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West Virginia Corporate Law: Is It "Broke"?

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I. INTRODUCTION

We are all familiar with the cliche "if it ain't broke, don't fix it." The sentiment is as applicable to law as it is to the rest of life. When a law does what it is intended to do, legislators and courts should leave it alone. However, when a

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law no longer serves its intended purpose, it is "broke," and should be revised. The question is whether West Virginia's corporate law is "broke."

In 1974, the West Virginia Legislature adopted the West Virginia Corporation Act (the "Act").[1] The Act brought then modern standards of corporate law to West Virginia. Since that adoption, corporate law in West Virginia has remained virtually unchanged.[2] However, the model codes on which the Act was based have been substantially revised to reflect changes in business practices.[3] Consequently, the Act no longer reflects modern standards of corporate law. The failure to keep pace with the evolving standards of corporate law is particularly interesting in light of the fact that the legislature has continually adopted and revised other business entity laws in the state to keep pace with modern standards.[4] A corporate law that reflects less than modern standards does not necessarily translate into a broken corporate law. Modern standards of corporate law are not necessarily appropriate for West Virginia. It does, however, suggest that the time has come to reevaluate the Act. This Article begins that process.

Any reevaluation of the Act must start with a common understanding of the purpose of the Act. Whether the Act succeeds in fulfilling its purpose must be assessed within the context in which the Act functions. Therefore, Part II sets forth the context in which the Act functions. I briefly explore the purpose of business entity law in general. I also examine the recent evolution in business entity law, including the trend towards enabling legislation and the evolving spectrum of business entities. Next, Part III sets forth the purpose of the Act and the state of business entity law in West Virginia, and Part IV explains why the Act has stagnated while other business entity law in West Virginia has kept pace with modern standards.

Having established the purpose of the Act and context in which it functions, Part V examines whether the Act furthers its purpose. Using selected examples from the Act, I examine the structure and the substance of the Act. Finally, Part VI

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1 1974 W. Va. Acts 176.

2 *See infra* note 74 and accompanying text.

3 The Act is based on the 1969 version of the Model Business Corporation Act (the "MBCA") and the 1964 version of the Model Nonprofit Corporation Act. Note, *Corporations – A Survey of the Pending West Virginia Corporation Act*, 77 W. VA. L. REV. 50, 50 (1975). The MBCA was completely revised and reorganized in 1984. *See* 1 MODEL BUS. CORP. ACT ANN., Introduction (3d ed. Supp. 1995). *See infra* notes 31-40 and accompanying text. The Model Nonprofit Corporation Act also underwent comprehensive revision. *See* REV. MODEL NONPROFIT CORP. ACT, Introduction (1988). While both business corporation law and nonprofit corporation law have been substantially revised, this Article focuses on business corporation law.

4 *See infra* Part III.B.

concludes that the Act is "broke." The time has come to reassess the purpose of corporate law in the state, and to revise the Act accordingly.

II. THE CONTEXT

Whether the Act succeeds in fulfilling its purpose must be assessed within the context in which it functions. The fundamental purpose of business entity law has not changed. However, since the adoption of the Act, there have been substantial developments in business entity law. These developments reflect a trend favoring enabling legislation. Examples of this trend include the evolution of the Model Business Corporation Act (the "MBCA") to the Revised Model Business Corporations Act (the "RMBCA") and the expanding spectrum of business entities. The results of this enabling trend is that organizers of business, usually management, have previously unattainable flexibility in managing their business entities.

A. Purpose of Business Entity Law

In a capitalistic society, the goal of economic activity is to make money.[5] Business entity law facilitates the organization of economic activity; it promotes economic activity by establishing rules that govern the relationships between owners, managers, and third parties.[6] Like all substantive law, the intent is to provide guidelines pursuant to which behavior is determined and standards pursuant

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5 *See* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) (explaining that the purpose of corporation is to maximize shareholder profits); Adolph A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV 1365, 1367 (1932) (arguing that corporations exist solely to make a profit for their shareholders). *But see* Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 582-83 (1992) (questioning the paradigms underlying traditional corporate law); Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 867 (1990) (proposing that hostile takeovers in the 1980s have lead to reconsideration of the reasons for the existence of corporations).

6 *See* Antoinette Sedillo Lopez, Comment, *The Alter Ego Doctrine: Alternative Challenges to the Corporate Form*, 30 UCLA L. REV. 129, 133 (1982) ("The primary reason for treating the corporation as a separate entity is to encourage the efficient operation of a free enterprise system. Efficiency is achieved by reducing transaction costs, streamlining business operations, and encouraging the aggregation of large amounts of capital. The separate entity status furthers these goals by providing a convenient and efficient form for transacting business.") (footnotes omitted). *See also* Alchian & Demetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 778-89 (1972) (offering economic analysis of the desirability of associating for business purposes); Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 260 (1967) (proposing development of corporations because of need to raise capital).

to which disputes are resolved.[7] Business entity law attempts to provide guidelines that strike a balance between equity, fairness and efficiency.[8]

Each state has a strong incentive to encourage organization of economic activity under its laws. Business entity formation in a state generates revenue for that state.[9] In particular, business entity formation generates filing fees, franchise taxes, license fees and taxes, and promotes employment and work for the local bar.[10] While managers of economic activity seek to realize a profit for the owners of that activity, the state in which the economic activity is formed also seeks to derive economic benefit.

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7 *See* D. Michael Risinger, *"Substance" and "Procedure" Revisited With Some Afterthoughts on the Constitutional Problems of "Irrebuttable Presumption,"* 30 UCLA L. REV. 189, 203 (1982); *see also* Debra R. Cohen, *The Single Publicaiton Rule: One Action Not One Law*, 62 BROOK. L. REV. 921, 953-55 (1996).

8 *See* Robert W. Hamilton, *Reflections of a Reporter*, 63 TEX. L. REV. 1455, 1456 (1985) ("[The RMBCA] strikes a reasonable balance between equity and fairness on the one hand and efficient corporate operation on the other."); William E. Kirk, III, *A Case Study in Legislative Opportunism: How Delaware Used the Federal-State System to Attain Corporate Pre-Eminence*, 10 J. CORP. L. 233, 236 (1984) (arguing that various interests are served by corporate law – creditors, investors and general public); Lopez, *supra* note 6, at 133-135 (proposing that corporate statutes provide a convenient and efficient form to transact business.); Mitchell, *supra* note 5, at 584 ("[T]he essential goal of corporate law [is] to restrain managerial self-dealing – by conforming directors' duties, stockholders' rights, constituents' rights, and enforcement mechanisms. . . . ").

9 *See* William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEGAL STUD. 303, 306-7 (1997) ("[I]t produces franchise tax revenues for the chartering state but also because interest groups within the state are benefitted by this activity."); Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, But Heading Where?*, 45 SYRACUSE L. REV. 1193, 1193-94 (1995) ("Any state which induces a significant number of businesses to choose that forum in which to incorporate stands to gain significant financial benefits, or at least certain groups within such states stand to benefit.") (footnotes omitted); John A Mackerron, *Variety of Choice in the Corporate Law "Menus" of the Great Lakes States*, 71 U. DET. MERCY L. REV. 469, 470 (1994) ("Incorporations are a source of tax revenues and create other more general economic benefits for a state."); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 710 (1987) ("[R]evenues derived from franchise taxes provide a powerful incentive for state legislatures to implement corporation codes that will maintain the number of domiciled corporations, if not lure new firms to incorporate in their state."); William Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 666 (1974).

10 Carney, *supra* note 9 (franchise tax revenues, interest groups within the state benefit); Cary, *supra* note 9, at 668 (franchise tax revenue); Goforth, *supra* note 9 (certain groups gain significant financial benefit); Jonathan R. Macey & Geoffrey P. Miller, *Towards an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 492 (1987) (indirect benefits like fees to accountants and attorneys); Mackerron, *supra* note 9, at 470 (tax revenues, and other general economic benefits); Romano, *supra* note 9 (franchise tax revenues).

States generally recognize the internal affairs rule.[11] States also generally recognize foreign entities.[12] At a minimum, a state may not keep a foreign entity

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[11] The internal affairs rule states that the internal affairs of a business entity are governed by the laws of the state of creation. This rule is almost universally accepted in corporate law. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971) ("[L]ocal law of state of incorporation will be applied to determine such issues."). *See also* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987) (stating that "[n]o principle of corporation law and practice is more firmly established than a state's authority to regulate domestic corporations"); First Nat'l City Bank v. Banco Parel Comercio Exterior de Cuba, 462 U.S. 611, 621 (1983) ("[T]he law of the state of incorporation normally determines issues relating to the internal affairs of a corporation. Application of that body of law achieves the need for certainty and predictability of result while generally protecting the justified expectations of parties with interests in the corporation."); Jennifer J. Johnson, *Risky Business: Choice-of-Law and the Unincorporated Entity*, 1 J. SMALL & EMERGING BUS. L. 249, 268-275 (1997); P. John Kozyris, *The Limited Liability Company: Does it Exist Out-of-State? What Law Governs It?*, 64 U. CIN. L. REV. 565, 569 (1996) (noting that *lex incorporationis* for the internal affairs of a corporation is widely accepted); Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161 (1985); Willis L.M. Reese & Edmund M. Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 1118 (1958) (arguing that relationships among the corporation, its directors, officers, and stockholders are generally governed by the law of the state of incorporation). Many states have codified the internal affairs rule by negative inference. Johnson, *supra*, at 271-272. *See* W. VA. CODE § 31-1-49(a) (1996) ("[N]othing in this article contained shall be construed to authorize this State to regulate the organization or the internal affairs of such corporation."); 4 MODEL BUS. CORP. ACT ANN. § 15.05(c) (3d ed. Supp. 1995) (This statute "does not authorize this state to regulate the organization or the internal affairs of a foreign corporation authorized to transact business in this state."). The internal affairs rule has found growing acceptance, both judicially and through statute, in limited liability companies ("LLCs"). UNIF. LTD. LIABILITY CO. ACT § 1101, 6A U.L.A. 498 (1995); Kozyris, *supra*, at 568. The same is true for limited partnerships and limited liability partnerships. *See* REV. UNIF. LTD. PARTNERSHIP ACT, § 901, 6A U.L.A 254 (1976); UNIF. PARTNERSHIP ACT § 1101, 6 U.L.A. 66 (Supp. 1997). Partnerships are generally governed by the law of their principal place of business. *See* UNIF. PARTNERSHIP ACT § 106, 6 U.L.A. 25 (1994).

[12] A state may restrict a foreign entity from engaging in intrastate commerce. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 544 (1933) (Brandeis, J., dissenting) ("The Federal Constitution does not confer upon either domestic or foreign corporations the right to engage in intrastate commerce in Florida. The privilege of engaging in such commerce in corporate form is one which the state may confer or may withhold as it sees fit."). West Virginia may prevent a foreign corporation from carrying on its business within the state. *See* Floyd v. National Loan & Inv. Co., 38 S.E. 653 (W. Va. 1901). The legislature may prescribe limitations under which foreign corporations may do business in this state. *See* Archer v. Baltimore Bldg. & Loan Ass'n, 30 S.E. 241 (W. Va. 1898); Toledo Tie & Lumber Co. v. Thomas, 11 S.E. 37 (W. Va. 1890); Penberthy Electromelt Co. v. Star City Glass Co., 135 S.E.2d 289 (W. Va. 1964). *See also* 4 MODEL. BUS. CORP. ACT ANN. § 15.01 (3d ed. Supp. 1995); W. VA. CODE § 31-1-49 (1996).

from conducting interstate commerce.[13] Therefore, organizers of economic activity can organize under the laws of a state with more advantageous law regardless of where they conduct business. The state of incorporation, by virtue of its more advantageous law, will reap the derivative economic benefit.[14] Scholars have long discussed competition among states for business formation. It has been termed both the "race for the bottom"[15] and the "climb to the top."[16] Traditionally, this debate

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13 The United States Constitution does not permit a state to exclude a foreign entity from conducting interstate business. *See* U.S. CONST. art. I, § 8. While the privileges and immunities clause has not been held applicable to business entities, under the clause, a state may not prohibit a citizen from one state from entering into intrastate commerce in another state. *See id.* at art. IV, § 2. Additionally, there is an argument that full faith and credit requires a state to recognize an entity formed in a sister state. *See id.* § 1. *See also* Reese & Kaufman, *supra* note 11.

14 "Lesser states, eager for the revenue derived from the traffic in charters, had removed safeguards from their own incorporation laws." *Liggett*, 288 U.S. at 557. *See* Kirk, *supra* note 8, at 243 ("[S]trict laws would probably not prevent a corporation from doing business in the state, but would only cause it to seek its charter (and pay its taxes) elsewhere.").

The states where business is conducted still reap some economic benefit. Most states minimize the economic loss of organization in another state by imposing fees on foreign business entities when they conduct intrastate activity. In 1997, West Virginia increased filing fees for foreign entities seeking to qualify to do business in the state. The filing fee to qualify as a foreign corporation was raised from $10 to $100, and the filing fee to qualify as a foreign LLC was raised from $10 to $150. *See* WEST VIRGINIA CORPORATIONS, PARTNERSHIPS AND ASSOCIATIONS LAW ANN. 553 (Michie 1994); WEST VIRGINIA BUSINESS ORGANIZATIONS LAWS ANN. 607 (Michie 1997).

15 Justice Brandeis voiced concern over state competition for corporate charters. *See Liggett*, 288 U.S. at 557-564. He decreed that "[t]he race was one not of diligence but of laxity." *Id.* at 559. He wrote that

> [t]he removal by the leading industrial states of the limitations upon the size and powers of business corporations appears to have been due, not to their conviction that maintenance of the restrictions was undesirable in itself, but to the conviction that it was futile to insist upon them; because local restriction would be circumvented by foreign incorporation.

Id. at 557. Professor Cary coined the phrase "race for the bottom" in his article. Cary, *supra* note 9, at 705. In his article, Professor Cary expressed his concern over the movement of state corporate law towards "the least common denominator." *Id.* at 663.

16 *See* Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections of Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 920 (1982). *See also* Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation*, 53 J. BUS. 259 (1980); Romano, *supra* note 9.

has been couched in terms of competition for corporate charters; however, it applies equally well to the growing spectrum of business entities.[17]

While business entity rules are designed to strike a balance between the various interested parties, the balance among the parties changes over time to reflect developments in the business community. Essentially, the battle comes down to the struggle between two conceptual philosophies: the contractarian theory and the regulatory theory.[18] The contractarian theory, also known as the enabling theory, views business entity law as a substitute for private contracts.[19] Statutes provide default rules that the parties may revise to suit their particular needs. They are designed to reduce transactions costs.[20] Contractarians believe that managers and owners should have complete freedom to negotiate the terms of their contract and that shareholder protection will be provided by the market, which will appropriately value the entity in accordance with the contractual terms.[21] The regulatory theory, also known as the legal constraint theory or institutional theory, views business entity law as a series of mandatory restrictions imposed as a condition of creation.[22]

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17 State competition for business entities has expanded to include competition for LLCs and LLPs. *See* Goforth, *supra* note 9; Larry E. Ribstein, *Statutory Forms for Closely Held Firms: Theories and Evidence From LLCs*, 73 WASH. U.L.Q. 369, 430-31 (1995) ("[T]he rapid evolution of the LLC demonstrates that jurisdictions compete for formations of closely held firms."). The effect of state competition for business has also arisen in other areas law. *See* Kirsten H. Engel, *State Environmental Standard-Setting: Is There a "Race" and is it "To the Bottom"?*, 48 HASTINGS L.J. 271 (1997) (environmental laws).

18 For a concise overview of the two philosophies, see HENRY N. BUTLER, AND LARRY E. RIBSTEIN, THE CORPORATION AND THE CONSTITUTION 1-28 (1995). This discussion is also generally couched in terms of corporations, but it applies equally well to other types of business entities. Economists refer to "the firm." *See* Ronald Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

19 *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 2-18 (1992); Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1, 8 (1989) ("[T]he corporation is nothing more than a nexus of contracts made between and among self-interested individuals."); Coase, *supra* note 18; Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

20 Statutes provide a standard form contract which reduces the transaction costs associated with formation and operation of an entity. *See* Ribstein, *supra* note 17, at 374-380 (discussing that transaction costs include fees for customizing contracts, information costs, and interpretation costs).

21 *See generally* EASTERBROOK & FISCHEL, *supra* note 19; Coase, *supra* note 18; Ribstein, *supra* note 17.

22 *See* ADOLF A. BERLE, JR., THE MODERN CORPORATION AND PRIVATE PROPERTY (1932); Bradley & Schipani, *supra* note 19, at 5.

The regulations are designed to protect shareholders and third parties because the market does not.

Contractarians believe state competition in business entity law is a "climb to the top" because shareholders are rational and will not invest in entities in which owner concerns have been ignored.[23] Regulatory theorists believe state competition in business entity law is a "race for the bottom" because the shift towards management-oriented rules is usually at the expense of owner-oriented protection.[24] Contractarian theory and regulatory theory are "abstract polar extremes."[25] Neither theory alone explains all corporate law. Business entity law should and does contain elements of both theories – the enabling rules, which may be modified, and the mandatory rules, which may not be modified.[26]

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23 Fischel, *supra* note 16, at 917; Goforth, *supra* note 9, at 1270.

24 *See* J. Robert Brown, Jr., *Discrimination, Managerial Discretion and the Corporate Contract*, 26 WAKE FOREST L. REV. 541, 541-42 (1991) ("Developments in the 1980s and 1990s suggest another fundamental shift of authority from owners to managers."); Cary, *supra* note 9 (arguing that Delaware's statutory and judicial corporate law favors management and therefore encourages incorporation; however, it is harmful to shareholder welfare.); Goforth, *supra* note 9, at 1270 ("[S]tates which pander to the interests of management over shareholder concerns are likely to be more successful in attracting corporations.").

25 Bradley & Schipani, *supra* note 19, at 5. However, if statutes become too enabling, abuses are likely to occur and then the pendulum is likely to swing back with resurgence of mandatory provisions. *See* Mark J. Loewenstein, *A New Direction for State Corporate Codes*, 68 U. COLO. L. REV. 453, 457 (1997).

26 *See* M. Thomas Arnold, *Administrative Aspects of State Corporation Law*, 28 U. RICH. L. REV. 1 (1994); Bradley & Schipani, *supra* note 19, at 5 ("It is undoubtedly the case that both liability rules and market forces are important in constraining the behavior of corporate officials."); Hamilton, *supra* note 8, at1455 n.4 ("[A]lthough corporation law obviously does have contractual aspects, some regulation was necessary."); Robert R. Keatinge, *Corporations, Unincorporated Organizations, and Unincorporations: Check the Box and the Balkanization of Business Organizations*, 1 J. SMALL & EMERGING BUS. L. 201, 216 (1997) ("Organizational characteristics fall into two categories: those that are merely default rules which are subject to modification . . . and those that constitute mandatory rules that may not be modified . . . .").

B. *The Enabling Trend*

Over time business entity law has become more flexible.[27] In the competition for revenues generated by business formation, many states have amended existing and adopted new business entity law to make their laws more attractive to management.[28] Although mandatory rules still exist, as incorporation and reincorporation decisions are made by management, the revisions have shifted power to management.[29]

The evolution of the MBCA to the RMBCA is a particularly good example of this trend.[30] The American Bar Association drafted the MBCA to provide states

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> For a century, statutes dealing with the law of corporations have evolved toward greater flexibility. For example, states have steadily eroded restrictions on mergers, corporate activities, and variations on the corporate form by closely held firms. In addition, the 1980's and 1990's saw the rapid development and spread of antitakeover mechanisms. Recent developments concerning unincorporated firms also have permitted significantly greater flexibility and accommodation to the needs of individual firms.

Larry E. Ribstein, *Changing Statutory Forms*, 1 J. SMALL & EMERGING BUS. L. 11, 13-14 (1997).

28 "[T]hose amending the various statutory forms are driving all forms toward each other. The drafters are attempting to allow businesses to register under whatever title they need for external regulatory advantage, and at the same time, contract specifically for the internal form of organization they prefer." Dale A. Oesterle & Wayne M. Gazur, *What's in a Name?: An Argument for a Small Business "Limited Liability Entity" Statute (with Three Subsets of Default Rules)*, 32 WAKE FOREST L. REV. 101, 104 (1997).

29 *See* Brown, *supra* note 24, at 550 ("States had a financial incentive to encourage more companies to enter, while management had incentive to go where the restraints were the least. Limitations on management, therefore, continued to recede at the expense of shareholders."); Cary, *supra* note 9; Goforth, *supra* note 9.

30 The evolution of the Uniform Partnership Act ("UPA") to the Revised Uniform Partnership Act ("RUPA") and the Uniform Limited Partnership Act ("ULPA") to the Revised Uniform Limited Partnership Act ("RULPA") also reflects this enabling trend in business entity legislation. RUPA provides more specificity than its predecessor. For example, RUPA provides express fiduciary duty standards and conditions under which disassociation of a partner does not dissolve the partnership. *See* RUPA §§ 404, 601, 801 (1996). However, RUPA also "reflects the supremacy of the partnership agreement and minimizes mandatory rules among partners." Donald J. Weidner, *Three Policy Decisions Animate Revision of Uniform Partnership Act*, 46 BUS. LAW. 427, 428 (1991). RULPA also provides more specificity while increasing flexibility. The restrictions on the degree of control limited partners may exercise is a key example. ULPA provided a general limitation which was subject to judicial interpretation; however RULPA provides more specific limitations, which in fact increase flexibility because limited partners can ascertain the governing standard prior to acting. *Compare* UNIF. LTD. PARTNERSHIP ACT, § 7, 6A U.L.A. 336 (1916) *and* UNIF. LTD. PARTNERSHIP ACT § 303, 6A U.L.A. 144 (1976). *See also supra* note 7 and accompanying text.

with a guide to modern business standards for state law revision.[31] The MBCA was "a modern state act that preserve[d] in proper balance the interests of the state and the rights and interests of corporations, shareholders and management."[32] It combined sound principles of existing corporate law with new ideas that had been successfully incorporated in some states while eliminating obsolete principles which still existed in the corporate law of many states.[33] The MBCA was very influential in state law revisions.[34]

By 1984, however, there had been so many "areas in which state experimentation had produced significant simplifications and innovations which were appropriate for inclusion,"[35] that the MBCA was completely revised. The result was the RMBCA.[36] The changes were both structural and substantive.[37]

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31 *See* MODEL BUS. CORP. ACT. ANN. § 1, ¶ 2 (2d ed. 1971). The purpose of the MBCA is to provide "a convenient guide for revision of state business corporation law, embracing the interest of the state and the rights and interests of the corporation, shareholders and management." *Id.*; *see also* Ray Garrett, *History, Purpose and Summary of the Model Business Corporation Act*, 6 BUS. LAW. 1, 2 (1950). The MBCA was first published in 1950. It was based on the Illinois Business Corporation Act of 1933. It was drafted by the Committee on Corporate Law for the Section of Corporations, Banks, Business Law of the American Bar Association [hereinafter Committee on Corporate Law]. MODEL BUS. CORP. ACT ANN. §1, ¶ 2 (2d ed. 1971).

32 Garrett, *supra* note 31, at 7.

33 *Id.* at 2-3. The MBCA preserves shareholder rights including limited liability and the right to examine books and records. Discarded provisions include recording requirements, use of the corporate seal, residential qualifications for directors, requirement that meetings be held in the state, and many instances where the defense of *ultra vires* was previously available. *Id.* at 3.

34 The MBCA was the basis for corporate statutes in 23 states and the District of Columbia, and was used extensively in drafting the corporate law in nine states. MODEL BUS. CORP. ACT ANN. § 1, ¶ 2 (2d ed. 1971); MODEL BUS. CORP. ACT ANN. § 1, ¶ 2 (2d ed. Supp. 1977). Professor Hamilton notes, however, that a number of states have "gone it alone" including Delaware, California, New York, and Pennsylvania. Hamilton, *supra* note 8, at 1455 n.4.

35 1 MODEL BUS. CORP. ACT ANN., Introduction (3d ed. Supp. 1995).

36 The Model Nonprofit Corporation Act has also undergone substantial revision and was replaced by the Revised Model Nonprofit Corporation Act in 1987. *See* REV. MODEL NONPROFIT CORP. ACT (1988). A discussion of these revisions is beyond the scope of this Article. For more information on these revisions, see Lizabeth A. Moody, *The Who, What, and How of the Revised Model Nonprofit Corporation Act*, 16 N. KY. L. REV. 251 (1989).

37 1 MODEL BUS. CORP. ACT ANN., Introduction (3d ed. Supp. 1995). As discussed in more detail *infra*, the model act was reorganized and renumbered. Substantive changes included elimination of the traditional legal capital rules and artificial restrictions on classes of shares, revision of the shareholder derivative action rules, and the right to dissent. Additionally, provisions like an express

Whereas the MBCA was "a middle of the road statute . . . offering more than a modicum of shareholder protection,"[38] the RMBCA reflects a dramatic pro-corporate manager shift.[39] "[O]pinions will differ about whether the RMBCA pursues 'flexibility' and 'modernization' too aggressively, at the cost of 'shareholder protection.'"[40]

Despite the model acts, corporate law has not become uniform; the enabling trend is reflected to various degrees in different states' corporate statutes.[41] In our federal system, these differences give management an opportunity, by careful selection of the jurisdiction of incorporation, to avoid mandatory rules imposed by a state's legislature. Management may incorporate in whichever state provides the most advantageous law. Once incorporated, management may conduct interstate commerce, and may qualify as a foreign corporation in any state to conduct intrastate commerce.

C. *Evolving Spectrum of Business Entities*

As there are transaction costs associated with organizing a business in a state other than the state of primary activity, like the cost of qualifying as a foreign entity, organizers have strong incentives to organize in the "home" state.[42] Historically, the only option available to the organizers of a business seeking limited liability was incorporation. If the state's corporate law was undesirable, management would assess whether the benefits from incorporating in another state

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duty of care were added and shareholder inspection rights were expanded. *See infra* Part V.

38 *See* Douglas M. Branson, *Recent Changes to the Model Business Corporation Act: Death Knells for Main Street Corporation Law*, 72 NEB. L. REV. 258, 259 (1993).

39 *Id.* at 260. This is not surprising as the drafting committee is comprised predominantly of management oriented lawyers. *See* Hamilton, *supra* note 8, at 1458.

40 Hamilton, *supra* note 8, at 1468. The model act cannot be too extreme. "[I]f the [m]odel [a]ct goes too far ahead of the states' corporate bar thinking, the [a]ct will lose its effectiveness and be ignored." *Id.* at 1470.

41 *See* Mackerron, *supra* note 9, at 517 (analyzing the corporate laws of nine states, and concluding that "[n]o two of the nine statutes are exactly the same, suggesting that states do offer different variations of legal rules with respect to corporations."). There is a question of whether uniform corporate law would be good. While it would provide some advantages in interstate commerce, however, it might also retard development by squelching experimentation. *See* Oesterle & Gazur, *supra* note 28, at 107-08.

42 *See* Ian Ayres, *Judging Close Corporations in the Age of Statutes*, 70 WASH. U.L.Q. 365, 374-376 (1992).

outweighed the associated costs.[43] Today, the growing spectrum of business entities provides many more options. Rather than incorporate in another state, management may organize in another form in the home state. The result is the creation of a business entity with the desired characteristics (usually flow-through taxation and limited liability for owners), with reduced transaction costs, and without the undesirable restrictions in the state's corporate law.

When organizing economic activity, the organizers choose a form that, based on their specific circumstances, provides the most advantage. The decision

43 *See id.*

is based on an analysis of both tax and non-tax factors.[44] Traditionally, the available forms of business organizations were the sole proprietorship, the general and limited partnership, and the corporation. Although sole proprietorships are the

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[44] When organizing economic activity, the organizers choose the entity that provides the desired characteristics. Stereotypically, each business entity can be identified by particular default characteristics. Although many of the characteristics may be modified by agreement, the following chart presents a simplified representation of the default characteristics of each business entity:

Option - Characteristics	Sole Proprietorship	General Partnership	Limited Partnership	Limited Liability Partnership	Limited Liability Company	Corporation
Definition	Single individual owns and operates the business	Two or more persons carrying on as co-owners of a business for profit	A partnership with one or more general partners who manage the business and one or more limited partners who do not actively participate in management	A general partnership that provides some limited liability for partners	An entity that combines the characteristics of a partnership and a corporation	A separate legal entity that exists independently of its owners
Governing Law	No specific governing law	Revised Uniform Partnership Act	Revised Uniform Limited Partnership Act	Article 10 of the Revised Uniform Partnership Act.	Uniform Limited Liability Company Act	Revised Model Business Corporation Act
Creation	Conduct, no required formalities	Conduct, no required formalities	Filing & fee required	Filing & fee required	Filing & fee required	Filing & fee required
Owner Liability	Yes, owner has unlimited liability	Yes, partners have unlimited liability	General Partners have unlimited liability; however, Limited Partners have limited liability	Each partner has unlimited liability for his/her own actions, but limited liability with respect to the action of other partners	No, members have limited liability	No, shareholders have limited liability
Taxation	flow-through	election of partners	election of partners	election of partners	election of company	entity taxation unless elect Subchapter S status
Management Structure (owner managed or centralized management)	Owner manages	Partners manage unless agree otherwise	General Partners manage	Same as general partnership	Election of company in articles of organization, either member managed or manger managed	Centralized managers — Board of Directors and Officers
Transferability of ownership interest	Freely transferable	Limitations on transfer	Limitations on transfer	Same as general partnership	Limitations on transfer	Freely transferable
Perpetual of Existence	No, limited to life of sole proprietor	Yes	Yes	Same as general partnership	Yes	Yes

most prevalent mode of conducting business, corporations are a popular choice because they provide owners with both limited liability and the ability to take an active role in management.[45] Unfortunately there are drawbacks to the corporate form. It carries significant federal tax consequences, generally referred to as the double-tax.[46] Additionally, other regulations may restrict a business from operating in the corporate form.[47]

Over the past decade, in response to the needs of modern business, the spectrum of business entities expanded to include the Limited Liability Company ("LLC") and the Limited Liability Partnership ("LLP").[48] The LLC and LLP were viewed as panaceas. These new forms provide management with the ability to create an entity with flow-through taxation and limited liability. While these new

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45 According to the United States Bureau of the Census, in 1984 there were three million active corporations but thirteen million proprietorships. ROBERT CHARLES CLARK, CORPORATE LAW, 1 (1986). People function as sole proprietorships or partnerships because they require no start-up action or costs. "The principal advantage of a corporation has been the limited liability afforded to the owners of the corporation, that is, generally the shareholders of the corporation are not personally liable for the obligations of the corporation . . . ." MICHAEL A. BAMBERGERS & ARTHUR J. JACOBSON, STATE LIMITED LIABILITY COMPANY AND PARTNERSHIP LAWS § 1 (1998).

46 *See* John H. Matheson & Brent A. Olsen, *A Call for a Unified Business Organization Law*, 65 GEO. WASH. L. REV. 1, 10 (1996) ("Since its inception, the Internal Revenue Code . . . has imposed a two-tier structure of taxation on corporations while treating partnerships . . . as mere aggregations of their partners not separately taxable as a business entity."); William J. Rands, *Passthrough Entities and Their Unprincipled Differences Under Federal Tax Law*, 49 SMU L. REV. 15, 16 (1995) ("No one, of course, can ignore the federal income tax consequences of operating the business – too often they constitute the single greatest cost affecting the choice of form issue."). The exception, two-tier taxation, is the subchapter S election. A subchapter S corporation is taxed like a partnership; however, to qualify for this election, the corporation must satisfy the statutory restrictions. These restrictions were recently revised to be more liberal; however, they still limit the number and type of owners. *See* 26 U.S.C.A. § 1361 (Supp. 1998).

47 Professional associations often restrict members from limiting liability. For example, until 1992, the American Institute of Certified Public Accountants limited members to practice as proprietorships, partnerships, and professional corporations. *See* Robert R. Keatinge, et al., *Limited Liability Partnerships: The Next Step in the Evolution of the Unincorporated Business Organization*, 51 BUS. LAW. 147, 158 (1995). The *Model Rules of Professional Conduct* prohibit lawyers from prospectively restricting their liability. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.8(h) (1989). Additionally, state regulations may restrict operation in the corporate form. *See* Oesterle & Gazur, *supra* note 28, at 109-111.

48 *See* Keatinge, *supra* note 47 (stating that the growth was a response "to the needs of modern business"); Matheson & Olson, *supra* note 46, at 3 ("Many states boast over a half dozen separate statutes and codes governing the organization and operation of business entities."); Ribstein, *supra* note 27, at 12-13 (discussing rapid growth of LLC and LLP legislation).

business entity laws borrow from existing law, they provide organizers of business entities with more options than ever before.[49]

The most recent tax development in business entity law was the advent of the "check-the-box" regulations in January 1997.[50] Check-the-box permits unincorporated business entities to elect taxation as either a partnership or corporation without complying with the traditional formalistic rules.[51] These regulations have largely eliminated the tax factor from the entity selection decision, permitting organizers to focus on other, more specific, concerns.[52]

The development of check-the-box has also given rise to a new debate questioning whether the current array of business entity laws is necessary.[53] Some commentators argue that so many distinct statutes, each with its own default rules, creates a "hodge-podge of unwieldy, illogical, and even irrational legislation and decisions bristling with incoherence and inconsistencies."[54] Other commentators argue that different entity forms suit different businesses and that, tax and limited liability issues aside, these different entity laws have value.[55] Who is right? Only time will tell. Business entity law is in the midst of an era of evolution. It is

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49 *See* Keatinge, *supra* note 26 at 212-213 ("[B]usiness organization statutes . . . often borrow provisions from statutes governing another form of business organization. . . . many LLC statutes contain provisions borrowed from both traditional corporation and partnership statutes."); Ribstein, *supra* note 17, at 382 ("The efficiency of combining terms into coherent sets also explains why a separate business form . . . is more efficient than adapting the corporate form . . . ").

50 26 C.F.R. §§ 301.7701-1 to -3 (1996). The Internal Revenue Service adopted these regulations, effective January 1, 1997, to simplify the classification of business entities for tax purposes.

51 Check-the-box eliminates the traditional formalistic rules referred to as the "Kitner regulations." *See* 26 C.F.R. §§ 301.7701-2 (1996). The Kitner regulations provided that an entity would be taxed as a corporation if it possessed at least three of four distinguishing characteristics – continuity of life, centralized management, limited liability, and free transferability of interest.

52 *See* Keatinge, *supra* note 26, at 202.

53 *See* Symposium, *Check-the-Box and Beyond: The Future of Limited Liability Entities*, 52 BUS. LAW. 605 (1997). *See also* Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 Wake Forest L. Rev. 1 (1997).

54 Matheson & Olson, *supra* note 46, at 3.

55 *See* Keatinge, *supra* note 26, at 247; Ribstein, *supra* note 17, at 383 ("[T]here is an efficiency justification for a business association statute that is distinct from general partnership in providing for limited liability, and from other limited liability forms (i.e., corporation and limited partnership) in providing for direct member participation in management.").

interesting to note, however, that in spite of the expanding entity options, the corporation is still a dominant choice for new businesses.[56]

III. BUSINESS ENTITY LAW IN WEST VIRGINIA

A. *The Purpose of the Act*

West Virginia's corporate law derives from Article XI of the Constitution of West Virginia. Article XI section one of the constitution provides that "[t]he legislature shall provide for the organization of all corporations hereafter to be created, by general laws."[57] This approach to state incorporations was an alternative to the traditional approach of chartering corporations by special act.[58]

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56 *See* Keatinge, *supra* note 26, at 202. For a brief discussion of why corporations are still the dominant choice, see *infra* note 97 and accompanying text.

57 W. VA. CONST. art. XI, § 1. The West Virginia Constitution also mandates limited stockholder liability for corporate debt and cumulative voting for directors. *See id.* § 2 ("The stockholders of all corporations . . . shall be liable for the indebtedness of such corporations to the amount of their stock subscribed and unpaid, and no more."). This requirement has been codified in West Virginia Code section 31-1-89. *See* W. VA. CONST. art. XI, § 4 (amended 1958):

> [I]n all elections for directors or managers of incorporated companies, every stockholder holding stock having the right to vote for directors, shall have the right to vote, in person or by proxy, for the number of shares of stock owned by him, for as many persons as there are directors or managers to be elected, or to cumulate said shares, and give one candidate as many votes as the number of directors multiplied by the number of his shares of stock, shall equal, or to distribute them on the same principle among as many candidates as he shall think fit; and such directors or managers shall not be elected in any other manner.

Id.; W. VA. CODE § 31-1-89 (1996) (A shareholder "shall be under no obligation to the corporation or its creditors with respect to such shares other than the obligation to pay to the corporation the full consideration for which such shares were issued . . . ."). More recently, the West Virginia Constitution was amended to permit the issuance of more than one class of stock. *See* W. VA. CONST. art. XI, § 4 (amended 1958) ("[E]very corporation . . . shall have power to issue one or more classes and series within classes of stock . . . ."). This has been codified under West Virginia Code section 31-1-78. *See* W. VA. CODE § 31-7-78 (1996) ("[S]hares may be divided into one or more classes, any or all of which classes may consist of shares with par value or shares without par value, with such designations, preferences, limitations and relative rights as shall be stated in the articles of incorporation.").

58 *See* Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124, 143, n.46 (1994); Kirk, *supra* note 8, at 244.

Originally based on Virginia law, West Virginia corporate law provisions were scattered among multiple chapters relating to corporations.[59] Like most states' corporate law, the purpose of West Virginia's corporate law is to encourage incorporation in the state.[60] For a short period, just prior to the turn of the century, West Virginia was successful in its bid to attract incorporations.[61] However, by 1901, West Virginia lost its popularity.[62]

In 1930, the West Virginia Legislature adopted a restated code which revised, consolidated, and simplified West Virginia statutory law.[63] This was the first comprehensive revision to the state's corporate law.[64] The result was chapter thirty-one of the West Virginia Code, which eliminated obsolete provisions, and assembled the remaining provisions under proper headings in appropriate chapters.[65] All general provisions regarding the creation of a corporation were consolidated in a single chapter containing nine articles.[66]

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59 For example, in the West Virginia Code of 1868, chapter 52 addressed corporations generally, while chapters 53 and 54 regulated joint stock companies, and chapter 55 addressed incorporated associations other than joint stock companies. *See*, OFFICIAL CODE OF WEST VIRGINIA Report of the Revisers of the Code to the Governor at xi (1931).

60 Since the mid 1800s, states have been competing for corporate charters. *See* Liggett Co. v. Lee, 288 U.S. 517, 557-564 (1933).

61 From 1883 to 1888, West Virginia issued 330 charters to corporations that had their principal place of business elsewhere. Kirk, *supra* note 8, at 244.

62 *See Liggett* 288 U.S. at 557 n.34. Around 1901, West Virginia increased its annual tax. This may be attributable to the fact that, at some point, price cutting to attract incorporations becomes unprofitable. *Id.*

63 Adopted April 3, 1930, effective January 1, 1931. *See* OFFICIAL CODE OF WEST VIRGINIA Report of the Revisers of the Code to the Governor at xi (1931).

64 The revisions were based on the corporate statutes of Delaware, Maryland, Maine, Massachusetts, and Illinois. *Id.*

65 The revised code contains 63 chapters, in contrast to the then existing code which contained approximately 180 chapters. *See id.*

66 The restated code "consolidate[s] into one article all of the general provisions for chartering and organizing corporations for every purpose for which a corporation could be chartered or organized under existing laws." OFFICIAL CODE OF WEST VIRGINIA chapter 31, revisers' note at 776 (1931). This included business and charitable corporations. *Id.* Provisions applicable to specific types of corporations, like railroad companies and banking institutions comprise the subsequent eight articles. *See* OFFICIAL CODE OF WEST VIRGINIA chapter 31, art. 2-9 at 778-781 (1931).

The purpose of the revision was explicitly stated in the revisers' note. First, the legislature intended that the reorganization would promote more careful observance of the law.[67] Second, the legislature hoped to encourage businesses to incorporate in West Virginia and, as a result, generate additional revenue.[68] These are meritorious goals for the state corporate law and they comport with the general purpose of business entity law.[69] A statute, whatever its subject matter, cannot be effective if it is does not set forth the relative rights and duties in a clear manner such that affected parties know where they stand and the ramifications of their actions.[70] Certainty is a fundamental purpose of statutory law. A consolidated and simplified corporate law promotes this goal. Additionally, because it is easier to use, it encourages incorporation in the state, in turn promoting economic benefit in the state.

In the decades following this comprehensive revision, corporate law continued to evolve.[71] In light of the many changes, in 1972, the legislature formed The West Virginia Corporation Law Study Committee to review the state's corporate law. The study committee proposed a second comprehensive revision of the state's corporate law modeled on the MBCA and the Model Nonprofit Corporation Act.[72] The result was the Act -- a statute that deals with the organization of all corporation, business and nonprofit.

Unlike the 1930 restated code, the Act contains no express statement of purpose. Despite this omission, the logical inference is that the purpose of the Act remains unchanged. Like its predecessor, the purpose of the Act is to promote careful observance of the law and encourage incorporation in the state, thereby generating revenue. This inference is drawn from two facts. First, the Act contains no statement to the contrary. Second, the Act was modeled on the MBCA. As indicated above, the purpose of the MBCA was to promote better understanding and

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67 OFFICIAL CODE OF WEST VIRGINIA chapter 31, revisers' note at 776 (1931).

68 *Id.*

69 *See supra* Part II.A. Of course, state corporation law will only encourage incorporations if it is perceived favorably by the people making the incorporation decision, usually management.

70 *See supra* note 7 and accompanying text.

71 Many of these changes were chronicled in the MBCA. *See supra* notes 31-34 and accompanying text.

72 *See supra* note 3.

administration of corporate law.[73] As West Virginia modeled its law on the MBCA, it follows that it has the same purpose. This is particularly likely as the purpose is similar to the previously stated purpose of West Virginia corporate law. While silence alone is not particularly persuasive, when combined with the second fact, it supports the conclusion that the adoption of the Act did not change the purpose of West Virginia corporate law.

B. *Other Business Entity Law*

Although the Act has remained essentially static since its adoption,[74] West Virginia has maintained modern standards in all other business entity law. Unfortunately, like the Act, the statutes contain no statement of legislative purpose and there is no legislative history explaining the underlying intent. The logical inference is that, similar to the Act, modern business entity law has been adopted to encourage economic activity in the state.[75]

Generally, West Virginia's legislature adopts uniform business legislation promulgated by the National Conference of Commissioners on Uniform State Law ("NCCUSL").[76] When the NCCUSL revises a business entity statute, the legislature

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73 *See supra* notes 31-34 and accompanying text.

74 The Act, as originally adopted in 1974, was perceived to be flawed. Therefore, before becoming effective in 1975, the Act was submitted to the Special Committee to Study the Recodification of the Corporation Laws of West Virginia, established by the West Virginia State Bar, for review. *Corporations – A Survey of the Pending West Virginia Corporation Act, supra* note 3, at 50. Most of the amendments provided clarifications. *See* W. VA. CODE § 31-1-19 (1996) (adding "unless otherwise provided in the bylaws" as an introduction); W. VA. CODE § 31-1-36 (1996) (adding "by the shareholders or members"); W. VA. CODE § 31-1-46 (1996) (adding "and a certified copy" and "or recording"); W. VA. CODE § 31-1-48 (1996) (adding subsection (d) explaining what activities would not be considered to be transacting business in the state); W. VA. CODE § 31-1-109 (1996) (adding a requirement that any articles of amendment contain a statement of the name and address of the person who prepared it). Additionally there were some amendments to add fees and filing requirements. *See* W. VA. CODE § 31-1-15 (1996) (amended to provide for a two dollar filing fee); W. VA. CODE §§ 31-1-56a and 31-1-56b (1996) (added to require the filing of annual reports and the penalty for failure to comply).

75 *See supra* notes 14-17 and accompanying text.

76 The legislature's proclivity for adopting uniform law is not new. It is also not limited to business entity law. West Virginia has adopted 47 uniform laws. *See* ULA DIRECTORY OF UNIFORM ACTS & CODES TABLES-INDEX MASTERS EDITION (1997). Generally a state adopts uniform law because it thinks it will become uniform or because it thinks it is a "carefully drafted, well reasoned proposal." Larry E. Ribstein, *A Critique of the Uniform Limited Liability Company Act*, 25 STETSON L. REV. 311, 315 (1995).

The importance of uniform business law is well recognized. In *Swift v. Tyson*, Justice Story follows suit and revises the appropriate West Virginia business entity law. Like the MBCA and RMBCA, uniform law is designed to provide states with a well-developed body of law on a particular subject matter while substantially reducing the transaction costs generally associated with drafting and interpreting a new statute.[77] Although the state clearly reaps benefits from adopting uniform law, there are also associated costs.

Wholesale adoption of uniform business entity law reduces the transaction costs associated with adopting a new statute, but the policy decisions underlying the various provisions may not be appropriate for West Virginia.[78] West Virginia is not perceived as a commercial state.[79] The balance among owners, managers and third parties may not be the same as the balance in a more commercially oriented state.[80] Additionally, the legislature cannot adopt or revise business entity law in a vacuum.

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explained that a uniform national law, particularly in the commercial arena would permit a person in one state to know the ramifications of his actions in another state. *See* Swift v. Tyson, 41 U.S. 1, 19 (1842), *overruled by* Erie R. Co. v. Tompkins, 304 U.S. 64 (1938). In other words, uniform laws facilitate interstate commerce. *See* WALTER P. ARMSTRONG, A CENTURY OF SERVICE: A CENTENNIAL HISTORY OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAW 13 (1991).

77 Uniform laws are an amalgamation of laws derived from the experiences in various states. They provide states with statutes which have been tested by use. *See* Fred H. Miller, *The Future of Uniform State Legislation in the Private Law Area*, 79 MINN. L. REV. 861, 867 n.23 (1995). However, unlike uniform laws, neither the MBCA nor the RMBCA seeks uniform acceptance. They are intended as guidelines for incremental improvements. *See* Hamilton, *supra* note 8, at 1470.

78 Policy choices underlying uniform laws are not always adequately disclosed. *See* Miller, *supra* note 76, at 875. Additionally, all interests may not be represented in the drafting process. *See id.* at 873. For example, the RMBCA was drafted by a committee comprised of predominantly management oriented lawyers and the result was a pro-management statute. *See supra* notes 38-39 and accompanying text.

79 Gordon, *supra* note 58, at 148, 165. West Virginia corporations are predominantly closely held. There are less than twenty publicly traded corporation that are incorporated in West Virginia. Of these corporations, one is traded on the New York Stock Exchange, another is traded on the American Stock Exchange and the remainder are traded in the over-the-counter market. Briefly, around the turn of the century, West Virginia was successful in its bid to attract incorporations. *See supra* notes 61-62 and accompanying text.

80 West Virginia, on occasion, has deviated from uniform law to protect public policy issues. For example, when adopting revised article 4 of the Uniform Commercial Code, which is a pro-bank statute, the legislature revised some provisions to protect consumers.

The legislature must remain alert to the effect that changes to one statute have on other statutes.[81]

In 1953, West Virginia adopted the Uniform Partnership Act,[82] and the Uniform Limited Partnership Act.[83] In 1981, the legislature adopted the Revised Uniform Limited Partnership Act (1976),[84] and when the NCCUSL again revised the limited partnership law in 1985 and 1986, the legislature adopted these modifications.[85] West Virginia was also among the first states to adopt the Revised Uniform Partnership Act when the NCCUSL promulgated it in 1995.[86]

In 1992, West Virginia expanded the available business entity options by adopting legislation authorizing LLCs.[87] As there is no legislative history, it is

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81 For example, the adoption of RUPA creates serious problems for the state's limited partnerships. RULPA provides that the Uniform Partnership Act governs any cases not provided for in the limited partnership statute, expressly referring to West Virginia Code section 47-8A-1. *See* W. VA. CODE § 47-9-63 (1996). However, when the legislature adopted RUPA, it repealed the UPA. *See infra* notes 82 and 86 and accompanying text. The limited partnership statute is now ambiguous. Does it refer to the repealed UPA or RUPA? If it refers to RUPA, there is the additional problem that RUPA expressly excludes limited partnerships from its scope. *See* W. VA. CODE § 47B-2-2(b) (1996). For a detailed discussion of the problem and the various solutions, see Allan W. Vestal, *A Comprehensive Uniform Limited Partnership Act? The Time Has Come,* 28 U.C. DAVIS L. REV. 1195 (1995).

82 1953 W. Va. Acts 139 (repealed 1995).

83 1953 W. Va. Acts 140.

84 *See* 1981 W. Va. Acts 208.

85 *See* 1984 W. Va. Acts 41; 1984 W. Va. Acts 160; 1984 W. Va. Acts 167.

86 After more than seventy years, the Business Law Section of the American Bar Association determined it was time to review the UPA. The report recommended extensive revisions. *See* Uniform Partnership Act Revision Subcommittee of the Committee on Partnerships and Unincorporated Business Organizations, *Should the Uniform Partnership Be Revised?*, 43 BUS. LAW. 121 (1987). The result was the Revised Uniform Partnership Act ("RUPA") (1994). *See* REV. UNIF. PARTNERSHIP ACT, 6A U.L.A. 1-124 (1995). West Virginia is one of twelve states to adopt RUPA. *See id.* at 6 U.L.A. 1 (Supp. 1997). RUPA moves away from the aggregate theory toward the entity theory, rewrites the rules on dissolution to provide more stability, minimizes mandatory rules among partners, and stresses the preeminence of the partnership agreement. *See* Weidner, *supra* note 30.

87 *See* W. VA. CODE §§ 31-1A-1 to -69 (repealed 1995). West Virginia was one of the first states to adopt LLC legislation. *See* Mary Elizabeth Matthews, *The Arkansas Limited Liability Company: A New Business Entity is Born,* 46 ARK. L. REV. 791, 798 n.39 (1994) (placing West Virginia among the first 18 states to enact LLC legislation); Ann Maxey, *West Virginia's Limited Liability Company Act: Problems with the Act,* 96 W. VA. L. REV. 905, 906 (1994) (stating that West Virginia was the thirteenth state to adopt LLC legislation); Goforth, *supra* note 9, at 1228 (stating that West Virginia was the ninth state to adopt LLC legislation).

difficult to be certain of its goal. However, this new legislation appears to have been motivated by a desire to enhance economic development.[88] As there was no uniform LLC law at that time of adoption, the legislation, drafted by Jackson & Kelly, was based loosely on Virginia's LLC statute.[89] There were concerns about the original statute.[90] In 1996, the legislature repealed its LLC act and replaced it with the Uniform Limited Liability Company Act ("ULLCA").[91] While revising the West Virginia LLC statute was a good decision, it is not clear that wholesale adoption of the ULLCA was the best choice.[92]

At the same time it revised the LLC statute, the legislature also created a fifth business entity option; the LLP.[93] As there was no uniform law available for

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88 *See supra* note 17. The LLC provided formerly unattainable flexibility for the organizers of business – a hybrid entity that gave members limited liability and flow-through taxation. *See supra* note 44. *See also* Larry E. Ribstein, *The Emergence of the Limited Liability Company*, 51 BUS. LAW. 1, 2-3 (1995). The perception was that LLCs would help the state to attract and retain small businesses. *See* Goforth, *supra* note 9, at 1228. Additionally, foreign LLCs conducting business in the state were eager to ensure recognition of their limited liability status. *See* Johnson, *supra* note 11 at 277; Kozyris, *supra* note 11, at 540. Most LLC statutes include an internal affairs provision for foreign LLCs. *See supra* note 11 and accompanying text; *infra* note 111 and accompanying text.

89 *See* Goforth, *supra* note 9, at 1228.

90 *See* Maxey, *supra* note 87. Concerns included the fact that members were "not treated on parity with West Virginia shareholders or limited partners." *Id.* at 967. Members also lacked the protection of indemnification and a mechanism by which they could bring a derivative action. *Id.* at 968. Additionally, there was no statute of limitations to cut off creditors' claims. *Id.*

91 The NCCUSL promulgated the ULLCA in 1994; however, it has been subsequently revised. *See* UNIF. LTD. LIABILITY CO. ACT, 6A U.L.A. 429-508 (1995). West Virginia adopted the ULLCA in March 1996. *See* W. VA. CODE §§ 31B-1-101 to -13-1306 (1996).

92 Professor Ribstein concludes that the "ULLCA is not even a suitable model for future LLC legislation. ULLCA makes many poor policy choices, including terms that are unsuited for informal firms, unnecessary mandatory rules, and rules that are inappropriately borrowed from other business forms. The drafting is often convoluted, complex and otherwise inept." Ribstein, *supra* note 76, at 387. The ABA concurs with Professor Ribstein that "no state should rush to scrap its current law to adopt this one." *Id.* Professor Maxey suggested that the state form a committee to investigate whether the ULLCA would meet the needs of West Virginia business persons. Maxey, *supra* note 87, at 969 n.185. However, the state did not follow this sound advice.

93 The LLP is governed by an additional new article inserted into the state's partnership act. *See* W. VA. CODE § 47B-10-1 to -5 (1996).

adoption at that time, the legislature loosely relied on Texas Limited Liability Partnership law.[94]

It is not clear whether revising existing and creating new business entity law has helped West Virginia attract businesses from other states to organize under West Virginia law. My impression is that, overall, the state has not been successful. Although revenues in 1997 and subsequent years will probably increase, this is probably attributable to the recent increase in the fee schedule.[95]

Although the new business entities have been well received, they have in no way replaced the corporation. While the exact number of LLCs and LLPs is not readily available, many have been formed. This has not, however, significantly changed the number of corporations formed in the state each year.[96] There are many reasons why corporations are still a dominant choice of entity. Aside from general inertia, many existing corporations could not convert without serious tax ramifications, and some business people have expressed scepticism and concerns about forming new entities with as yet unknown statutory interpretation.[97] Therefore, the question remains, why has the Act stagnated when all other business entity law has been kept current?

IV. WHY THE ACT HAS STAGNATED

The answer to this question lies in the legislative process. When adopted, statutes represent the legislative majority view of the best means of dealing with a situation based on current needs. However, as time passes, situations change, and

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94 Uniform law was subsequently promulgated by the NCCUSL. It is found in RUPA. *See* UNIF. PARTNERHSHIP ACT (1994) with 1996 Amendments constituting the UNIF. LTD. LIABILITY PARTNERSHIP ACT, 6 U.L.A. 8 (Supp. 1997).

95 Increased fees went into effect in July 1997. *See supra* note 14.

96 The Secretary of State was unable to provide the number of LLCs and LLPs that have been formed; however, anecdotal evidence supports this assertion. With respect to incorporation in West Virginia, in 1990, 2542 corporations were formed; in 1991, 2219 corporations were formed; in 1992, 2236 corporations were formed; in 1993, 2406 corporations were formed; in 1994, 2326 corporations were formed; in 1995, 2535 corporations were formed; and in 1996, 2380 corporations were formed. Dunn & Bradstreet Corporation, *New Businesses and Corporations*, 32-38 CURRENT ECONOMIC INDICATOR 12 (1990-1996).

97 *See* Keatinge, *supra* note 26, at 233-241; Symposium, *supra* note 53, at 623-627.

the changed circumstances are not reflected in the existing statutes.[98] As Professor Gilmore noted, "getting a statute enacted in the first place is much easier than getting the statute revised so that it will make sense in the light of changed conditions."[99]

To undertake revision of a statute, the potential gain must outweigh the transaction costs.[100] Professor Eisenberg offers two reasons why statutory revisions have been slow to occur in the corporate arena.[101] First, there is limited incentive to lobby for revision of any single state's archaic corporate law.[102] The corporate internal affairs rule, combined with a corporation's ability to incorporate in one state and transact business in other states, eliminates the incentive to lobby for revision of any single state's archaic corporate law.[103] Second, corporate law is comprised of non-neutral rules, rules which predictably and systematically promote the interest of a particular class – shareholder, management, and in some cases, creditors. Revising non-neutral rules affects the relative rights of these classes. Such a revision raises interest group and information problems.[104] If all the classes were well organized, they would lobby the legislature, and the decision would be one of political power. However, when one of the classes is not well organized the system does not function as well. If the injured class is not organized, it cannot bring the information before the legislature, and the legislature is unlikely to raise the issue itself.[105]

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98 *See* GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 5-6 (1982). "A well drafted statute will deal sensibly with the issues which have come into litigation during the twenty or twenty-five years which preceded the drafting. However, the focus of litigation has a way of shifting unexpectedly and unpredictably." GRANT GILMORE, THE AGES OF AMERICAN LAW 96 (1977).

99 GILMORE, *supra* note 98, at 95.

100 Transaction costs are costs associated with the process of creating and implementing a new law. *See supra* note 76 and accompanying text.

101 Melvin Aron Eisenberg, *The Modernization of Corporate Law: An Essay for Bill Cary*, 37 U. MIAMI L. REV. 187 (1983).

102 *Id.* at 188.

103 *Id.* If the cost of avoiding the rule is less than the cost of revising the rule, there is no rational reason for a state to undertake the cost of revision.

104 *Id.* at 189-90.

105 *Id.* at 190.

The Act is a perfect example. When adopted, the Act reflected modern standards for corporations. In the interim, significant developments in corporate law have not been reflected in the Act. If these changes are appropriate for West Virginia, revising the Act seems the obvious solution. However, revising the Act involves transaction costs, not only to the legislature, but also to the corporate bar and the people who use the corporate law, namely shareholders and management. Probable transaction costs include time and money that would need to be allocated to draft and learn the revised law. These transaction costs must be balanced against the benefits expected from the revisions. Expected benefits would be increased revenue, and possible increased flexibility.

Although some provisions of the Act may be disadvantageous to management,[106] as a class, management has little incentive to seek revision. In accordance with Professor Eisenberg's first reason, rather than incur the transaction costs involved in revising the Act, management will incorporate in another state and qualify the corporation as a foreign entity in West Virginia. Under the corporate internal affairs rule, corporate matters will be governed by the more attractive laws of the state of incorporation. Alternatively, management may form a different entity which provides substantially similar characteristics within West Virginia.

On the other hand, some provisions of the Act are disadvantageous to shareholders.[107] As shareholders as a class do not control incorporation decisions, they have more incentive to seek revision. However, shareholders have not lobbied to revise the Act. In accordance with Professor Eisenberg's second reason, shareholders are not generally a well-organized constituency and do not efficiently bring issues to the legislature.

Additionally, as there are no West Virginia representatives serving on the Committee on Corporate Law which promulgates the RMBCA, the West Virginia Legislature is likely unaware of many of the revisions that have been made to the model corporate law. Unless the problem is placed effectively before the legislature, there is no impetus for the legislature to undertake the transaction costs associated with revision. Consequently, the Act remains stagnant.[108]

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106 For example, the legal capital rules are archaic and restrict management; mandatory cumulative voting limits management entrenchment; and the lack of an express duty of care leaves management without appropriate guidelines. *See infra* Part V.B.1, 2, & 4.

107 For example, the events that trigger a shareholder's right to dissent are not sufficiently broad. *See infra* Part V.B.3.

108 "[A]lthough an area of statutory corporate law has become badly outmoded in a manner that has an unsound impact . . . the problem is not effectively brought to the legislature's attention." Eisenberg, *supra* note 101, at 191. The result is that the "legislature may fail to make needed changes to modernize its corporate law." *Id.*

The remaining question, then, is why have other West Virginia business entity laws been so successfully adopted and revised. New business entity law has been successfully adopted because, as Professor Gilmore indicated, it is much easier to adopt a new statute than revise an old one.[109] Additionally, West Virginia professional groups, like lawyers and accountants, actively lobbied for the adoption and revision of LLC legislation and the adoption of LLP legislation because these statutes provided them with some limited liability protection, which might otherwise have not been available.[110] LLCs and LLPs formed outside of West Virginia that sought to do business in the state were concerned that they might not be accorded limited liability status in West Virginia. Eager for legislative recognition of their limited liability status, they lobbied the legislature to adopt LLC and LLP provisions which recognized foreign LLCs and LLPs.[111]

West Virginia partnership law and limited partnership law have been successfully revised for two reasons. One reason is the availability of information. West Virginia regularly adopts modernized uniform legislation because the legislature is aware of the revisions and their importance. The legislature is aware of these changes because West Virginia has two active commissioners serving on the NCCUSL.[112] Additionally, articles, like Professor Ann Maxey's analysis of the state's original LLC legislation, provided the legislature with the necessary information to act.[113] The second reason these laws have been successfully revised is because a particular constituency, often the bar, has viewed the value of revision

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109 *See* GILMORE, *supra* note 98.

110 *See* Gary W. Derrick, *Oklahoma Limited Liability Companies and Limited Liability Partnerships*, 22 OKLA. CITY U. L. REV. 643, 669 (1997) ("The American Institute of Certified Public Accountants undertook a nation-wide lobbying effort to secure passage of LLP legislation."); Goforth, *supra* note 9, at 1274 (1995) ("In addition to attorneys, business groups such as local Chambers of Commerce were also supportive of LLC legislation . . . . professional associations, particularly Certified Public Accountants' groups, supported LLC legislation."); Oesterle & Gazur, *supra* note 28, at 105 ("The LLC was propelled through legislatures by a force of accountants, tax lawyers and business development lobbies"). It also provided potential revenue. *See* Goforth, *supra* note 9, at 1272-74.

111 If a state did not recognize foreign. entities and did not provide that these entities are governed by the state of their creation, courts would likely treat them as partnerships. This would undercut the desired characteristic of owner limited liability. *See* Johnson, *supra* note 11, at 277-78; Kozyris, *supra* note 11, at 565.

112 The current commissioners from West Virginia are Richard E. Ford, John L. McClaugherty, and Frederick P. Stamp, Jr.

113 *See* Maxey, *supra* note 87.

as greater than the transaction costs, and therefore has effectively lobbied for the change.

V. IS IT "BROKE"?

I now turn to analyze whether the structure and substance of the Act further the purpose of the Act. I examine the structure of the Act in light of modern legislative drafting conventions, and I compare it to the structure of contemporary corporate law and other business entity law. I examine the substance of the Act by comparing selected provisions of the Act to contemporary corporate law and other business entity law. For modern legislative drafting conventions, I refer to the Drafting Rules for Uniform or Model Acts (the "Drafting Rules") approved by the NCCUSL.[114] For corporate law, I compare the Act to the RMBCA.[115] For other business entity law, I compare the Act to the other West Virginia business entity laws.

A. Structure of the Act

"The principal functions of an [a]ct are (i) to create or establish, (ii) to impose a duty or obligation, (iii) to confer a power, create a right, or grant a privilege, and (iv) to prohibit."[116] The Act is a series of non-neutral rules that sets forth the relative rights and duties of corporations in West Virginia.[117] To be effective, the Act must set forth these rights and duties in a manner that can be understood, such that management, shareholders, and third parties know where they stand and the ramifications of their actions.[118]

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114 *Drafting Rules for Uniform or Model Acts*, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAW AND PROCEEDINGS, 421-438 (1989) [hereinafter *Drafting Rules*].

115 I use the RMBCA as a guideline of modern business corporate law for two reasons. First, West Virginia based the Act on the MBCA. *See supra* note 3 and accompanying text. Second, the RMBCA reflects many of the changes that have occurred and become widely accepted in corporate law. *See supra* notes 30-40 and accompanying text.

116 *Drafting Rules*, *supra* note 114, at 421.

117 *See* LAWRENCE E. FILSON, THE LEGISLATIVE DRAFTER'S DESK REFERENCE 87 (1992). Statutes are "the crystallization and expression in definitive form of a legal right, privilege, function, duty, status or disposition." *Id.* To be effective, they must "inform the intended audience." *Id.*

118 *See supra* note 7 and accompanying text.

The structure of the Act is important in advancing this end. To be effective, the Act "must be cast in language that is clear, consistent, legally effective, technically sound, administrable, enforceable, and constitutional; is correct in form and style; and is as readable and aesthetically pleasing as possible."[119] Historically the legislature recognized this necessity. Reorganization of the code to create a law more easily followed was a stated purpose for the 1930 revision.[120] Today, in light of current drafting conventions, and in comparison to other statutes, the structure of the Act is not ideal.

1. Organizational Matters

The Act, which is divided into four parts, combines business and nonprofit provisions in the same article.[121] This creates a disjointed statute that is difficult to use and likely to cause confusion. For example, if management or shareholders want to voluntarily dissolve a business corporation the relevant provisions are scattered throughout both the general provisions and the business corporation provisions.[122] Similarly, if management or shareholders want to amend the articles of incorporation or merge into another corporation, the relevant provisions are distributed between the general provisions and the business corporations

119 FILSON, *supra* note 117, at 8. ("The essentials of good bill drafting are accuracy, brevity, clarity and simplicity."); *Drafting Rules*, *supra* note 114, at 421-430.

120 *See supra* note 67 and accompanying text.

121 Part I deals with introductory issues, like construction, scope of application, and severability. W. VA. CODE §§ 31-1-1 to -5 (1996). Part II deals with corporations generally. W. VA. CODE §§ 31-1-6 to -76a (1996). Part III deals with business corporations. W. VA. CODE §§ 31-1-77 to -135 (1996). Part IV deals with nonprofit corporations. W. VA. CODE §§ 31-1-136 to -158 (1996).

122 Among the general provisions of Part II, W. VA. CODE § 31-1-39 (1996), sets forth the required contents of the articles of dissolution, W. VA. CODE § 31-1-40 (1996), addresses filing the articles of dissolution and the certificate of dissolution, W. VA. CODE § 31-1-48 (1996), articulates the effect of dissolution, including survival of remedy, and W. VA. CODE § 31-1-61 (1996), sets forth the requirement of a tax certificate in order to dissolve. Among the business corporation provisions of Part III, W. VA. CODE § 31-1-124 to -126 (1996), provide the means for voluntary dissolution by incorporators, shareholders and the corporation, W. VA. CODE § 31-1-127 to -129 (1996), set forth the requirements and effect of the statement of intent to dissolve, which is distinct from the certificate of dissolution, and W. VA. CODE § 31-1-130 to -133 (1996), provide for revocation of voluntary dissolution proceedings.

provisions.[123] A business corporation needs to delve through two parts of the Act to ascertain all applicable statutory law on any given issue. Additionally, the business corporation must be wary of inadvertently applying a nonprofit corporation provision.

Other than the changes required by the combination of the business and nonprofit corporations in the same article, the organization of the Act substantially parallels the organization of the MBCA. In comparison to modern drafting conventions, this organization is substandard. The only subdivisions delineated in the Act are the four parts.[124] Related provisions are not consistently grouped together.[125] There are no topic headings and subheadings to help identify related provisions. Additionally, the numbering style among the various provisions is inconsistent; some provisions use an outlining format, while others simply use a paragraph format.[126]

The limited ad hoc changes which have been made to the Act have left it even more disjointed.[127] While the changes have instituted valuable modern policies, and corrected some problems,[128] these piecemeal revisions have created

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123 With respect to amendment of the articles of incorporation, W. VA. CODE § 31-1-31 to -33 (1996), address filing requirements and effect of amending the articles and W. VA. CODE § 31-1-106 to -111 (1996), address the procedures for, and form of, amendments. With respect to mergers or consolidation, W. VA. CODE § 31-1-34 to -38 (1996), address the procedures for merger or consolidation and W. VA. CODE § 31-1-117 to -119 (1996), deal with the required approval, the articles of merger or consolidation, and subsidiary mergers.

124 *See supra* note 121.

125 *See supra* notes 122-123 and accompanying text.

126 *Compare* W. VA. CODE § 31-1-28 (1996) (provision for filing of articles of incorporation which denotes subsections in paragraphs with (a) and (b)) *and* W. VA. CODE § 31-1-33 (1996) (provision for filing of restated articles of incorporation which does not use any outlining, only paragraphs).

127 The revisers' note to chapter 31 of the 1931 Official Code of West Virginia points out that the prior code was "made up of many different acts of the legislature passed at different times since the organization of the state, and much duplication of needless matter necessarily arises from the manner in which these statutes originated." OFFICIAL CODE OF WEST VIRGINIA chapter 31 revisers' note at 776 (1931). In support of her suggestion to adopt a new limited liability statute, Professor Maxey points out that ad hoc amendments often create ambiguities. Maxey, *supra* note 87, at 969.

128 For example, West Virginia Code section 31-1-73, was amended in 1989 to add a subsection permitting meetings by conference call or similar electronic communications. *See* W. VA. CODE § 31-1-73 (1996). Additionally, West Virginia Code section 31-1-25 was repealed because it duplicated section 31-1-73; and section 31-1-97, relating to directors' conflict of interest, was moved from Part III where it was applicable only to business corporations to section 31-1-25, in Part II where it is now

inconsistencies. For example, in 1992, the provision permitting business corporations to limit or deny preemptive rights, and the provision requiring corporations to file annual reports, were repealed.[129] However, conforming changes were not made and references to these repealed provision were not deleted from remaining provisions.[130]

Modern drafting conventions assert that a statute should be arranged "rigorously and systematically."[131] A statute should be "as clear and accurate as possible, with the relationship between the main and subordinate ideas made readily apparent, and the subjects to be covered are arranged so that they can be found, understood, and referred to with the least possible effort."[132]

The 1930 revision consolidated all general provisions for chartering and organizing corporations, business or non-profit, in a single article. The revisers saw no reason to have different proceedings for corporate organization. The intent was to provide a consolidated and simplified statute that would, because it was easy to use, promote careful observance and encourage businesses to incorporate in West Virginia.[133] The Act continued this practice.[134] From the legislature's perspective, combining the general provisions for business and nonprofit corporations in the same article is efficient. This consolidation permits the legislature to set forth the requirements applicable to all corporations, like organizational and filing rules, only once. While historically this may have been a desirable organization, today it is not.

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applicable to all corporations. *See* W. VA. CODE §§ 31-1-25, -72, -97 (1996).

129 *See* W. VA. CODE § 31-1-90 (repealed 1992);W. VA. CODE § 31-1-27 (1996). The repeal of section 31-1-90 was logical because it was duplicative. West Virginia Code section 31-1-27(b)(4), provides " (b) . . . the articles of incorporation shall set forth : "(4) Any provisions limiting or denying to shareholders the preemptive right to acquire additional unissued or treasury shares of the corporation." W. VA. CODE § 31-1-27 (1996). *See also* W. VA. CODE § 31-1-56a (repealed 1992) (annual reports).

130 *See* W. VA. CODE § 31-1-84 ("Subject to the provisions of section ninety [W. VA. CODE § 31-1-90 (1996)] of this article . . . "); W. VA. CODE §§ 31-1-56(b) to -62 (referring to section 31-1-56a providing possible penalties for failure to file the once required annual report).

131 REED DICKERSON, THE FUNDAMENTALS OF LEGAL DRAFTING 16 (2d ed. 1986).

132 FILSON, *supra* note 117, at 59.

133 *See supra* notes 63-70 and accompanying text.

134 *See supra* Part III.A.

According to modern drafting conventions, subdivisions and heading designations promote clarity and precision, thereby making the statute easier to understand.[135] According to Rule 24 of the Drafting Rules, a statute should be organized "in the most useful and logical format for the reader."[136] Sections dealing with a common subject should be grouped together.[137] Headings should inform the user of the contents of the provision.[138] Numbering schemes should be consistent. These may seem to be simple stylistic matters; however, they are important because they affect readability.[139]

While initially the organization of the MBCA was deemed "the best that can be devised,"[140] over time, the organization of the MBCA was found to be "not entirely logical"[141] In particular, the piecemeal revisions to the MBCA over many years had caused some drafting inconsistencies, and the ordering of sections was not optimal. When the MBCA was revised in 1984, the drafters reorganized the provisions, grouping related provisions together, and arranging the groups in a logical order with appropriate chapter and subchapter headings.[142] By conforming to some simple statutory drafting rules, particularly with respect to formatting, the RMBCA became a much more user-friendly statute. For example, in the RMBCA, all provisions relating to dissolution are now found in chapter 14; all provisions relating to voluntary dissolution are grouped together in subchapter A, while provisions relating to administrative dissolution are grouped together in subchapter B and provisions relating to judicial dissolution are grouped together in subchapter

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135 FILSON, *supra* note 117, at 220.

136 *Drafting Rules*, *supra* note 114, at 428.

137 *Id.*

138 *See* DICKERSON, *supra* note 131, at 190; FILSON, *supra* note 117, at 226.

139 DICKERSON, *supra* note 131, at 190 (noting that topic headings are a neglected device for making a statute more readable).

140 Garrett, *supra* note 31.

141 1 MODEL BUS. CORP. ACT ANN. Introduction (3d ed. Supp. 1995).

142 *See* 1 MODEL BUS. CORP. ACT ANN. Introduction (3d ed. Supp. 1995). As the MBCA never combined business and nonprofit provisions in the same article, the confusion created in the Act was never a concern.

C.[143] The same is true for the provisions relating to merger or consolidation which are grouped together in chapter 11. The new organization, with descriptive subheadings and consistent numbering within sections, vastly simplifies finding provisions.

As West Virginia generally adopts uniform law, on the whole, its other business entity laws conform to modern legal drafting conventions. Related provisions are grouped together in articles under appropriate headings. For example, West Virginia's LLC statute groups related provisions together in thirteen articles, each of which has a descriptive heading.[144] The same is true of West Virginia's partnership statute, which is broken down into eleven articles, each with a descriptive heading.[145] These statutes also utilize a consistent numbering style.

The current organization of the Act is difficult to work with. The scattering of related provisions among the various parts is likely to cause confusion. A confusing statute neither promotes careful observance of the law, nor encourages businesses to incorporate in the state. Therefore, it does not further the purpose of the Act. If a user is not certain that he has found all the relevant provisions, then, contrary to its purpose, the Act does not promote careful observance of the law. Although those who have mastered the Act are unlikely to have difficulty, the current structure imposes a barrier on the unsophisticated business person seeking to incorporate. It also imposes a barrier on the new attorney, and the out-of-state attorney who is unfamiliar with the Act. Rather than incur the cost of learning the Act, they may, instead, incorporate elsewhere. In the end, the current structure of the Act discourages incorporation in the state.

143 *See* 3 MODEL BUS. CORP. ACT ANN. § 14 (3d ed. Supp. 1995). This is also true of chapter 10, amendments, which is divided into subchapter A for amendments to the articles of incorporation and subchapter B for amendments to the bylaws, and chapter 13 on dissenters' rights which is divided into three subchapters; A, the right to dissent, B, procedure for dissent and C, judicial appraisal.

144 *See* W. VA. CODE chapter 31B (1996). The chapter's articles include the following: Article 1. General Provisions; Article 2. Organization; Article 3. Relations of Members and Managers to Persons Dealing with LLC; Article 4. Relations of Members to Each Other and to LLC; Article 5. Transferees and Creditors of Member; Article 6. Member's Dissociation; Article 7. Member's Dissociation When Business Not Wound Up; Article 8. Winding Up Company's Business; Article 9. Conversions and Mergers; Article 10. Foreign LLCs; Article 11. Derivative Actions; Article 12. Miscellaneous Provisions; Article 13. Professional LLCs.

145 *See* W. VA. CODE chapter 47B (1996). The chapter's articles include the following: Article 1. General Provisions; Article 2. Nature of Partnership; Article 3. Relations of Partners to Persons Dealing with Partnership; Article 4. Relations of Partners to Each Other and to Partnership; Article 5. Transferees and Creditors of Partner; Article 6. Partner's Dissociation; Article 7. Partner's Dissociation when Business Not Wound Up; Article 8. Winding Up Partnership Business; Article 9. Conversions and Mergers; Article 10. LLPs; Article 11. Miscellaneous Provisions.

The solution is simple. First, separate the business and nonprofit provisions; revise the Act to deal solely with business corporations and create a new act to govern nonprofit corporations. Then, redraft the Act in accordance with modern drafting conventions. If the Act were reorganized so that like provisions were grouped together under appropriate subheadings, using a consistent outline format, substantial confusion would be eliminated. Even where there are no substantive changes, these drafting revisions would produce a clearer, more readable and more useable statute, and therefore, be more likely to further the purpose of the Act.

2. Consistency of Word Choice

The Act contains three different definitions of "corporation." In parts I and II, "corporation" is defined as a business corporation or a nonprofit corporation.[146] However in part III, "corporation" is defined exclusively as a business corporation; and in part IV, "corporation" is defined exclusively as a nonprofit corporation.[147] When referencing the Act, if a user is not focused on the particular part of the Act, she could easily misconstrue a provision by applying the wrong definition of a "corporation."

Consistency is also imperative in word choice; in fact, it is the golden rule of drafting.[148] Rule five of The Drafting Rules for the National Conference of Commissioners on Uniform State Laws states that the drafter should "[b]e consistent in the use of language throughout the Act."[149] Consistency in terminology affects substantive clarity. The comment to the Drafting Rules explains that the consistency in terminology prevents "different interpretations of similar provisions."[150] Consistency requires that a drafter should never change her

146 *See* W. VA. CODE §31-1-6(f) (1996).

147 *See* W. VA. CODE §§ 31-1-77 to -136 (1996).

148 *See* SCOTT J. BURNHAM, DRAFTING CONTRACTS 228 (2d ed. 1988) ("Never change your language unless you wish to change your meaning and always change your language if you wish to change your meaning."); DICKERSON, *supra* note 131, at 15 ("[S]trive for complete internal consistency of terminology, expression and arrangement."); FILSON, *supra* note 117, at 215; *Drafting Rules*, *supra* note 114, at 422 ("Be consistent in the use of language throughout the Act. Do not use the same word or phrase to convey different meaning. Do not use different language to convey the same meaning."). The Act attempts to deal with this potential confusion by providing a rule of construction. *See* W. VA. CODE § 31-1-2 (1996).

149 *Drafting Rules*, *supra* note 114, at 422

150 *Id.*

word choice unless she intends to change her meaning; and that she should always change her word choice if she intends to change her meaning. This prevents similar interpretation of different provisions. This rule is intended to avoid just that confusion which the three definitions of "corporation" in the Act cause.

Like the other structural problems, this is easily resolved. If the Act is revised to separate business and nonprofit provisions, the problem disappears. If not, the legislature could simply define different terms for different types of corporations.

B. *Substance of the Act*

1. Legal Capital Rules

While the Act eliminated a few archaic legal capital rules in West Virginia,[151] it generally retained the traditional legal capital structure. Under the Act, paid-in capital must be segregated into stated capital and capital surplus and the use of these funds is restricted.[152] The Act continues the concept of treasury shares.[153] It also continues the concept of earned surplus, and generally limits pay-outs to shareholders to this surplus.[154]

Legal capital rules were originally developed to protect third party creditors.[155] These mandatory rules were intended to assure creditors that, despite

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151 "The pending Act omits the current requirement that the amount of capital with which the corporation will commence business must be included in the articles." *Corporations – A Survey of the Pending West Virginia Corporation Act*, *supra* note 3, at 59 (referring to W. VA. CODE § 31-1-6(d)(3) (1972 replacement volume)). *See also id.* at 118-123.

152 *See* W. VA. CODE § 31-1-85 (1996). Stated capital is that portion of consideration received for the issuance of shares equal to the par values of the shares. W. VA. CODE § 31-1-6(q) (1996). Capital surplus is any excess consideration received in consideration for the shares. W. VA. CODE § 31-1-6(e) (1996).

153 *See* W. VA. CODE § 31-1-6(t) (1996). Treasury shares are shares which were issued and reacquired by the corporation but not canceled or returned to authorized but unissued shares. They are deemed issued but not outstanding.

154 *See* W. VA. CODE § 31-1-6(h) (1996). Earned surplus is all surplus except capital surplus; often referred to as net profits. W. VA. CODE §§ 31-1-83, -99, & -100 (1996). Generally, distributions must be made from earned surplus; however, in limited circumstances they may be made from capital surplus.

155 *See* BAYLESS MANNING & JAMES J. HANKS, JR., LEGAL CAPITAL 12 (3d ed. 1990). John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1633 (1989).

statutory limited liability afforded to owners, the corporation had a certain amount of "permanent capital."[156] The capital rules, at least in theory, provide an equity cushion thereby protecting creditors by restricting the amount and sources of money shareholders may withdraw from the corporation.[157] At the same time, legal capital rules provide the corporation with a measure of assurance that creditors will not seek to foreclose too quickly.[158] They also provide some protection to shareholders. For example, the par value rules were intended to insure that each shareholder contributes equitably – pays a minimum value for her shares.[159]

Theory and practice have not converged; legal capital rules have not been effective.[160] While historically, there was some relationship between the value of the corporation and its stated capital, over time, stated capital became an abstract number obtained by multiplying the number of shares outstanding by the par value assigned to each share.[161]

> In a bygone era, all shares had a par value and most probably were issued at a price equal to par value. In that era, the concept of legal capital had a certain economic significance: legal capital was conventionally more or less equal to the economic capital created by the issue of stock."[162] However, "[w]ith the introduction of penny-par stock and then no-par stock, the par doctrines were in

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156 *See* 1 MODEL BUS. CORP. ACT ANN. § 6.21 (3d ed. Supp. 1995); Wood v. Dummer 30 F. Cas. 435 (C.C.D. Me. 1824) (trust fund for creditors). Creditors "want to preserve a cushion of protective assets, . . . [so] that no claimants who rank junior to [them] . . . make off with assets of the corporation while the creditor's claim is still outstanding and unpaid." MANNING & HANKS, *supra* note 155, at 11.

157 Coffee, *supra* note 157; Kirk, *supra* note 8, at 237 (explaining that creditors want to require substantial assets, prevent encumbrances on these assets and limit payouts to shareholders, and that these objectives are aided by limitations in the corporate law).

158 *See* William W. Bratton, Jr., *Corporate Debt Relationships: Legal Theory in a Time of Restructuring*, 1989 DUKE L.J. 92, 101.

159 *See* MANNING & HANKS, *supra* note 155, at 17.

160 *See* Coffee, *supra* note 155, at 1634; Bratton, *supra* note 158, at 106-07.

161 Eisenberg, *supra* note 101, at 199 ("Modern statutes, however, do not require that shares have a par value, and even shares that have a par value may carry a par value much lower than the price at which they are issued.").

162 *Id.*

> trouble."[163] "Accordingly, the economic capital generated by the issue of stock may be much greater than the corporation's legal capital, which has become a mere legal construct determined in a wholly arbitrary manner.[164]

Additionally, while distributions and dividend payments are statutorily limited to certain legal capital sources, the rules can be manipulated and, in the end, are meaningless.[165]

Therefore, the "statutory legal capital machinery provides little or no significant protection to creditors of corporations."[166] The legal capital rules no longer assure creditors that the corporation has substantial assets. Additionally, the legal capital rules never prevented the erosion of corporate cash flow, nor did they prevent the incurrence of additional, possibly secured or senior, corporate debt.[167] These rules have become merely "a legal invention, . . . *not relatable in any way to the ongoing economic condition of the enterprise*."[168] Understandably, creditors ceased to rely on legal capital rules; they developed other mechanisms to protect their investments.[169]

In 1980, the Committee on Corporate Law of the American Bar Association acknowledged that legal capital rules were technical and arcane, and completely revised the financial provisions in the MBCA.[170] Under the revised rules, the traditional legal capital structure was eliminated. The new rules regulating

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163 Bayless Manning, *Assets In and Assets Out: Chapter VI of the Revised Model Business Corporation Act*, 63 TEX. L. REV. 1527, 1528 (1985).

164 Eisenberg, *supra* note 101, at 199.

165 *See* Maxey, *supra* note 87, at 951 n.143.

166 MANNING & HANKS, *supra* note 155, at 91.

167 *Id.*

168 *Id.* at 39. The legal capital rules may still provide some protection; however, it is mostly that of historic precedent and psychological effect. *Id.* at 91-92.

169 *Id.* at 98-114. Today, creditors generally use guarantees, secured loans, and stringent default provisions to protect their interests.

170 *See* Committee on Corporate Laws, *Changes in the Model Business Corporation Act – Amendments to Financial Provisions*, 34 BUS. LAW. 1867 (1979).

shareholder pay-in and pay-out rules were simplified, and reflect "modern thought and practice in corporation law, finance and accounting."[171]

> The amendments to the financial provisions of the [MBCA] reflect a complete modernization of all provisions of the [MBCA] concerning financial matters, including (a) the elimination of the outmoded concepts of stated capital and par value, (b) the definition of 'distribution' as a broad term governing dividends, share repurchases and similar actions that should be governed by the same standard, (c) the reformulation of the statutory standards governing the making of distributions, (d) the elimination of the concept of treasury stock.[172]

Additional refinements were made when the RMBCA was promulgated in 1984.[173]

Traditional legal capital requirements do not exist in other West Virginia business entity law. In fact, there are very few rules dictating capital requirements in other West Virginia business entity law. West Virginia's Uniform Partnership Act requires partnership accounts; however, this is not truly a requirement because the partners may agree otherwise.[174] The LLP and PLLC statutes require each LLP and PLLC to maintain at least one million dollars of liability insurance or otherwise reserved funds.[175] West Virginia's Uniform Limited Liability Company Act does impose limitations on distributions to members;[176] however, these limitations are modeled on the revised capital rules found in the RMBCA, not the archaic legal capital restrictions. At least in other business entity law, the state legislature has not deemed detailed legal capital requirements necessary.

The continued inclusion of traditional legal capital rules in the Act does not further the purpose of West Virginia corporate law. While those who have worked with the provisions for many years have mastered the intricate requirements, the

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171 MANNING & HANKS, *supra* note 155, at 177.

172 *See* Committee on Corporate Laws, *supra* note 170, at 1867.

173 MANNING & HANKS, *supra* note 155, at 177. Still further amendments were made to the RMBCA in 1987. *Id.*

174 *See* W. VA. CODE §47B-4-1(a) (Supp. 1996) (requiring capital accounts); W. VA. CODE § 47B-1-4 (Supp. 1996) (permitting partners to agree otherwise).

175 *See* W. VA. CODE § 47B-10-5 (Supp. 1996); W. VA. CODE § 31B-13 (1996).

176 *See* W. VA. CODE § 31B-4-406 (1996).

rules are technical and difficult to follow which does not promote careful observance of the corporate law. More importantly, the rules are archaic and ineffectual and add unnecessary costs for the corporation. Particularly as there are many other options – incorporation in another state or formation of another entity form in the state – the rules discourage incorporation in the state. When organizers of business can choose to incorporate in different states or form a different entity within the same state, they will not choose to incorporate under a law that imposes technical, archaic provisions which are not only difficult to follow, but ineffectual in the end.

2. Cumulative Voting

When electing directors, cumulative voting provides each shareholder with as many votes as she has shares, multiplied by the number of directors to be elected, and permits the shareholder to distribute those votes in any manner among the candidates.[177] West Virginia is one of the six states that mandates cumulative voting.[178] The state has constitutionally required cumulative voting since its inception.[179] This constitutional mandate is codified in the Act.[180]

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177 *See* CLARK, *supra* note 45, § 9.1 (1986); HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS, §189 (3d ed. 1983); CHARLES M. WILLIAMS, CUMULATIVE VOTING FOR DIRECTORS, 40-42 (1951). For a comparison of straight and cumulative voting, see June A. Striegel, Comment, *Cumulative Voting, Yesterday and Today: The July, 1986 Amendments to Ohio's General Corporation Law*, 55 U. CIN. L. REV. 1265, 1265-66 (1987).

178 Arizona, Kentucky, Nebraska, North Dakota, South Dakota, and West Virginia. *See* Gordon, *supra* note 58, at 181 (appendix I). Cumulative voting is a constitutional requirement in all six states. *Id.* None of these states is deemed an important commercial state. *Id.* at 165. "No important corporate law jurisdiction maintained mandatory cumulative voting." *Id.* at 145.

179 *See* W. VA.. CONST. art. XI, § 4. For the text of this section, see *supra* note 57. For a history of cumulative voting in West Virginia, see *Sate ex rel Dewey Portland Cement Co. v. O'Brien*, 96 S.E.2d 171, 174-180 (1956).

180 *See* W. VA. CODE § 31-1-93 (1996).

> Voting of Shares. . . . At each election for directors every shareholder entitled to vote at such election *shall* have the right to vote, in person or by proxy, the number of shares owned by him for as many persons as there are directors to be elected and for whose election he has a right to vote, or to cumulate his votes by giving one candidate as many votes as the number of such directors multiplied by the same number of his shares shall equal, or by distributing such votes on the same principle among any number of such candidates.

Id. (emphasis added).

A shareholder's right to manage corporate affairs is limited to voting. Shareholders generally vote for the election and removal of directors, and for fundamental change to the corporation.[181] Traditionally, when voting, a shareholder is entitled to one vote for each share she owns.[182] Cumulative voting is a statutory creation that evolved as a means of facilitating minority representation.[183] It arose during an era when market liquidity was limited; therefore, there was a particular need to protect minority shareholders.[184]

Initially cumulative voting was well received. By the 1940s, almost half the states had mandatory cumulative voting.[185] The original MBCA called for mandatory cumulative voting.[186] However, as a result of a series of proxy fights for corporate control, by the 1950s the tide began to turn.[187] In 1955, the MBCA renounced mandatory cumulative voting, providing instead for a state by state election.[188] Since then, the trend away from mandatory cumulative voting became

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181 For example, under the Act, shareholders are entitled to vote on matters submitted to a vote at a meeting of shareholders. *See* W. VA. CODE § 31-1-93 (1996). This usually includes electing and removing directors, and other fundamental changes amending the articles of incorporation, merger, consolidation or sale of assets. *See* W. VA. CODE §§ 31-1-93, -96, -107, & -117 (1996).

182 *See* W. VA. CODE § 31-1-93 (1996); 2 MODEL BUS. CORP. ACT ANN. § 7.21(a) (3d ed. Supp. 1995).

183 Gordon, *supra* note 58, at 143 ("The objective was to protect minority interests against overreaching by a majority); Striegel, *supra* note 177, at 1268-1270; 2 MODEL BUS. CORP. ACT. ANN. § 7.28 (3d ed. Supp. 1995). Cumulative voting for directors developed in Illinois based on John Stuart Mill's theory of proportionate representation. JOHN STUART MILL, REPRESENTATIVE GOVERNMENT (1861). *See* HENN & ALEXANDER, *supra* note 175, § 189 n.12; Whitney Campbell, *The Origins and Growth of Cumulative Voting for Directors*, 10 BUS. LAW. 3, 4-6 (1955); Gordon, *supra* note 58, at 143.

184 *See* Gordon, *supra* note 58, at 173. Cumulative voting may still have a place in closely held corporations where market liquidity tends to be limited.

185 *Id.* at 145. Thirteen states constitutionally mandated cumulative voting. *See* Campbell, *supra* note 183, at 7.

186 MODEL BUS. CORP. ACT § 31, ¶ 4 (1950).

187 Gordon, *supra* note 58, at 148-151.

188 *Id.* at 152 n.83. *See also* MODEL BUS. CORP. ACT ANN. § 33, ¶ 4 (Supp. 1977).

even more pronounced.[189] The RMBCA currently provides that if a corporation wants cumulative voting, it must "opt in" to cumulative voting.[190]

The arguments for and against mandatory cumulative voting have been well recounted. Proponents argue that mandatory cumulative voting provides minority representation in corporate management and permits early detection and deterrence of unacceptable behavior.[191] Opponents counter that mandatory cumulative voting interferes with effective decision making, limits management's freedom to operate the business and makes the corporation vulnerable to takeover.[192] Although cumulative voting is likely to improve shareholder welfare in certain corporations, qualitative evidence indicates that all else being equal, management is unlikely to incorporate in a state which mandates cumulative voting.[193]

Eliminating mandatory cumulative voting does not necessarily mean eliminating shareholder protection. Many other mechanisms can protect minority shareholders. If the corporation has a liquid market, the shareholder may always sell her shares. Additionally, other statutory provisions, including increased disclosure requirements, more precise standards of conduct for directors, and dissenter's rights can protect minority shareholders.

Although West Virginia mandates cumulative voting, anecdotal evidence indicates that shareholders do not exercise this right.[194] If in fact shareholders are

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189 *Id.* at 145.

190 RMBCA § 7.28 provides "(a) Unless otherwise provided in the articles of incorporation, directors are elected by a plurality of votes cast by the shares entitled to vote. . . . (b) Shareholders do not have a right to cumulate their votes for directors unless the articles of incorporation so provide." 2 MODEL BUS. CORP. ACT ANN. § 7.28 (3d ed. Supp. 1995).

191 Gordon, *supra* note 58, at 146 (noting that cumulative voting helps prevents management entrenchment); John G. Sobieski, *In Support of Cumulative Voting*, 15 BUS. LAW. 316 (1960); Charles W. Steadman, *Should Cumulative Voting for Directors be Mandatory? – A Debate*, 11 BUS. LAW. 9 (1955); George H. Young, *The Case For Cumulative Voting*, 1950 WIS L. REV. 49.

192 Ralph E. Axley, *The Case Against Cumulative Voting*, 1950 WIS. L. REV. 278; George D. Gibson, *Should Cumulative Voting for Directors be Mandatory? – A Debate* 11 Bus Law 22 (1955); Gordon, *supra* note 78, at 146 (explaining that cumulative voting prevents disruption by willful minority); Striegel, *supra* note 177, at 1270; Herbert F. Sturdy, *Mandatory Cumulative Voting: An Anachronism*, 16 BUS. LAW. 550 (1961).

193 *See* Gordon, *supra* note 58, at 148. Numerous corporations have reincorporated to eliminate cumulative voting, and several states, including California, Ohio, Illinois and Missouri have revised their corporate law to eliminate mandatory cumulative voting. *See id.* at 156-160 (appendix II).

194 This is based on my conversations with various members of the West Virginia bar.

aware of their right, it is questionable whether they understand it.[195] This conclusion is supported by several facts. First, unlike the RMBCA, the cumulative voting requirement is not highlighted in a separate provision. Instead it is buried in the fourth paragraph of the voting of shares provision, which contains nine paragraphs and no subheadings or subsections.[196] Second, although the statute includes the word "cumulate" in its expression of the mechanism, the wording is less than clear, especially to the average shareholder for whom this right is created. Cumulative voting is confusing. The concept and process is difficult for lawyers who have studied it, let alone people who have not. Third, in practice, cumulative voting can turn the election process into a confusing numbers jumble.[197] This is especially true in West Virginia because there is no requirement that shareholders who intend to exercise this right give advance notice to the inspector of election.

Cumulative voting is constitutionally mandated in West Virginia corporations; however, this restriction does not exist in the state's other business entity laws. Although the state's partnership law provides a default rule that every partner has an equal say in management, the law also permits partners to agree otherwise.[198] Additionally, West Virginia law does not mandate cumulative voting in manager-managed limited liability companies. If members want this right, they must contract for it.

Cumulative voting is certainly appropriate in certain corporations. As a prophylactic requirement, however, it undercuts the purpose of West Virginia corporate law. First, careful observance of a provision that is not clearly stated is difficult. Second, mandated cumulative voting is generally disfavored by organizers of business and management and therefore, is likely to discourage incorporation in the state.[199] Third, if the legislature intends to protect minority representation in management, protection should be fostered consistently among the state's other business entity statutes. The failure to do so permits management to avoid the restriction by choosing a business entity other than the corporation.

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195 *See* Federal Deposit Ins. Corp. v. D'Annunzio, 524 F. Supp. 694 (N.D.W. Va. 1981) ("Holland and the other shareholders of West Union . . . came to the further realization of cumulative voting under West Virginia law.").

196 *See* W. VA. CODE § 31-1-93 (1996). *See also supra* Part V.A.1.

197 *See* Sturdy, *supra* note 192, at 565.

198 *See* W. VA. CODE § 47B-4-1(f) (1996).

199 *See supra* note 193. Wall Street tends to disfavor cumulative voting. *See* Sturdy, *supra* note 192, at 550.

3. Right to Dissent

The right to dissent is a statutory "buy-out" provision; it is designed to provide minority shareholders with liquidity.[200] The Act provides the limited dissenter's rights found in the MBCA.[201] A shareholder may dissent only in the event of "(a) [a]ny plan of merger or consolidation to which the corporation is a party; or (b) any sale or exchange of all or substantially all the property and assets of the corporation . . . ."[202]

This was a marked change from the historic rule that fundamental changes to the corporation required the unanimous consent of all shareholders.[203] Unanimity was essential because fundamental changes altered the nature of a shareholder's investment.[204] In effect, this unanimity requirement provided every shareholder with a veto. In other words, a single shareholder could block fundamental corporate change. Not surprisingly, this created tension between shareholders and management. Recognizing that shareholder protection could be provided via other mechanisms, the MBCA provided management with greater flexibility by requiring

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200 Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEORGETOWN L.J. 1, 18 (1995).

201 *Compare* MODEL BUS. CORP. ACT ANN. § 81 (2d ed. 1971) *and* W. VA. CODE § 31-1-122 (1996).

202 *See* W. VA. CODE § 31-1-122 (1996). W. VA. CODE § 31-1-123 (1996), provides the mechanism that dissenting shareholders must follow. This mechanism follows the MBCA. *See* MODEL BUS. CORP. ACT ANN. § 81 (2d ed. 1971). The RMBCA revised the mechanism to provide a more workable process. *See* 3 MODEL BUS. CORP. ACT chapter 13, subchapter B (3d ed. Supp. 1995). For a discussion on West Virginia Code section 31-1-123, see *Fair Value of Shares of Bank of Ripley*, 399 S.E.2d 678 (W. Va. 1990).

203 WILLIAM M. FLETCHER, 12 CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5906.10 (1993).

204 "[E]ach shareholder had a contractual right to continue in the enterprise as originally chartered, and could not be forced to invest in a different business." Recent Developments, *Corporate Fusion by Sale of Assets and Dissolution Held Free From Delaware Statutory Right of Appraisal Despite Claims of DeFacto Merger*, 63 COLUM. L. REV. 1135, 1136 (1963). *See* HODGE O'NEAL & ROBERT B. THOMPSON, O'NEALS' OPPRESSION OF MINORITY SHAREHOLDERS § 5.03 (2d ed. 1991).

majority approval for fundamental change.[205] To protect minority shareholders, the MBCA provided dissenter's rights.[206] Dissenter's rights

> balance the interests of the majority, who wished to reorganize the corporation to better serve their purposes, with the interests of the minority, who either desired to retain the basic characteristics of the company in which they had invested or to receive the fair value of their investment as an alternative.[207]

Minority shareholders could no longer block fundamental changes; however, at least under certain circumstances, they were protected as they had the right to withdraw their investment from the corporation at a fair value.[208]

The Act permits a shareholder to dissent from specified corporate action – a merger, consolidation, or sale or exchange of all or substantially all of the assets of the corporation.[209] The provision, however, is incomplete. It does not provide dissenter's rights for all corporate action in which a minority shareholder may be subjected to fundamental change. Under the Act, a shareholder of a corporation which is merged will have dissenter's rights; however the shareholder of a corporation which is a party to a share exchange will not.[210] The end of these two transactions is identical, yet careful structuring by management can avoid dissenter's rights. Adequate dissenter's rights for minority shareholders are particulary important because most West Virginia corporations have a limited market for their shares.[211]

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205 *See* MODEL BUS. CORP. ACT ANN. § 73 (2d ed. 1971). *See also* 3 MODEL BUS. CORP. ACT ANN. § 1103 (3d ed. Supp. 1995); 2 ALI PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, chapter 4, introductory note (1994).

206 *See* MODEL BUS. CORP. ACT ANN. §§ 80, 81 (2d ed. 1971); FLETCHER, *supra* note 203, § 5906.10.

207 Henry F. Johnson & Paul Bartlett, Jr., *Is a Fistful of Dollars the Answer? A Critical Look at Dissenters' Rights Under the Revised Model Business Corporation Act*, 12 J.L. & COM. 211, 213 (1993).

208 MODEL BUS. CORP. ACT ANN. §§ 80, 81 (2d ed. 1971).

209 *See supra* note 201 and accompanying text.

210 *See* W. VA. CODE § 31-1-122 (1996). When possible, management would like to avoid dissenter's rights. The potential cost creates uncertainty.

211 *See supra* note 79.

If dissenter's rights are intended to provide shareholders with protection against fundamental changes to their investment, dissenter's rights should cover all fundamental changes. When revising the MBCA, the drafters recognized this limitation and added additional transactions for which dissenter's rights exist.[212] The additional events include a share exchange, amendments to the articles of incorporation that impair a shareholder's rights as a shareholder in certain enumerated ways, and any other corporate action to the extent dissenter's rights were provided by the articles, bylaws or resolution of the board of directors.[213] These additions may not address all fundamental changes which should give rise to dissenter's rights; however, they are a step in that direction.[214]

No other West Virginia business entity law provides the right to dissent; however, they all have more expansive "buy-out" provisions than the Act. Historically the partnership statute did not provide a buy-out provision. If a partner wanted to leave the partnership, she had to dissolve it. Under the revised partnership statute, however, there are provisions for purchasing a disassociated partner's interest at her request.[215] Additionally, West Virginia's LLC act provides broad repurchase rights for a disassociated member.[216]

The right of shareholders to dissent is designed to provide minority shareholders with liquidity. However, when compared to the buy-out provisions in other West Virginia business entity statutes, this is not an especially flexible "buy-out" provision. Unlike the other provisions discussed in this Article, this provision may in fact promote the purpose of the Act. Management views limited dissenter's as a positive attribute. Limited dissenter's rights increases management flexibility. Management can structure a fundamental change to a shareholder's interest so that

212 "The 1978 revision of the [MBCA] . . . sought to increase the frequency with which assertion of dissenters' rights leads to economical and satisfying solutions." Johnson & Bartlett, *supra* note 206, at 213. *Business Corporation Act*, 12 J.L. & COM 211, 213 (1993). The revision also attempts to decrease the frequency with which the assertion of dissenters' rights leads to delay, expense and dissatisfaction. *See* 3 MODEL. BUS. CORP. ACT ANN. § 13.01 (3d ed. Supp. 1995).

213 *See* 3 MODEL BUS. CORP. ACT ANN. § 13.02(a) (3d ed. Supp. 1995).

214 The American Law Institute ("ALI") has drafted an appraisal remedy which it believes to be more inclusive. *See* 2 ALI PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.21 (1994). According to a survey by the American Bar Association, all states have a statute that provides dissenter's rights; however, the circumstances under which dissenter's rights are available vary. *See id.* at reporters' note to chapter 4 (1994).

215 *See* W. VA. CODE § 47B-7-1 (1996).

216 *See* W. VA. CODE § 31B-7-701 (1996).

it does not trigger a shareholder's right to dissent.[217] A shareholder can be stuck holding shares of a corporation which has fundamentally changed. This may not, as a matter of public policy, adequately protect minority shareholders.

4. Duty of Care

Directors owe a fiduciary duty to the corporation.[218] This fiduciary responsibility is inherent to the relationship between the director and the corporation and its shareholders; it is also fundamental to the functioning of a corporation. Generally, directors have a duty to act within their authority, exercise due care and act fairly and in good faith.[219] The duty of care on which this Article focuses holds directors liable "for negligence in the performance of their corporate duties."[220] With the exception of a provision providing for director liability with respect to certain distributions,[221] the Act is silent as to a director's duty of care. In addition to the lack of statutory guidance, to date, there is no judicial guidance.[222]

Historically, the duty of care was defined at common law on a case-by-case basis.[223] As often occurs in case-by-case determinations, there was no uniformity, and in turn, no predictability.[224] Although each standard involved some degree of

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217 *See* Farris v. Glen Alden, 143 A.2d 25 (Pa. 1958).

218 Historically, directors were viewed as agents or trustees of the corporation. Today courts characterize directors as "fiduciaries who have a 'distinct legal relationship' with the corporation." Marcia M. McMurray, Note, *An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule*, 40 VAND. L. REV. 605, 605-06 (1987).

219 HENN & ALEXANDER *supra* note 176, at §§ 231-235.

220 *Id.* at § 234.

221 *See* W. VA. CODE § 31-1-102 (1996).

222 There are no reported state decisions setting forth a common law standard of care for directors of West Virginia corporation.

223 McMurray, *supra* note 218.

224 *See* MODEL BUS. CORP. ACT ANN. § 41, ¶ 2 cmt. (2d ed. 1971). The standard for the duty of care has been described in several ways. *See* Anderson v. Akers, 7 F. Supp 924 (W.D. Ky. 1934), *modified sub nom.* Atherton v. Anderson, 86 F.2d 518 (6th Cir. 1936), *modified sub nom.* Anderson v. Atherton, 302 U.S. 643 (1937) (a reasonably prudent person); Medfort Trust Co. v. McKnight 197 N.E. 649 (Mass. 1935) (gross negligence standard); Swentzel v. Penn Bank, 23 A. 405 (Pa. 1892) (only liable for fraud). *See also* HENN & ALEXANDER, *supra* note 176, at 622-623. A lack of predictability undercuts the purpose of substantive law. *See supra* note 7 and accompanying text.

negligence, divergent standards arose.[225] Today, a majority of states have codified the common law duty of care. [226]

A statutory duty of care was first inserted in the MBCA in 1974.[227] When the committee revised the MBCA, it retained substantially the same language.[228] The standard requires a director to act with the care that "an ordinarily prudent director in a like position would use under similar circumstances."[229] The standard essentially codifies one of the common law standard of conduct for directors. It is important to note that the standard is procedural; it focuses on the manner in which a director acts, not on the validity of her decisions.[230] Directors are not "insurers and are not liable for errors of judgment or mistakes while acting with reasonable diligence, care and skill."[231]

West Virginia law remains all but silent on the duty of care standard for corporate directors;[232] however, all other West Virginia business entity law provides

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225 McMurray, *supra* note 218, at 607 (discussing "three common-law standards . . . (1) only the degree of care required to avoid gross negligence, (2) the degree of care that an ordinarily prudent director in a like position would exercise under similar circumstances, and (3) the degree of care that an ordinarily prudent person would exercise in conducting personal business affairs").

226 *See* Bradley & Schipani, *supra* note 19, at 18 n.107; 2 ALI PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS Part IV, introductory note, at 34 (1994) ("In the past 25 years, . . . over two-thirds of the states have enacted statutory provisions concerning the duty of care.").

227 The committee approved a second paragraph to MBCA section 35 Board of Directors on September 21, 1974. *See Report of Committee on Corporate Laws: Changes in the Model Business Corporation Act*, 30 BUS. LAW. 501 (1975). Although the duty of care was added to the MBCA prior to the effective date of the Act, it is not included in the Act. The Act was modeled on an earlier version of the MBCA. As of December 1, 1994, 41 jurisdictions impose a statutory standard similar to the RMBCA standard. 2 MODEL BUS. CORP. ACT ANN. § 8.30 statutory comparison (3d ed. Supp. 1995).

228 *See* 2 MODEL BUS. CORP. ACT ANN. § 8.30(a) (3d ed. Supp. 1995). "[T]he changes made by section 8.30(a) in its final form from section 35 are primarily stylistic, and designed to place section 8.30(a) in the same format at the balance of the revised Model Act." 2 MODEL BUS. CORP. ACT ANN. § 8.30 annotation – historical background (Supp. 1995).

229 MODEL BUS. CORP. ACT § 35, ¶ 2 (2d ed. 1977). Most states have adopted this standard. McMurray, *supra* note 218, at 608.

230 McMurray, *supra* note 218, at 613-614 (noting that directors are not liable for honest mistakes or judgment errors).

231 HENN & ALEXANDER, *supra* note 176, § 234.

232 *See supra* note 221 and accompanying text.

an express and exclusive duty of care standard. This standard requires that anyone who manages an entity must refrain "from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law."[233] This standard provides entity owners and managers with ascertainable, predictable standards to guide behavior. Additionally, both West Virginia's partnership statute and LLC statute permit the owners to, within reason, modify the duty of care.[234] This reflects the modern trend towards enabling legislation; specific default rules that may be modified.

This lack of consistency among the state's business entity statutes is troublesome. Anyone who manages a business entity owes a fiduciary duty of care to the owners. This duty should not vary depending on the entity chosen.[235] When it does, managers can, through careful selection of an entity, avoid the duty without owner agreement.

Additionally, the lack of an express duty of care standard in the Act leaves directors adrift. Other West Virginia business entity statutes provide an express standard of care; however, corporate directors are left not knowing to what standard they must comply. No director wants to function under an unknown standard. Given a choice, organizers of business activity who wish to function under a specified duty of care, or an agreed upon duty of care, may do so by forming a LLC or partnership. Therefore, the omission of a duty of care standard in the Act hinders the purpose of the Act.

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233 W. VA. CODE § 47B-4-4(c) (Supp. 1996) (setting forth a partner's duty of care to the partnership and other partners); W. VA. CODE § 31B-4-409(c) (1996) (setting forth a member's duty of care to the LLC (and other members) in a member-managed LLC, and a manager's duty of loyalty to the LLC (and other members) in a manager-managed LLC). In theory, this duty of care standard also applies to West Virginia Limited Partnerships in accordance with West Virginia Code section 47-9-63; unfortunately, the provision has not been revised and still refers to the repealed partnership act (47-8A-1 et. seq.). *See supra* note 81.

234 *See* W. VA. CODE § 31B-1-103(b)(3) (1996) ("(b) The operating agreement may not . . . (3) Unreasonably reduce the duty of care under section 4-409(c) or 6-603(b)(3)."); W. VA. CODE § 47B-1-3(b)(4) (Supp. 1996) ("(b) The partnership agreement may not . . . (4) Unreasonably reduce the duty of care under subsection (c), section four, article four or subdivision (3), subsection (b), section three, article six of this chapter."). To date, there is no precedent in the state of what would constitute an unreasonable reduction of the duty of care.

235 *See* William H. Clark, Jr., *What the Business World is Looking for in an Organizational Form: The Pennsylvania Experience*, 32 WAKE FOREST L. REV. 149, 172 (1997).

VI. CONCLUSION

Organizers of economic activity have more options than ever before. If they wish to form a corporation, they may incorporate under the law of the state with the most advantageous corporate law. If they wish to organize a business entity under the laws of West Virginia, they may choose the entity that provides the desired characteristics and most advantageous law. Given this flexibility, organizers are unlikely to incorporate under the Act. The organization of the Act is confusing and difficult to work with. Many of the standards set forth in the Act, like the legal capital rules and mandatory cumulative voting, are technical and archaic. Yet other standards articulated in the Act, like the right to dissent and the fiduciary duty provisions, lack specificity. In the context in which it functions, the Act does not further its purpose – to promote more careful observance of the law and to encourage businesses to incorporate in the state and, thereby generate additional revenue. Therefore, the Act is "broke!"

Despite the fact that by my definition the Act is "broke," corporations continue to be formed and function under it.[236] The final question, then, is do the potential gains from revising the Act outweigh the inevitable transaction costs? The answer lies in a reevaluation of the purpose of the Act.

Promoting careful observance of law is a fundamental goal of all statutory law. In furtherance of this goal, the legislature should always strive to produce well drafted statutes. Well drafted statutes are more likely to advance their substantive purpose.

The goal to encourage incorporation in West Virginia and thereby generate additional revenue, however, requires further analysis. The value of encouraging incorporation in the state to generate revenue turns on the answer to two questions. First, can West Virginia encourage incorporation in the state over incorporation in other states. Second, where does the Act fit in the spectrum of West Virginia business entity law. There are three alternatives: (1) to encourage incorporation in the state over the formation of other types of entities, (2) to encourage the formation of other types of entities over incorporation, or (3) to create a neutral set of business entity laws that makes the entity decisions solely a question of business judgment.

With respect to the first issue, West Virginia is not considered a commercial state. To even attempt to compete in the market for corporate charters, the state would have to attract managers from other states to incorporate here. To achieve this goal, the state would have to transform itself into a haven for corporations. This would require more than the adoption of contemporary standards – it would require anticipating and providing the next wave of pro-management

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236 This is attributable to inertia, cost of conversion, concern regarding untested statutes. *See supra* note 97 and accompanying text.

enabling legislation. Many of these standards would infringe even more on shareholder welfare and creditor protection, and, as a matter of public policy, may be unacceptable.

Recognizing this limitation, however, does not mean that West Virginia should stop seeking to obtain and retain its share of corporate charters. Rather it suggests that the purpose should be narrowed. Instead of seeking to generate revenue by luring incorporations from other states, West Virginia should focus on encouraging local businesses that have decided to incorporate to do so in the state. As West Virginia primarily has closely held corporations,[237] I suggest that the legislature revise the Act to deal specifically with closely held corporations. As very few corporate codes are directed towards closely held corporations, West Virginia could create a statute which would serve its constituency and potentially create a niche market that might actually attract incorporations from other states.[238]

With respect to the second issue, the legislature needs to create a consistent legislative policy with respect to business entities. Unfortunately, because the state consistently adopts uniform legislation, it has never established an overriding policy with respect to business organizations. Without an express policy, it is difficult to assess whether the current business entity statutes advance the state's policies and interests. Even if some do, the lack of consistency among entities permits organizers of business to avoid potentially important legislative policy.

Although some commentators argue that revising the Act is a waste of time;[239] I disagree. While changing tax rates and check-the-box taxation may make one form of entity more favorable than another, these trends tend to evolve over time. At this juncture, even though LLCs and LLPs are being haled as the wave of the future, corporations are still thriving entities and are likely to remain so for the foreseeable future.[240] The next step is for the West Virginia Law Institute. The Institute should analyze the role of business entities in the state. Based on this

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237 Closely held corporations are much more prevalent than publicly traded corporations. Nearly 90% of all corporations are closely held. *See* 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 1.19, at 108 (3d ed. 1992). As indicated earlier, there are less than 20 publicly traded corporations incorporated in West Virginia. *See supra* note 79.

238 Less than half the states have close corporation statutes; furthermore, where adopted, they are rarely used. *See* Ayres, *supra* note 42, at 377 n.49. Professor Ayres argues that there is little incentive for state legislatures to create corporate laws directed towards closely held corporations. *See id.* at 376.

239 *See supra* note 53 and accompanying text.

240 *See* Keatinge, *supra* note 26, at 234-237. Some commentators would argue that some of the newer entities may lose their appeal in the wake of check-the box. Oesterle & Gazuer, *supra* note 28, at 214.

analysis, the Institute should articulate a purpose that can then be used to draft and revise West Virginia business entity law.

At a minimum the Act should be reorganized. A revised organization which groups related provisions together, uses subheadings and a consistent drafting style, would create a more readable statute. This in turn would promote careful observance of the law. Hopefully, more substantive revisions will also be made. In assessing possible substantive revisions, shareholder welfare must be balanced against management flexibility. Attention must also be given to consistency with the state's other business entity statues.

This Article has highlighted a few of the many areas where I would recommend substantive revision to the Act. The legal capital rules should be eliminated. The revised Act should provide more realistic and effective capital structure provisions. Mandatory cumulative voting should be eliminated. I recognize that this would require a constitutional amendment therefore, at least in the short run, this may not be feasible. In the interim, or in the event that the state elects to maintain mandatory cumulative voting, the revised Act should provide better crafted provisions which explain the right so that it is used under appropriate circumstances. Dissenter's rights should also be revised to include additional circumstances which warrant a legislatively mandated "buy-out" for minority shareholders. Finally, an articulate statement of the duty of care should be developed. However, the particulars of these revisions have been left for future discussion.

If substantive revision is undertaken, appropriate provisions must be drafted. The contemporary standards reflected in the RMBCA are a good starting point, but I do not recommend adoption of the RMBCA. Although this would reduce the transaction costs in both drafting and interpreting the statute, it would not necessarily provide the desired results; particularly if West Virginia opts to create a corporate law which deals with issues specific to closely held corporations.[241]

241 *See supra* notes 38-39 and accompanying text.