers — can run into a variety of legal problems, including the following:

- 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

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**Case law on administrative dissolution**

The following cases illustrate those legal problems.

- The Mississippi Supreme Court affirmed the dismissal of a lawsuit brought by a corporation that was administratively dissolved for failing to file an annual report while the suit was pending. The court interpreted the corporation law as not only preventing administratively dissolved corporations from bringing suits, but from maintaining those previously brought. Tellingly, the owner of the corporation, when asked why he did not file an annual report, responded that he didn’t have a business anymore and believed he didn’t need to file a report. *Wayne Johnson Electric Inc. v. Robinson Electric Supply Company, Inc.*, 266 So.3d 643 (Miss. 2019).

- A federal district court held that a member of an LLC was a proper party to a suit for breach of contracts entered into by the LLC where the LLC continued to do business after its administrative dissolution and the plaintiff alleged the member was actually aware of its administrative dissolution. *S-Fer International, Inc. v. Stonestreets, LLC*, 2016 U.S. Dist. LEXIS 190241 (S.D. Fla. 2016).

- A breach of contract action was brought against a corporation. A default judgment was obtained. The corporation’s charter was forfeited at the time and never reinstated. The corporation filed a bill of review challenging the default. The Texas Court of Appeals held...
that a terminated entity may not be injured or have a then existing interest or right that was prejudiced by a default judgment. Thus, it lacked standing to file a bill of review. Donica Group, LP v. Thompson Excavating, Inc., 2020 Tex. App. LEXIS 39

REINSTATEMENT OF ADMINISTRATIVELY DISSOLVED BUSINESS ENTITIES

The best way to avoid administrative dissolution is to make sure all annual reports are filed and other statutory obligations are fulfilled.

If that didn’t happen, then one of the first steps that should be taken by, or on behalf of, an administratively dissolved entity 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 order to be reinstated, a business entity must do the following:

- Cure the grounds that caused it to be dissolved
- Pay all taxes, interest, and penalties that are due
- File an application for reinstatement with the state administrator

In some 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.

IMPACT OF REINSTATEMENT - “RELATION BACK” PROVISIONS

The 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, are eliminated.

Case law on reinstatement

The following cases illustrate the impact of the “relation back” provision.

- Homeowners sued the members of the LLC that built their home, claiming they should be personally liable for the defects because the LLC had been administratively dissolved. The court held that the members were relieved of personal liability when the LLC was reinstated as the LLC law states that any liabilities incurred after dissolution but before reinstatement will be determined as if the administrative dissolution never occurred. Brown v. Waldron, 186 So.3d 955 (Miss. App. 2016)
- The Pennsylvania Commonwealth Court held that a Delaware LLC whose certificate of formation was canceled by the Delaware Division of Corporations could challenge an assessment of its property in an eminent domain proceeding because it had its good standing restored before the trial court entered judgment. Township of Bristol v. 1 Enterprise, LLC, 177 A.3d 1045 (Pa. Commw. 2018)
- The California Court of Appeal upheld the renewal of a default judgment in favor of a corporation that was suspended at the time of renewal. The corporation’s powers were revived by its paying franchises taxes, filing an annual statement, and changing its name, which had been taken by another company during the period of suspension. The revival validated the renewal of the default judgment. Pacific West Group, Inc. v. Interlandi, 2018 Cal. App. Unpub. LEXIS 5920

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

- The California Court of Appeal ruled that a corporation that had its powers suspended and then revived could not assert a claim for fraud because it was not revived before the statute of limitations had run. Green Mutual Property & Investment Co. v. Wilshire Bank, 2018 Cal. App. Unpub. LEXIS 8162
- 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. The corporation was reinstated. Nevertheless, 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

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during a period of dissolution, even if the corporation is subsequently reinstated, if, as in this case, there is evidence the officer knew or should have known about the dissolution. Benetton U.S.A. Corp. v. Dinky, Inc., 2011 U.S. Dist. LEXIS 121187 (N.D. Ill. 2011)

A federal district court ruled that an LLC lacked the capacity to bring an action for breach of a contract where the breaches occurred while the LLC was administratively dissolved. Although the LLC was reinstated after bringing the suit the court found that under the relevant provision of the LLC Act, reinstatement does not retroactively revive claims of an LLC that arose while it was administratively dissolved. Fill It Up, LLC v. MS LZ Delta, LLC, 342 F.Supp.3d 707 (N.D. Miss. 2018)

**Loss of name**

Another problem an administratively dissolved entity can face that reinstatement may not cure involves the loss of its name. In many states one of the effects of administrative dissolution is that the name returns to the status of being available to other business entities.

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.

**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.

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.

Administrative dissolution is not an uncommon occurrence. Consequently, business owners, managers, and lawyers with business entity clients should be aware of the statutes and case law governing administrative dissolution and reinstatement for the states in which they, or their clients, are organized.

Some companies seek assistance in preparing, filing, or managing their annual reports from corporate service companies like CT. And CT can also assist in the reinstatement process. We identify the steps you need to take to regain your good standing, calculate any overdue fees owed to the state, obtain the necessary forms and audit them to spot errors, submit your completed forms to the right state agencies, and notify you as soon as reinstatement is complete. Learn more about how we can help you with your annual reports or reinstate your business.