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KENNETH M. ROSEN*

**Company Law and the Law of Succession Droit
Commercial/Commercial Law†**

TOPIC III. A

This Report explores the intersection of company law and the law of succession in the United States of America. U.S. company law features a complex variety of business entity forms, available in different U.S. states, with their own legal rules related to important issues such as the how much ownership is separated from control. The death of an owner, and the potential distribution of her rights and interests to heirs, can be a significant turning point in a business entity's life as personal succession and business succession intersect. This paper offers a structure for understanding the complexity of the U.S. system by examining some potential legal effects of the death of an owner and by identifying a set of key factors of the U.S. approach to succession issues. Significant factors include the federalist nature of the U.S. system, the importance of small and family-owned businesses, and an emphasis on freedom of choice in business entity governance. Considering why these factors are critical to understanding the U.S. approach offers general insight into the current state of U.S. law as well as possible directions the law might move in the future.

I. INTRODUCTION

Business succession is a critical issue for the economy. If businesses are the factories that manufacture growth and wealth, then succession may offer both the opportunity for factory upgrades as well as the danger of a shut down as businesses transition into a new

* Associate Professor, The University of Alabama School of Law. The author thanks his colleagues in the American Society of Comparative Law and the participants in the 2014 Congress of the International Academy of Comparative Law in Vienna, Austria for the opportunity to serve as the U.S. Reporter on company law and the law of succession and to collaborate on the exploration of this important matter. In addition, he thanks Professor Frank Gevurtz for comments on this paper. The author also thanks his colleagues at The University of Alabama School of Law and the University of Alabama Law School Foundation for their generous support of his research. He also thanks Caroline Cease and Thomas Bridges for excellent research assistance.

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era. Better understanding how different jurisdictions provide a legal infrastructure for business succession offers insight into those jurisdictions' potential to succeed and a reflection of the values and priorities of those jurisdictions.

The United States of America takes an approach to this infrastructure that may share components and differ in some respects from that of other nations. The U.S. approach to business succession is complex. In part, this reflects the variety of business entity forms that may further vary under the laws of the different U.S. states and that also may affect the treatment of succession issues. A key component of business entity law is to what extent that law provides for the separation of ownership and control of the entity. The extent of separation may be especially important as it relates to the impact on the entity of the death of one or more of its owners. Behind business entities often are real persons, who own but may or may not manage the entity.¹ Thus, personal succession may be intricately interwoven with business succession. The death of an owner, and the potential distribution of her rights and interests to heirs, can be seen as a potential, significant turning point in the business entity's life as personal succession and business succession intersect.

It would be impossible in a limited report to describe every legal issue related to business succession and the rules adopted by each relevant state and federal law-maker to address every issue. Accordingly, in reporting on the U.S. approach and dealing with such complexity, this paper's key aim is to offer a structure for understanding the complexity of the U.S. system by examining some potential legal affects of the death of an owner and further by identifying a set of key factors of the U.S. approach to succession issues. Considering why these factors are critical to understanding the U.S. approach offers general insight into the current state of U.S. law as well as possible directions the law might move in the future.

Accordingly, this Report proceeds by first looking at how the death of an owner and succession potentially triggers the intersection of rules from multiple legal subject matter areas, particularly business entity and trust and estate laws. Second, the Report explores the impact of the federalist nature of the United States and the roles assigned to states and the federal government that might affect succession. Third, the Report examines how the significance of small and family businesses in the U.S. economy might affect one's understanding of succession issues. And, fourth, the Report evaluates U.S. approaches as reflecting a more deeply embedded normative value of freedom in the U.S. legal infrastructure. Exploring in turn each of

1. Of course, entities might own other business entities as well. However, as one goes through even a complex ownership structure, one generally will find at some point real persons, even if that is several layers of ownership away.

these major facets of U.S. law related to business succession offers insight into both the current state of U.S. law as well as its potential further evolution.

II. LEGAL SUBJECT MATTER NEXUS POINT

An initial, critical characteristic of U.S. law on business and personal succession is that such law is not a single subject matter area of law standing on its own. Rather, succession situations potentially implicate numerous areas of law—and the normative values reflected in those different areas of law. Thus, the event of succession is characterized by serving as a type of nexus point between different legal subject matter areas. The term nexus derives from the Latin for “a binding together”² and circumstances of business succession may necessitate the melding of principles and rules from different areas of law. For instance, the type of business entity involved may dictate legal implications for succession and which areas of law dominate. As this paper’s title suggests, two areas of particular interest are business entity law and the law of trusts and estates. However, additional legal subject matter areas may come into play as well. Accordingly, it becomes useful to explore briefly how the individual death of an owner might have different impacts on a business under different legal circumstances.

A. *Business Entity Law*

U.S. business entity law is noteworthy for the wide range of permissible business entity forms. These may range from businesses operated by individuals as sole proprietorships to large, public corporations. Certainly, corporations may get much attention and spring to mind when one considers U.S. company law.³ The law surrounding corporations has been subjected to extensive study.⁴ Such study reveals that even when one refers to a particular business entity form such as a “corporation,” great diversity may exist leading to nuances for the law applying to different corporate entities.⁵ One can add to this the fact that there are numerous other business association forms beyond corporations such as partnerships and limited liability

2. See *Definition of Nexus in English*, OXFORD DICTIONARIES, http://oxforddictionaries.com/us/definition/american_english/nexus (last visited Oct. 1, 2013).

3. In recent times, public attention on corporate scandals may exacerbate the inclination to focus on corporations. Indeed, such scandals tend to draw both public and regulatory attention. See Kenneth M. Rosen, “Who Killed Katie Couric?” and *Other Tales from the World of Executive Compensation Reform*, 76 *FORDHAM L. REV.* 2907, 2908-09 (2008).

4. See generally FRANKLIN A. GEVURTZ, *CORPORATION LAW* (2d ed. 2010); ROBERT CHARLES CLARK, *CORPORATE LAW* (1986).

5. For example, closely held corporations have interesting legal issues associated with them. See GEVURTZ, *supra* note 4, at 471-550.

companies with their own subspecies and sets of rules.⁶ The narratives surrounding the emergence of different types of business entities tell the story of different mixes of legal rules to address particular concerns.⁷ Thus, to understand company law's role in succession means to first appreciate multiple sets of rules applicable to a wide range of business entities.

1. Entity Law Basics and Succession

Company law itself may define certain basic aspects of entity transitions and succession. Some business entities achieve a status equivalent to legal personhood. For instance, the law's conception of corporations as "legal persons" introduces a variety of concerns.⁸ Once an entity is itself a legal person created pursuant to company law, it becomes clear how the law of creation also may help define when such an entity ceases to exist in its current form and fades away or turns into something else. This situation illustrates a type of business succession moment governed, at least in part, by business entity law. For example, Chapter 14 of the Model Business Corporation Act provides for the dissolution of a corporation.⁹ Such dissolution might be voluntary,¹⁰ administrative,¹¹ or judicial, and has legally prescribed ramifications related to each.¹² For instance, in the case of a voluntary dissolution, corporate existence can continue for the winding up and liquidation of the entity with the possibility of transference of shares in the corporation.¹³ There are also provisions for handling claims against the corporation.¹⁴ Such provisions are important as they ultimately might affect what is left to distribute to shareholders as part of the succession moment.

Of course, there also are moments of succession, in a broader sense, at corporations that might not have reached the finality of dissolution. This broader sense of succession could include transitions of who manages and controls the corporation. Company law covering corporate governance is particularly relevant here. At the heart of traditional U.S. corporate law is a governance norm of the separation of ownership and control; in many corporations, the shareholder own-

6. See generally CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 3-4 (6th ed. 2010).

7. See, e.g., Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459 (1998).

8. See CLARK, *supra* note 4, at 675-703.

9. See MODEL BUS. CORP. ACT §§14.01- 14.05 (2011). As discussed further below, the Model Business Corporation Act is not itself legally binding, but is a model statute that states may choose to use as their binding law. See Part III, *infra*.

10. MODEL BUS. CORP. ACT §§14.01-14.09 (2011).

11. *Id.* §§ 14.20-14.23.

12. *Id.* §§ 14.30-14.34.

13. See *id.* §14.05 (describing "effect of dissolution").

14. See *id.* §§14.06-14.07.

ers are not directly in charge of the management of the company, which is left to the board of directors and corporate officers.¹⁵ In addition to the corporate governance rules establishing such norms,¹⁶ company law corporate governance rules further provide for the election and dismissal of those in control of corporation's management.¹⁷ Shareholders' ability to indirectly influence the corporation's path by electing and removing directors, as further constrained by the method of elections and removal, can critically affect their true power.¹⁸ These company law based rules can affect greatly the ability to transition from one group of leaders to the next.

It is worth emphasizing at this point that not all corporations in the United States are large or publicly held ones. Some family and other corporations may be closely held by more limited numbers of shareholder owners. Such entities may be subject to special rules both under public law and under private arrangements by the owners. These entities, sometimes labeled as "close" corporations, can be defined differently in various jurisdictions.¹⁹ As a practical matter, separation of ownership and management in the governance of these entities may not be as formally separated in some of these entities as in larger, publicly held corporations.²⁰ For instance, shareholders may expect to be employees of the corporation or have other more active roles.²¹ Such entities also may trigger special concerns about

15. See O'KELLEY & THOMPSON, *supra* note 6, at 153-58 (contrasting roles of directors, officers, and shareholders).

16. See, e.g., MODEL BUS. CORP. ACT, § 8.01 (2011) ("All corporate powers shall be exercised by or under the authority of the board of directors of the corporation . . ."); Del. Gen. Corp. L. § 141 (noting authority of board of directors over major corporate matters).

17. See, e.g., MODEL BUS. CORP. ACT §§ 8.02-8.06 (governing election and terms of directors); §§ 8.07-8.09 (governing resignation and removal of directors); § 8.43 (governing resignation and removal of officers).

18. See MODEL BUSINESS CORPORATION ACT, §§ 7.01-732 (2011) (governing shareholder meetings, voting, and voting trusts, voting agreements, and shareholder agreements); see also Kenneth M. Rosen, *Mickey, Can You Spare a Dime? DisneyWar, Executive Compensation, Corporate Governance, and Business Law Pedagogy*, 105 MICH. L. REV. 1151, 1162-65 (2007) (noting views of shareholder power's importance in corporate governance debate).

19. See F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL & THOMPSON'S CLOSE CORPORATIONS AND LLCs: LAW & PRACTICE § 1:2 (3d ed. rev. 2013). While many close corporations may be smaller enterprises, size is not necessarily determinative of whether an entity falls into a close corporation regime. See *id.*, § 1:3. Even the term "close" corporation may have different meaning in different jurisdictional settings from "closely held" or similar terms and can certainly differ in aspects from similar non-corporate entities such as limited liability companies. See *id.*, §§ 1:4-1:10. It is not within the scope of this paper to delineate all of the possible variations, but rather to note that special rules may be associated with each.

20. See *id.*, §§ 1:13.

21. See *id.*

oppression of minority shareholders and attempts by the law or private agreement to protect such minority stake owners.²²

Moreover, after focusing on the law of corporations, it is important to note, if one selects a non-corporate business entity form in the United States, she also must be aware of the rules related to that particular entity that similarly might affect succession. For instance, returning to an issue discussed earlier in the corporate context, partnership law may have its own rules for dissolution. Article 8 of the Uniform Partnership Act contains provisions related to winding up a partnership form of business.²³ Interestingly, some parties might avoid or prefer using the partnership form because of its inherent volatility, as there are multiple events that may cause dissolution and winding up the business.²⁴ Among these in some instances, if steps are not taken to prevent it, is the possibility that dissociation by one partner may trigger dissolution.²⁵ Dissolution again represents a major transition of succession and rules related to the transition under partnership law. For example, as the entity is dissolved, the Uniform Partnership Act provides for settling accounts amongst partners, which may in some instances leave surplus for distribution to partners.²⁶ Interestingly, the Uniform Partnership Act specifically provides for some situations, beyond the dissolution of the entity, to situations involving the death of a partner. It makes clear that “[t]he estate of a deceased partner is liable for the partner’s obligation to contribute to the partnership.”²⁷

Of course, the end of a life of a business entity under company law can become even more complex when the succession involves transference of assets to another entity. Where an existing entity

22. See generally F. HODGE O’NEAL & ROBERT B. THOMPSON, O’NEAL & THOMPSON’S OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS (2d ed. rev. 2013). Classically, one concern is the possibility of a squeeze out of minority shareholders from their ownership interests and avoiding unfair valuation of their interests. See generally *id.*

23. See UNIF. P’SHP ACT §§ 801-807 (1997). Again, as with the Model Business Corporation Act, one must be cautious that the Uniform Partnership Act itself is not binding law but may be utilized by states. See *supra* note 9. Other types of partnerships and business entities similarly may have their own rules. See, e.g., UNIF. LTD LIAB. CO. ACT §§ 701-08 (2006) (providing for winding up and dissolution of limited liability companies); UNIF. LTD P’SHP ACT §§ 801-808 (2001) (providing for limited partnership dissolution).

24. See UNIF. P’SHP ACT § 801 (1997).

25. See UNIF. P’SHP ACT §§ 601-03; 801 (1997).

26. See UNIF. P’SHP ACT § 807 (1997). For instance:

(a) In winding up a partnership’s business, the assets of the partnership, including the contributions of the partners required by this section, must be applied to discharge its obligations to creditors, including, to the extent permitted by law, partners who are creditors. Any surplus must be applied to pay in cash the net amount distributable to partners in accordance with their rights to distributions under subsection (b).

See *id.*

27. See UNIF. P’SHP ACT § 807(e) (1997).

seeks to have assets moved to it, one might have a combination through a sale or merger in a variety of ways.²⁸ State corporation statutes can play a significant role in determining how combinations proceed as these statutes are set up to, among other things, protect shareholder interests.²⁹ Moreover, in the United States, an outgrowth of the increasingly large assortment of entity forms under state company law is the desire to better accommodate transactions involving them. These might include conversion of an entity from one business entity form to another as well as combination of entities of different forms.³⁰ From the 1980s, one saw multiple states adopt their company law to be more accommodating with, for example, Delaware permitting mergers of corporations with limited partnerships, joint-stock associations, nonprofit corporations, and partnerships and Texas “broadly [authorizing] cross-entity conversion and merger.”³¹

2. Death of an Owner, Personal Succession, and Company Law

Understanding some of these basic concepts in business succession, one can proceed to view them alongside personal succession. Having recognized that company law’s distinctive rules for different entities directly affect transitions in governance and entity succession, one can draw some specific linkages to the affect of the death of an owner. While alive, as indicated above, a strategic owner likely may choose to invest in a particular type of entity to serve specific goals. Among these may be the desire to exercise greater or lesser control over management of that entity. Some investors may choose to be passive regarding most management functions, for instance, buying shares of a large publicly held corporation and perhaps not even exercising their minimum rights to cast ballots in director elections or for other matters. To the extent these investors participate in an entity with a legally limited managerial role for shareholders, such limitations may pass forward to their heirs after death as those heirs take ownership of shares.

However, if a strategic owner chose to invest in an entity to attempt to exert greater managerial control—for instance, to secure personal employment or other influence on decision-making—when she dies, her heirs may or may not have claim to the greater manage-

28. See CLARK, *supra* note 4, at 401-61.

29. See *id.* at 414-18. Of course, applicable law may extend beyond state corporate codes to other rules such as the federal securities laws and antitrust laws. See *id.* at 413-18.

30. See Robert C. Art, *Conversion and Merger of Disparate Business Entities*, 76 WASH. L. REV. 349 (2001).

31. See *id.* at 379. When the Model Business Corporation Act initially moved into reform in this area in 1999, it interestingly chose to focus on permitting corporations to merge with “other entities,” rather directly accommodating conversions. See *id.* at 380.

rial role or privileges. This outcome may hinge on specific managerial rights associated with particular owners under different entity forms provided by public law or on how iron-clad are private agreements among the decedent and other owners on managerial participation for themselves and their heirs. For instance, during her lifetime, she might enter into a shareholder agreement with fellow owners that not only governs certain voting of shares but also provides that the agreement is binding on heirs and gives the opportunity for her heir to sign and to join the agreement after she is deceased.³²

And, the strategic owner may have different aspirations on the control issue for themselves as compared to her heirs. For instance, an owner who sought active managerial control during her lifetime might anticipate ceding such control for the next generation after her death. Various motivations might inform such a desire. For example, in a more closely held entity that restricts who may buy shares in the entity to avoid the introduction of new, unfamiliar owners, the current owner might be concerned about liquidity for her estate and the ability of her heir to transfer ownership given such transfer restrictions after her death. Thus, during their lifetimes, the owners might, for example, agree to a buyout agreement triggered by death.³³

In summary, it is clear that U.S. business entity law has an important role to play for informing business succession, and that as that entity law continues to provide for more entity types it also evolves to address what happens when entities cease to exist as they once were. However, an analysis of business succession would be far from complete without examining other areas of law at the nexus with company law during a business succession. Which area of law dominates at the nexus may vary by circumstance. For instance, the significance of those other areas of law may fluctuate with the nature of the business entity at issue and the details of coverage of succession-related issues by the company law for those entities. Another legal area with potentially large impact is U.S. trust and estate law.

32. *See, e.g.*, O'NEAL & THOMPSON, *supra* note 19, § 1:2. Prior planning and anticipation of death can be useful for other owners as well as the decedent. All of the owners might avoid some problems if they anticipate the death of one of their number early in the entity's existence. They might consider the advantages and disadvantages of arrangements for disposing of the decedent's shares, including various alternatives such as placing shares in trust or buying insurance to allow payment of an estate for shares. *See id.*, § 2:27.

33. *See id.*, § 7:3. Another issue might arise related to death and transfer restrictions. During an entity's lifetime, especially in more closely held entities, owners might informally choose to ignore transfer restrictions otherwise present in writing to allow transfer of shares to family members or others. This leaves open the danger, at a later time of less cordial relations, for attempts to stop such an informal tradition based on the written restrictions; of course, the prior informal conduct might or might not lead a court to refuse to enforce the restriction at a later point in time. *See id.*, § 7:15.

B. *Trust and Estate Law*

Trust and estate law is an excellent example of another area of U.S. law that is relevant, because it illustrates that when thinking of other relevant areas of law, relevance may come either directly or indirectly. The more direct relevance may come from trust and estate law directly settling how assets of a business are dispersed during a business succession. But trust and estate law also may come into play indirectly as it informs the more detailed settlement of issues related to succession from other legal areas.

1. Direct Relevance

As noted above, the company law governing some business forms may contain relatively detailed instruction on certain succession issues. This was a natural result as partnership law became codified and other business entity forms were statutorily created. If one engages in a program of codification, it may make sense to cover succession-related issues where possible as part of that project. Of course, as also reflected above, details may vary for company law's coverage of different entities. And, it is important to note that many businesses may be run as sole proprietorships that largely are the alter egos of their individual owners rather than constituted in a business organization form with detailed legal constraints.³⁴ In such instances, for example, if the business owner dies, that passing may result in the business assets settling into the trust and estate legal system to determine how to proceed properly with succession.

U.S. law in this area can be quite varied in the results for specific jurisdictions.³⁵ However, as a general matter, the possibility exists for addressing numerous issues under trust and estate law. For instance, there is the possibility of a business owner's demise without a will plunging one into the trust and estate law of intestate succession.³⁶ Jurisdictions may have rules to deal with a variety of issues such as the share of the estate for surviving spouses or other relatives,³⁷ the possibility of statutory wills,³⁸ heirs' gifts,³⁹

34. See O'KELLEY & THOMPSON, *supra* note 6, at 1-2 (describing sole proprietorships). This is not to say that such businesses are unregulated. They may be subject to a host of law and rules. For example, agency law may be especially significant. See, e.g., *id.* at 20-21; see also Kenneth M. Rosen, *Financial Intermediaries as Principals and Agents*, 48 WAKE FOREST L. REV. 625 (2013) (discussing generally significance of revisiting agency law, including traditional principles developed at common law). The point is that rules for some issues related to succession, such as governance, may not be developed in the same way as they are for other business entities.

35. See *infra* Part III for additional discussion of the U.S. state by state approach.

36. See generally WILLIAM M. MCGOVERN, ET AL., *WILLS, TRUSTS AND ESTATES* 49-132 (4th ed. 2010).

37. See *id.* at 49-65. For spouses, one interesting question possibly covered by legal rules is who constitutes a spouse. See *id.* at 121-32.

38. See *id.* at 67-68 (noting promulgation of statutory wills by some states as an alternative for lay persons where boxes might be ticked to show desires rather than

advancements,⁴⁰ homicide,⁴¹ disclaimers,⁴² and children who are not from marriage,⁴³ adopted⁴⁴ or the result of using reproductive technology.⁴⁵

A sole proprietor who chooses to anticipate her death and to try to arrange for her business' succession may have a variety of legal options to give effect to her intent from simple wills to the creation of more sophisticated trusts. While freedom of choice is large,⁴⁶ constraints may exist. Some jurisdictions may limit testamentary power.⁴⁷ And, even when giving is legitimate, to successfully execute her plan, she should be mindful of the variety of legal formalities associated with wills, trusts and other conveyance vehicles; failure to observe formalities might question the legitimacy of efforts after death.⁴⁸

As different business entity forms under U.S. company law have proliferated to meet the needs of users, it is useful to note that the U.S. legal system also has evolved to provide very sophisticated vehicles for those achieving great wealth in business to see that their wealth is delivered to causes close to them. For example, the Bill and Melinda Gates Foundation formed by the Microsoft co-founder and his wife has an asset trust endowment of over \$38 billion.⁴⁹ The foundation's size makes it a significant entity in its own right, and it is not surprising that the Gates' family embarked during their lifetime on forming this enterprise separate from the Microsoft company as a way to share its wealth.

Notwithstanding the above stated significance of trust and estate law for business succession, it is useful to refer back to the previous section's discussion of company law. While trust and estate law is sophisticated and varied across the United States, that law's ability to directly control business succession again may relate to the busi-

accruing the expense of having a lawyer draft a will.) Of course, even attorneys might use statutory wills, especially more sophisticated ones being created such as the Uniform Statutory Will Act. *See id.* at 68.

39. *See id.* at 68-71 (noting use of the term heirs, even when a will is drafted, possibly drawing in interpretations from intestate succession rules).

40. *See id.* at 74-79 (noting some states making adjustments to account for certain advancements to those who end up as heirs by a decedent prior to death).

41. *See id.* at 80-88 (noting rules possibly barring taking by will, will substitute, or inheritance by possible heir who killed the decedent).

42. *See id.* at 88-96 (noting rules where an otherwise legitimate heir may decline inheritance by intestate succession for reasons such as tax consequences).

43. *See id.* at 96-107 (noting importance of rules when many children are born out of wedlock).

44. *See id.* at 107-117.

45. *See id.* at 117-121.

46. *See infra* Part V.

47. *See* MCGOVERN ET AL., *supra* note 36, at 133-96.

48. *See id.* at 197-253.

49. *See Who We Are Foundation Fact Sheet*, BILL AND MELINDA GATES FOUNDATION, <http://www.gatesfoundation.org/Who-We-Are/General-Information/Foundation-Factsheet> (last visited Oct. 2, 2013).

ness entity form at issue, causing corporation, partnership or limited liability company law, for instance, to apply more directly on numerous issues instead of laws such as intestate succession. However, this does not mean that trust and estate law might still not apply in part, albeit more indirectly.

2. Indirect Relevance

Indirect relevance of trust and estate law to succession for more sophisticated business entities might come in several forms. Accordingly, it is useful to contemplate an example. For instance, although a corporation's legal personality continues despite the death of a shareholder, what happens to the decedent's shares upon death is relevant and may be affected by trust and estate law covering those shares as part of the property of her estate.⁵⁰ Who inherits those shares pursuant to trust and estate law may affect the future of the corporation. As already discussed, shareholders—particularly shareholders with large holdings—may have power in corporate elections governed by company law that select the directors empowered under company law to control the corporation's affairs.⁵¹ Trust and estate law's ability to indirectly affect business succession, even where it does not directly control all succession issues, should make another point lucid: other areas of law also might be informative and apply in some instances, further crowding the nexus created by business succession.

3. Beyond Business Entity and Trust and Estate Law

It is useful to briefly amplify how areas of law beyond business entity and trust and estate law may become relevant by exploring some examples. First, other areas of law might enhance or substitute for business entity and trust and estate law as they affect business succession. Recent U.S. legal action regarding same-sex marriage reinforces this point. The United States Supreme Court recently made major rulings in this area including recognition of the entitlement of married same-sex couples to federal benefits.⁵² Efforts to be more inclusive in our conception of families, and more generally to adjust attitudes related to sexual orientation,⁵³ necessarily implicate concepts that arise under trust and estate law and that can accordingly affect business succession. For instance, just as same sex marriage

50. Trust and estate law may not always be independently dispositive on this issue either. For example, there may be a transfer restriction agreement in place. See F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL & THOMPSON'S CLOSE CORPORATIONS AND LLCs: LAW & PRACTICE § 7:20 (3d ed. rev. 2013).

51. See *supra* Part II.A.

52. See Adam Litpak, *Supreme Court Bolsters Gay Marriage with Two Major Rulings*, N.Y. TIMES, June 26, 2013.

53. See, e.g., Elisabeth Bumiller, *Obama Ends 'Don't Ask, Don't Tell' Policy*, N.Y. TIMES, July 22, 2011 (noting move towards open service regardless of sexual orientation in the military).

has evolved as a legal issue, so too may concepts of who has inheritance and other rights under trust and estate law.⁵⁴ Ultimately, those issues may be settled directly in trust and estate law by altering statutes fully across the nation to more explicitly recognize rights for additional family under that law. In the interim, however, the development of new ideas in other areas of the law, like family law and employee benefits law, might buttress broader interpretations of who is eligible under business succession schemes.

Second, other areas of law may be so important as to affect which choices are made under business entity and trust and estate law that ultimately also affect business succession. Tax law illustrates this point. As already noted, tax concerns may have led to the development and uses of additional business entity forms⁵⁵ and also can affect choices about accepting a share of inheritance under trust and estate law.⁵⁶ Accordingly, the best student of U.S. business succession law will recognize that it is importantly characterized by a nexus of many types of law. She also will recognize another important characteristic: the significance of federalism.

III. FEDERALISM

Under the United States Constitution, the drafters decided not to centralize all legal authority in the federal government. Rather, much is left to state law, and this is particularly the case for business entity and trust and estate law. Accordingly, another key characteristic of law applicable to business succession is that its details vary from one state to another. Notwithstanding the large state presence, however, it also is important to recognize trends of the federal government to get involved in some of the relevant legal areas.

A. *Role of State Law*

State law plays a major role in business entity and trust and estate law. For business entity laws there can be variances between states on legal rules, such as the ones mentioned above, related to business succession. In corporate law, for instance, states codes may differ. Some have seen this diversity possible under a federalist system as particularly beneficial, allowing states to serve as laboratories for different rules as they compete to attract companies.⁵⁷ Empirically, certain states with their own company law rules such as

54. Indeed, legal disputes related to same sex relationships already have been percolating in the trust and estate legal system. See McGovern et al., *supra* note 36, at 130.

55. See Hamill, *supra* note 7.

56. See *supra* note 42.

57. See ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 4-6 (1993). Interestingly, it appears that one technique of companies that faced barriers because of the proliferation of different types of business entities to merger or to conversion

Delaware have been particularly successful at attracting business seeking to incorporate.⁵⁸ Regardless of one's view of the federal system,⁵⁹ one must recognize its significance in the United States. For business succession, for instance, the details of shareholder voting rights under a particular state's corporate law can affect their ability to effect transitions to new directors and management. Moreover, differences between state laws have led to the creation of choice of law rules for the corporate arena that can affect which state's law will apply on particular issues. The internal affairs doctrine provides that courts often look to the state of incorporation, which is not necessarily the state of the company's principal operations, for determining which law governs the inner workings of a corporation.⁶⁰

Of course state corporate law differences may naturally lessen over time as states amend statutes in response to other states' statutory innovations.⁶¹ And, other efforts may encourage rule harmonization over longer periods of time for different types of company law. The United States is home to a variety of model company related laws put out by different organizations such as the American Law Institute,⁶² the American Bar Association,⁶³ and the Uniform Law Commission.⁶⁴ However, just the presence of multiple organizations promoting visions of what the law should be shows the lack of uniform views on the details of U.S. company law. Moreover, these model acts are not legally binding themselves, and must be adopted by those with law-making authority in states. Adoption might include legislatures amending company law statutes⁶⁵ as well as judges drawing on these models, not as binding in themselves, but as representative of what those judges believe the law in their jurisdictions to be.⁶⁶

Trust and estate law, which so greatly might affect business succession, similarly can differ from state to state rendering conflict rules in this area particularly important as well.⁶⁷ While uniform laws, such as the Uniform Probate Code and Uniform Trust Code, are present in this area to promote harmonization, they may be followed

might be to go to another state with more receptive rules and to set things up so that state's receptive rules applied. *See* Art, *supra* note 30, at 379-81.

58. *See* ROMANO *supra* note 57 at 6-12.

59. *Cf.* Carey, *infra* note 71.

60. *See* GEVURTZ, *supra* note 4, at 35.

61. *See* Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO LAW REVIEW 709 (1987).

62. *See, e.g.*, PRINCIPLES OF CORP. GOVERNANCE.

63. *See, e.g.*, MODEL BUS. CORP. ACT (2011).

64. *See, e.g.*, UNIF. LTD LIAB. CO. ACT (2006); UNIF. P'SHIP ACT (1997).

65. But even when a legislature largely adopts provisions from a model law, it may also include some of its own variances from the model law provisions.

66. *See, e.g.*, *Ne. Harbor Golf Club v. Harris*, 661 A.2d 1146 (Me. 1995) (utilizing American Law Institute's Principles of Corporate Governance).

67. *See* MCGOVERN ET AL., *supra* note 36, at 27-38.

even less than certain business-related uniform laws.⁶⁸ Even rules that seem nearly universal in the different states can have a major variant in some jurisdictions. For instance:

in all states, if an individual dies without a will, the surviving spouse gets a share of the estate, but the size of that share differs. When the law of foreign countries is taken into account, the differences may become greater. Nearly all American states reject a “forced share” for children of a person who dies with a will, but most other countries provide for this.⁶⁹

Once again, to the extent that trust and estate law drives results in business succession, these nuances and variants might lead to different succession outcomes in different states.

B. The Trend to Federalize Law

Notwithstanding that business entity law often is driven by the states, more recently, a trend worth recognizing is the federalization of business entity law, particularly in the corporate world. Certainly, corporate scandals heighten public, and thus federal government interest, in regulation of corporations.⁷⁰ However, these concerns are not entirely new. In the 1970s, Professor William Cary famously speculated as to why so many corporations from around the United States chose to incorporate in the state of Delaware, and wrote of “the movement to the least common denominator” in corporation standards and called for consideration of a greater federal role.⁷¹

For many years, the federal government has been heavily involved in the regulation of securities.⁷² As time progressed, the United States Securities and Exchange Commission (SEC) used its statutory authority to become more involved in the regulation of corporate processes, such as proxy voting,⁷³ that might be viewed as governance issues more traditionally handled by the states. However, SEC efforts in this area were not always successful or unopposed. For instance, efforts to secure greater shareholder rights to participate in the director nomination process have extended over numerous years and encountered various hurdles.⁷⁴ While these efforts may not always yield quick implementation of federal rules, they are efforts

68. *See id.* at iii.

69. *Id.* at 27 (footnotes omitted).

70. *See Rosen, supra* note 3.

71. *See* William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 *YALE L.J.* 663 (1974).

72. *See, e.g.*, Securities Exchange Act of 1934.

73. *See* THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* 358-89 (5th ed. 2005).

74. *See, e.g.*, *Rosen supra* note 3, at 2940.

that need to be considered for impact on the business succession process, since the U.S. federalist system includes *both* state and federal law. Beyond considering the federalist character of U.S. law affecting business succession, ascertaining the deeper nature of the law also involves recognizing certain cultural preferences that effect the U.S. law's creation. The first of these preferences is reflected in the significant presence of small and family businesses in the U.S. economy.

IV. SMALL AND FAMILY BUSINESS COROLLARY OF THE AMERICAN DREAM

U.S. recognition of the impact of small and family businesses on the American economy is another critical characteristic of business succession law. Admittedly, not all family businesses remain small nor are all small businesses run by families. However, it is useful to group small and family businesses together since their importance to business succession links to their cultural significance in the United States. They both can be linked to notions of the "American dream" that inform and permeate U.S. legal policy. While that dream is sometimes associated with specific material accomplishments, such as the purchase of a home,⁷⁵ at a more basic level the dream is about the ability for personal success and prosperity. As they are created, family and small businesses are ways for family members or close associates to enter the economy in a small way with the hope of growing the enterprise.

There is a reality associated with this dream. In the United States, these types of businesses may be very significant to the economy. PwC's *2012/2013 Family Business Survey* offers interesting insights into at least some family businesses.⁷⁶ Even in economically difficult times, almost three-quarters of surveyed businesses experienced growth in sales.⁷⁷ Moreover, 90% of these businesses viewed themselves as significant for job creation.⁷⁸ Similarly, great emphasis has been placed on the importance of small businesses to the economy and the large percentage of workers employed by small firms.⁷⁹

The perceived significance of small and family businesses translates into special attention from policy-makers.⁸⁰ For example, the

75. See Kristen David Adams, *Homeownership: American Dream or Illusion of Empowerment?*, 60 S. C. L. REV. 573 (2009).

76. *Playing Their Hand, US Family Businesses Make Their Bid for the Future*, PwC, <http://www.pwc.com/us/en/private-company-services/publications/assets/pwc-family-business-survey-us-report.pdf> (last visited Oct. 2, 2013).

77. See *id.* at 7.

78. See *id.* at 9.

79. See Todd McCracken & Dan Danner, *Commentary: The Economy Needs Small Business*, WASH. POST, Dec. 11, 2011, available at http://articles.washingtonpost.com/2011-12-11/business/35286873_1_small-business-small-business-small-firms.

80. Some actually have noted lack of uniformity on conceptualization of what businesses are small and have questioned benefits awarded based on perceptions of

White House emphasizes its focus on supporting these entities.⁸¹ Such support includes lending activity to assist these businesses.⁸² Legislators also focus on these entities both in specialized committees⁸³ and in the work of other committees.⁸⁴ This potentially impacts business succession in various ways.

The support for and prevalence of small and family businesses are significant because such entities may focus on specific succession strategies. Family businesses in particular care about succession, although not all successions are easy or without challenges.⁸⁵ Some have identified succession for family business as “the final test of greatness.”⁸⁶ The PwC survey found that 81% of surveyed businesses were family-run for multiple generations, but that a quarter anticipated changing ownership in around five years.⁸⁷ Of the latter group, 52% hoped to pass the business onto another generation to both run and own, 24% to pass the business on to the subsequent generation to only own, and then another 16% to sell to other companies or private equity investors.⁸⁸ If the economy incentivizes and holds an important place for entities that are particularly interested in succession issues, then one can declare previous legal issues associated with succession to be only more important. In addition, these issues may be even more nuanced for small and family businesses as those entities

the significance of small business. See, e.g., Mirit Eyal-Cohen, *Down-sizing the Little Guy Myth in Legal Definitions*, 98 IOWA L. REV. 1041 (2013); Mirit Eyal-Cohen, *Why is Small Business the Chief Business of Congress?*, RUTGERS L.J. 1 (2012). For purposes of this paper, it is important to recognize regardless of one’s views of how appropriate is the policy significance placed on small business, as a practical matter small business does draw great attention of policy-makers.

81. See *Jobs & The Economy: Putting America Back to Work, Supporting Small Businesses*, <http://www.whitehouse.gov/economy/business/small-business> (last visited Oct. 2, 2013).

82. See *id.*; see also *FY 2014 Congressional Budget Justification and FY 2012 Annual Performance Report*, U.S. SMALL BUSINESS ADMINISTRATION 1-4, <http://www.sba.gov/sites/default/files/files/1-508-Compliant-FY-2014-CBJ%20FY%202012%20APR.pdf> (describing Small Business Administration plans for assisting entities).

83. See, e.g., House Committee on Small Business, <http://smallbusiness.house.gov/>; Senate Committee on Small Business & Entrepreneurship, <http://www.sbc.senate.gov/public/>.

84. For instance, the House Committee on Financial Services has paid particular attention to the passage and implementation of the JOBS Act, including its desired effect of assisting start-up businesses. See *House Passes JOBS Act Deadline Bill and Homes for Heroes Act*, Press Release, Committee on Financial Services, <http://www.sbc.senate.gov/public/> (last visited Oct. 2, 2013).

85. See ROGER FRITZ, *WARS OF SUCCESSION, THE BLESSINGS, CURSES AND LESSONS THAT FAMILY-OWNED FIRMS OFFER ANYONE IN BUSINESS* (1997). Family businesses also may use legal business planning strategies as a means to not only deal with control issues but estate planning concerns. See, e.g., GEVURTZ, *infra* note 92, at 822-23 (describing freeze strategy for estate planning where elderly owners pass common stock to younger family members but keep preferred raising valuation questions.)

86. See CRAIG E. ARANOFF & JOHN L. WARD, *FAMILY BUSINESS SUCCESSION: THE FINAL TEST OF GREATNESS* (1992).

87. See PwC *supra* note 76, at 17.

88. See *id.*

might use law, such as governance rules, to deal with their special challenges such as the power dynamics of a small number of owners perhaps joining against the owner of a minority stake in the business. However, it is important to note that the “mom and pop” business also might be challenged to select the best legal solutions for their firms and are constrained by realities of family life in addition to the law.⁸⁹

Just as family and small businesses may affect the understanding of succession issues because of their prevalence given U.S. values, it is useful to explore the influence of another U.S. value, freedom, that is characteristic of the U.S. version of the business succession law.

V. FREEDOM

Law’s relationship with freedom is complex in that law can be a vehicle for both enhancing and limiting freedom.⁹⁰ On the enhancement side, law’s support of freedom of contract and choice in formulating legal relationships can be critical.⁹¹ In the United States, business succession law is quite open to parties ultimately modifying rules in some circumstances and choosing certain paths for the law’s application. This makes the role of legal counsel critical in the United States and has led to emphasis on business planning assisted by lawyers.⁹²

Previously discussed U.S. business entity law related to business succession reflects the prioritization of freedom in the U.S. system. Choices certainly abound. Parties can choose both their business entity form and a particular state with its own set of rules for that selected entity form. But the choices go further than selecting a form and jurisdiction.

Corporate law exemplifies this. Corporate codes may provide default rules, but they also typically provide charter options. Delaware law illustrates these options. In Section 102 of the Delaware General Corporation Law, after describing the contents of the certificate of incorporation, in subsection (b), Delaware permits the certificate to include a host of additional provisions at the option of the firm that

89. See Benjamin Means, *Nonmarket Values in Family Businesses*, 54 *William & Mary L. Rev.* 1185 (2013). And, in addition to ex ante contractual, legal solutions, one should not under appreciate potential judicial intervention to protect minority shareholder rights in closely held entities. See Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 *FORDHAM L. REV.* 1161 (2010).

90. See Kenneth M. Rosen, *Freedom*, 62 *ALA. L. REV.* 1023 (2011).

91. See *id.* at 1026.

92. See, e.g., FRANKLIN A. GEVURTZ, *BUSINESS PLANNING* 1-26 (4th ed. 2008).

can dramatically alter the firm's operations.⁹³ Model laws similarly provide options.⁹⁴

In addition to the freedoms inherent in U.S. statutes that might affect businesses, additional instances of the exercise of choice as it relates to rules are noteworthy. A corporation may choose to list on a stock exchange to enhance the liquidity of trading in its shares. By making that choice, the corporation voluntarily agrees to comply with that exchange's listing standards which may include significant regulation of the firm's governance.⁹⁵

Choices made through private agreements are not limited to corporations listed on stock exchanges. Partnerships often are heavily reliant on modifying default rules through a partnership agreement. Under the Uniform Partnership Act, partners are governed by a partnership agreement, but have the Act's default rules come into play when the agreement does not cover an issue.⁹⁶ Although the partnership agreement cannot waive certain aspects of the Act,⁹⁷ it can be critical in adjusting rules related to significant issues including business succession. As previously noted, the Act contains dissociation and dissolution provisions.⁹⁸ One way to avoid dissolution upon dissociation of a partner is to provide for this eventuality in a partnership agreement. Such provision could significantly clarify how a partnership will transition by business succession to new situations as partners depart for a variety of reasons.

The importance of freedom of choice extends beyond business entity law issues to trust and estate law issues that might affect succession. The ability for individuals to create wills and trusts is about deciding how their assets, which might include businesses, will move to others after their deaths. Given this potential for freedom, it is not surprising that trust and estate law seeks to give effect to the decedent's intention.⁹⁹

Recognition of the freedoms embodied in U.S. trust and estate and business entity laws becomes crucial. Because if the freedoms are not exercised, other rules from intestate ones to company law code rules may automatically apply.

93. See Del. Gen. Corp. L. § 102. Indeed, the options have expanded over time to include items such as the elimination of certain personal liability of directors. See Rosen, *supra* note 34 at 637-39.

94. See, e.g., MODEL BUS. CORP. ACT, § 2.02(b) (2011) (noting provisions that may be in articles of incorporation).

95. See, e.g., NYSE, LISTED COMPANY MANUAL, available at <http://nysemanual.nyse.com/lcm/>.

96. See UNIF. P'SHIP ACT § 103 (1997).

97. See *id.*

98. See *supra* notes 23-26 and accompanying text.

99. See ROGER W. ANDERSEN, UNDERSTANDING TRUSTS AND ESTATES 32 (3d ed. 2003) (noting that evaluation of whether to enforce a will might hinge on issues such as the intent for a document to be a will and the intent of the document's provisions).

VI. CONCLUSION

Given the inherent complexities of U.S. business succession law, including its coexistence with personal succession rules, this paper sought to provide a framework of critical characteristics of that law to help provide a better understanding of how the law operates and to provide a basis for comparison to succession laws in other jurisdictions. The lesson of U.S. law is that succession law is characterized by a need to manage multiple sets of legal rules from different subject matter areas that converge on the nexus of a business succession. In addition, one must recognize the federalist nature of the U.S. system and its impact on the laws applicable in this area. That nature requires attention to both state and federal law. Finally, for a deeper understanding of the U.S. rules, one must appreciate the values that drive them. This includes the priority placed on small and family businesses in the U.S. economy and the devotion to free choices as businesses prepare for succession.

