Mississippi College Law Review

Volume 12
Issue 1 *Vol. 12 Iss. 1*

Article 10

1992

The Background of the New Mississippi Business Corporation Act

Robert W. Hamilton

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I. INTRODUCTION

The following comments are divided into four sections.[1] The first revolves around my experiences as Reporter for the project that developed the Revised Model Business Corporation Act (RMBCA).[2] Mississippi, of course, faithfully followed this statute when it revised its corporation statutes in 1988. As a result, a good part of the Mississippi corporation statute was indirectly drafted by me or under my direct supervision.

The second section involves reflections on why some states decide to adopt the RMBCA while others "go it alone" and develop their own corporation statutes with their own resources. Section three involves my views on the relationship between the RMBCA and the Corporate Governance Project that has been under consideration by the American Law Institute for nearly ten years. The final section addresses a limited number of substantive questions about the RMBCA and the Mississippi Business Corporation Act. I hope that you will find my comments to be interesting and useful.

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1. Portions of these comments are drawn from Elliott Goldstein & Robert W. Hamilton, *The Revised Model Business Corporation Act*, 38 BUS. LAW. 1019 (1983); Robert W. Hamilton, *Reflections of a Reporter*, 63 TEX. L. REV. 1455 (1985).

2. At the September, 1990, meeting of the Committee on Corporate Laws, it was decided to drop the word "Revised" from the name of this statute, and in the future it will be referred to simply as the "Model Business Corporation Act." However, in this article, the older name, Revised Model Business Corporation Act will be used to distinguish it from the earlier 1950, 1955, 1960, and 1969 versions of the same Act.

II. THE DEVELOPMENT OF THE RMBCA

A. The RMBCA is "Model" Legislation

There are two major sources of uniform legislation in the United States today: the American Law Institute (ALI) and the Commissioners on Uniform State Laws. The RMBCA is not the creation of either of these organizations but rather of a committee of the American Bar Association (ABA) called the Committee on Corporate Laws. I believe it is the only model or uniform statute promulgated by the ABA in the business area,[3] outside, of course, of codes of professional responsibility and ethics. The reason for the ABA's involvement in the corporate law area is, I think, mostly an historical accident. It is, however, impossible to tell because there is almost nothing written or published on the activities of the Committee on Corporate Laws before 1950, the year the first version of the Model Business Corporation Act (MBCA) was published. We do know that the Commissioners on Uniform State Laws promulgated a "Uniform Business Corporation Act" in the late 1920s that never really caught on. This statute remained on the books until the early 1950s, at which time it was withdrawn when it became apparent that states were following the 1950 or 1955 versions of the Model Act.

There is a difference between a "model" statute such as the RMBCA and "uniform" statutes such as the Uniform Commercial Code or the Uniform Fraudulent Transfers Act that are promulgated by the Commissioners on Uniform State Laws, often with the advice and assistance of the ALI. The latter are intended to be enacted by each state in their entirety in order to develop a set of uniform principles to govern transactions wherever they are undertaken in the United States. A "model" statute, on the other hand, specifically encourages states to consider local practices and local considerations, deviating from the "model" when they feel it appropriate. Certainly it was the intention of the Committee on Corporate Laws, when it developed the RMBCA, to encourage local variations when that was felt appropriate. Indeed, it was realized that many states have state constitutional provisions that would prevent the enactment of the RMBCA in its entirety.

Thus, changes made by Mississippi from the language of the RMBCA—e.g., the inclusion of an alternative constituencies provision[4]—is entirely consistent with the basic concept of the RMBCA being a "model."[5]

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3. The Section on Business Law of the ABA has also promulgated a Model Non-Profit Corporation Act that is closely patterned after the RMBCA.

4. MISS. CODE ANN. § 79-4-8.30(d) (1972). Because the Mississippi Business Corporation Act numeration is so closely tied to that of the RMBCA, I will use only the RMBCA numeration in the balance of this article.

5. *But see* Committee on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253 (1990). In this particular case, the Committee has expressed serious reservations about the desirability of such provisions and decided not to include an alternative constituencies provision in the RMBCA. This decision was made despite the fact that about thirty states have adopted alternative constituency statutes.

B. The Committee on Corporate Laws

The Committee on Corporate Laws, which is part of the Section of Business Law of the ABA, has complete control over the RMBCA. This Committee is unique in several respects:

> (1) Its membership is limited to about thirty-five members and appointment is for six year terms and by invitation only. One cannot voluntarily become a member of the Committee and one cannot generally stay on the Committee forever (though former chairmen are often accorded the honor of what is in effect, life membership).
>
> (2) The Committee's decisions with respect to the RMBCA are not subject to review by the board of directors of the Section of Business Law or by the Board of Governors of the ABA. Proposed amendments are developed by the Committee (by the process described below) and published in *The Business Lawyer* for comment. After reviewing any comments that are received, the Committee simply promulgates the final text of the amendments and publishes them in *The Business Lawyer*.[6]
>
> (3) It is a working Committee that meets four times a year and decisions are made only after extensive oral discussions by the Committee acting as a body. Meetings of the Committee are generally scheduled for Friday afternoons and Saturday mornings. They are held around the country, often at expensive hotels or spas. Attendance is unusually good: I do not remember a meeting at which less than fifteen members were present, and it was not uncommon to have twenty-five to thirty members present. Of course, this method of decision-making is practical largely because of the size of the Committee.

Anyone who has participated in a typical ABA Committee with hundreds of members, written distributions in lieu of meetings, little member participation, and virtually total reliance on the Chairperson of the Committee to develop proposals, will know that all of this is unusual.

The membership of the Committee is drawn from senior members of the corporate bar from across the country. There are traditionally one or two members of the corporate plaintiffs' bar and two or three corporate law professors; the balance of the Committee consists of practicing corporate defense lawyers. Two or three may be inside general counsels of large, publicly held corporations, but the great bulk of them are in private practice. There are also usually one or more lawyers from smaller cities or towns, but the backbone of the Committee is the senior corporate lawyer from the very large firms in the major cities of the United States. Membership decisions are made by the Chairman, usually after consulting with the Committee as a whole. Selections are made to assure geographic diversity so that at any one time there are senior lawyers on the Committee who are knowledgeable about the corporation statutes of perhaps fifteen or so different states, including all of the important commercial states.

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6. The Committee on Corporate Laws also prepares studies and reports from time to time. Perhaps the best known of these is the *Corporate Director's Guidebook*. *See* Committee on Corporate Laws, *Corporate Director's Guidebook*, 33 BUS. LAW. 1591 (1978). These studies and reports are submitted to the Council of the Section of Business Law and the Board of Governors of the American Bar Association for approval before they are promulgated.

A fair description of the composition of this Committee is that it has representation of the principal groups that are interested in the development of corporation law, but it is not diversified and representational in the normal senses of those words. The membership is predominantly over fifty years of age and male (though there is a scattering of younger lawyers and women). Members' background is predominately successful corporate practice in the largest firms in the United States.

Unquestionably, the great strength of the Committee is the quality of the members: they are bright individuals, seasoned with twenty years' or more experience in corporate law, and, by-and-large, interested in the Committee discussions and the work product of the Committee. I was privileged to serve on the Committee from 1976 through 1982, and I know that I learned a great deal listening to the Committee discussions; indeed, one rapidly gained humility (if one did not previously have it) when participating in the discussions with these bright and articulate lawyers.

C. Why Was the RMBCA Produced When it Was?

The original Model Business Corporation Act was published in 1950, and after a rather slow start, the 1955, 1960, and 1969 versions achieved a considerable degree of popularity. By the end of the 1970s, it had been used as the model for the recodification of state corporation statutes in some thirty-odd states and had a strong influence on the statutes of a number of additional states. In other words the old MBCA was a highly successful Model Act.

There are several reasons – two major and the rest minor – for the decision in 1979 to develop an entirely new model statute. The first major reason was that a large number of significant amendments to the MBCA had been developed and approved during the 1970s. These amendments were developed by different subcommittees and different individuals, with the result that variations in language and method of presentation crept in. Indeed, by 1979 it was almost impossible to tell what precisely was in the MBCA and what was not, since one had to root around in various *Business Lawyers* in order to locate each amendment. The second major reason was that there was considerable dissatisfaction with the publication called *Model Business Corporation Act Annotated (2d ed.)*, which it had been hoped would be a modest money-maker but in fact did not sell well at all due to the form of the presentation and the lack of authoritativeness of much of the commentary in those volumes. It seemed logical to combine the revision of this supplemental book with a project to revise and update the underlying statute.

There were other complaints with the 1969 version of the Model Act as well. In 1979, an Overview Committee within the Committee on Corporate Laws reviewed the entire Act and highlighted a number of problems in specific sections. The language was sometimes turgid and complex. Obsolete practices, such as closing the transfer books in advance of a shareholders' meeting, continued to exist in the statute. The overall organization of the statute, which was based on the organization of the 1931 Illinois Business Corporation Act, left much to be desired: for example, the process of incorporation was dealt with only after numerous pro-

visions detailing the internal structure of a corporation. Some provisions – such as requiring a judicial determination before a corporation could be involuntarily dissolved for failing to pay state taxes – had not been accepted by any jurisdiction and were clearly unrealistic. And, finally, there were many sections and areas of the Model Business Corporation Act that had never been reconsidered by the Committee since 1950 and it was felt that an overall reexamination was overdue.

The original plan was to do a general updating and revision of the language of the MBCA, without undertaking large-scale substantive revisions. Many members of the Committee were basically satisfied with the familiar Model Act and resisted proposals for more significant change. What finally came out of the process, however, was a major substantive revision that was basically a new statute, a result that surprised many of the original participants in the process.

D. The Committee's Normal Development Process

The Committee on Corporate Laws generally works through subcommittees or working groups that are created on an *ad hoc* basis to consider discrete problem areas when they are identified as possible subjects for Committee consideration. The subcommittee, usually consisting of three or four persons, may meet or have discussions by conference telephone. Then the Chairman or another Committee member usually prepares discussion memoranda, and where appropriate drafts possible amendments to the Model Act to address the problem. The decisional process is a gradual one, progressing through two or three different "readings" before the full Committee takes final action. Discussions of proposed amendments might consume a couple of hours of Committee time at two or three successive meetings. It is a leisurely process, with usually at least twelve months elapsing between the time a proposal is first placed on the agenda for preliminary discussion and the time final approval is given to a proposed amendment addressing the problem.[7]

E. The Committee's Process Followed in the Development of the RMBCA

When the decision to develop a new version of the MBCA was reached, and I agreed to serve as the Reporter, consideration turned to the mechanics of drafting the new version. The amendment process described in the preceding section was not well suited to development of a new Act if it was to be completed within a reasonable period of time. The development process threatened to be extremely time-consuming; it was necessary to develop statutory language for more than 180 sections within a relatively brief period. It was essential that language be used consistently throughout the statute, and that each section be subjected to a review process within the Committee that assured that the background and experience of

7. On more complex issues, such as indemnification of directors, the duties of directors, and the statutory right of dissent and appraisal, several years might elapse between the time the proposal is first discussed in preliminary form and the time a formal amendment to the Model Act is approved.

the members – the great strength of the Committee – was brought to bear on that section. The impracticability of following the Committee's normal procedure should be evident when it is recalled that it was not uncommon for the full Committee to spend more than six hours deliberating a single proposed amendment ranging over some eighteen months. It was clearly impractical to increase the number of Committee meetings, given the regular demands of the members' practice.

The procedure that was adopted was to centralize the drafting of all sections and all official comments under my direction. Both initial drafts and final language were handled the same way. Then, at the very least, if things did not mesh properly, there was no doubt where the blame lay and who had the responsibility to fix it.[8] I should add that I was assisted in this process by Seth Searcy, an Austin lawyer and a highly skilled statutory draftsman, who was able to take complex ideas and express them in clear and readable statutory language.[9] Indeed, his ability to take the language of the old Model Business Corporation Act and simplify it while preserving its meaning was invaluable. Almost all of the work on the statute and the Official Comments was done by Searcy and me. The project ran for nearly five years and ultimately cost the American Bar Association and American Bar Foundation about $375,000.[10]

The development of the RMBCA can be divided into two broad stages: the first was the creation of the Exposure Draft which was published in the Spring of 1983, and was widely circulated for comment. The second was the consideration of the hundreds of comments received on this draft and the development of the final statute, which is what Mississippi enacted.

The Exposure Draft was prepared substantially as follows: The Committee on Corporate Laws created subcommittees to consider each tentatively reorganized chapter of the new Act. A rough draft of proposed textual revisions was created and presented to the subcommittee in a form that permitted direct comparison (on the same page) of the proposed language of the new statute and the corresponding language in the 1969 version of the MBCA, as amended. Changes were largely stylistic and simplifying; suggestions made by the 1979 Oversight Committee were incorporated in these earlier drafts, and in some instances, I proposed minor substantive changes. The proposed language and policy changes were debated at length by each subcommittee, which itself often made numerous substantive and stylistic changes. After this subcommittee review, the proposed chapter was presented for first reading to the full Committee along with the comparable language of the current Model Act. After sometimes-extended debate (in which what I thought was beautifully phrased and crystal-clear language was sometimes torn to

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8. Technical amendments to fix minor glitches were made in 1987. Committee on Corporate Laws, *Technical Changes in the Model Business Corporation Act*, 42 BUS. LAW. 603 (1987).

9. The project also hired an attorney, a secretary, and a number of students to assist in the preparation of annotations for the third edition of Model Business Corporation Act Annotated.

10. Most, if not all, of this investment has been recouped from royalties, principally from the third edition of the Model Business Corporation Act Annotated.

shreds), the proposed chapter would be approved in principle. At this stage, drafts of proposed official comments were prepared by me, and the revised statute and first draft of the Comments were returned to the subcommittee, where they were again reviewed, approved, and presented for further consideration "on second reading" by the full Committee. At this stage, drafts of chapters (and in some instances, individual sections) were circulated outside the Committee to interested individuals and organizations,[11] and some drafts were circulated to persons who requested them. Each chapter was then again revised and submitted, subject to further debate, amendment, and revision to the full Committee for "final reading."

As the Exposure Draft was being created, specific chapters were of course in different phases of the review process at the same time. For example, at a single meeting of the Committee, Chapter One might be ready for third reading, while Chapter Six had been presented for second reading at an earlier meeting and was ready to be reconsidered by the full Committee, while Chapter Ten was at the stage of first reading before the Committee. The Committee members, in addition to their subcommittee responsibilities, also had to read drafts of chapters prepared by other subcommittees. Different colored paper was used in notebooks to assist Committee members in keeping straight the stage of each chapter.

The drafting process continued from 1980 through the end of 1982, when the sixteenth and seventeenth chapters were finally approved. At this time more than 1,000 copies of the Exposure Draft were circulated to academics, practitioners, trade associations, and other individuals and groups for comment.

The response to the Exposure Draft exceeded all expectations. More than 100 letters of comment were received, many several pages long and dealing with a variety of subjects. Rather surprisingly, many of the comments were not limited to the text of the Exposure Draft: rather, many were quite substantive and some urged massive changes in traditional corporate statutory principles or approach. Many comments were highly complimentary of the quality of the new statute; some were mildly or extremely negative.[12]

After the close of the comment period, the Committee considered what to do about the comments. Even though many of the substantive proposals had considerable support in principle from members of the Committee, it was recognized that we could not now prepare a statute that incorporated many of the substantive suggestions. We would have had to virtually start over; we had to build from the Exposure Draft, not start anew. The Committee resolved to reconvene the subcommittees so that they could review the proposals and comments, placing them into three categories: (1) those not desirable to make; (2) those desirable to make if practical; and (3) those desirable to make in principle, but required additional consideration and should be put off until another day.

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11. For example, drafts of chapter one were submitted to a sampling of filing authorities for their comment; chapter five was submitted to several corporation service companies, and so forth. Provisions relating to voting of shares were also submitted to the Society of Corporate Secretaries.

12. Several academics criticized specific portions of the Exposure Draft as being too "permissive" or insufficiently sensitive to the possibility of abuse. By and large, these comments were not accepted by the Committee.

There followed a period that was even more frantic than the development of the Exposure Draft. It was clearly desirable for either me or Searcy to attend each meeting of each subcommittee since we had a much better idea than the subcommittee members as to the complexity of implementing many of the suggested changes. Meetings of subcommittees were held at irregular intervals or on Saturdays in various cities. Gradually we hammered out both the principles and the statutory language to effectuate the changes that were decided to be included. Many of the most significant innovations in the RMBCA were made during this period: for example, the elimination of the "money paid, labor done, or property actually received" standard for eligible consideration for issuance of shares, and the introduction of the concept of "voting groups" to straighten out the class voting rules for classes and series of shares.

During this entire period – from 1979 through 1984, when the RMBCA was finally approved – the only project that the Committee on Corporate Laws had was the development of the new statute. Many members spent a great deal of time in commenting on drafting efforts and making suggestions as to how the provisions might be simplified and clarified. It was not uncommon for me to receive several long letters a week from Committee members commenting on drafts of sections and proposing improvements. I have no idea of how many volunteer, uncompensated hours were put in by the Committee members and sometimes their associates and partners, but it must have numbered in the tens of thousands of hours that otherwise would have been compensated at very gaudy hourly rates. The real cost of the development project was not the $375,000 of outside costs that were incurred; it was the millions of dollars worth of free time donated by these senior partners in major law firms in making sure that the statute was the best that it could be.

III. WHY DO SOME STATES "GO IT ALONE"?

Mississippi attorneys may be interested in the reception other states have given the RMBCA. As of June, 1990, fifteen states had adopted the RMBCA substantially in its entirety as Mississippi has done. There may have been one or two since then that have also adopted the RMBCA. But these "substantially complete" adoptions are not the whole story about the impact of the RMBCA. A number of states, such as Maryland and Texas, have not completely revamped their corporation statutes but have made significant amendments to specific sections and have adopted much of the RMBCA language. Hence the single datum – fifteen states have adopted the RMBCA in the last seven years – understates the influence of the Act.

States considering the revision of their corporation statutes have basically two choices: they can follow the RMBCA or they can "go it alone."[13] In making this choice, the single most important factor appears to be the size of the corporate bar

13. They can also copy the Delaware statute for whatever benefit that provides, in terms of attracting new incorporation and providing a strong base of decisional law for the benefit of their corporations. So far as I know, the only state recently to follow this approach is Oklahoma.

within the state, though there certainly is no direct correlation between the extent of the RMBCA's acceptance and the size of the state. In practically every state, the corporate statute is a product of the state bar. Typically, amendments to corporation statutes—or the decision to adopt a complete revision of corporation statutes—are made by a committee of the state bar and presented to the state legislature. At the very least, in practically every state, enactment of amendments to corporate statutes requires the active support of, or at least the absence of objection from, the corporate segment of the state bar.[14]

The development of a state corporation statute "from scratch" basically requires the assistance of a large number of experienced corporate practitioners to assist in the development of the statutory language, and, equally importantly, to review the product of the statutory draftsman and make sure that hidden or unsuspected problems do not lurk in the statutory language. I have discovered from personal experience that it is very easy for a single individual to draft provisions that appear reasonable but which create serious unanticipated problems in situations not considered by the draftsman. The larger, more commercially important states, clearly have the capacity within their state bars to develop a sophisticated and workable corporation statute. In this category I would place not only the very largest states such as California, New York, Texas, Pennsylvania, and Ohio, but also states of more moderate size such as Washington, Indiana, Virginia, Florida, and Massachusetts.

Several states seem clearly committed to a "go it alone" approach. The clearest example is Delaware, the clear leader in the incorporation race, with a large and extremely sophisticated corporate bar. California, New York, and Pennsylvania also seem to be clearly committed to their individual corporation statutes.

What is particularly heartening to me, as the Reporter for the original RMBCA, is that in many of these states in which the capacity to develop new corporation statutes "from scratch" is clearly available, the state bar has opted to either adopt the RMBCA or to follow it closely in most respects. Virginia, Indiana, Illinois, and Georgia are good examples. Apparently what is happening is that state bar committees in these states are reviewing the RMBCA and concluding that the statute is basically satisfactory so that it is not necessary to "reinvent the wheel."

IV. THE RELATIONSHIP BETWEEN THE RMBCA AND THE CORPORATE GOVERNANCE PROJECT

The American Law Institute commenced a major study called the *Corporate Governance Project* at about the same time as the Committee on Corporate Laws commenced the project that led to the development of the Revised Model Business Corporation Act. As many of you are doubtless aware, the Corporate Governance

14. As with all comments there are exceptions. Alaska recently adopted a new corporation statute that was the product of its code revision commission with the assistance of an adviser who was a law professor from California. The state bar was successful in obtaining a number of amendments to the original commission draft before its enactment. Many of the provisions in the Alaska statute are similar to those in California statutes.

Project has been intensely controversial within the Institute and appears to be approaching completion in 1992. It has produced some ten "Tentative Drafts" of provisions that have been debated extensively and heatedly on the floor of the ALI for a decade.

The ALI project, of course, is not connected with the Committee on Corporate Laws, though practically all members of the Committee are also members of the ALI and many of them have participated actively in the floor debates. Even after the RMBCA was finally approved in 1984, the Reporters of the Corporate Governance Project have continued to forge their own solutions to many of the problems that are also addressed in the RMBCA. The likely outcome of the ALI process, in other words, is another legislative-like document covering many of the same issues as the RMBCA but offering solutions and language that differ from that statute.

Among the areas that do appear to involve different standards are: (1) procedures to be followed in dealing with conflicting interest transactions; (2) the effect of the decision of an independent litigation committee recommending that derivative litigation not be pursued; and (3) the scope of permissible indemnification of directors and officers. However, I would not make too much of these differences at the present time.

One issue on which significant disagreement between the RMBCA and the Corporate Governance Project may exist is the desirability of the "alternative constituencies" statutes that have been so popular (and which Mississippi has enacted). These statutes provide that in making decisions affecting the corporation, the board of directors is authorized to consider the interests of creditors, employees, customers, communities, and the like. The Committee on Corporate Laws has clearly taken the position that these statutes are undesirable since they depart from the traditional notion that the ultimate goal of the corporation is to maximize the value of the shares for the benefit of the owners of the corporation.[15]

The position of the American Law Institute on alternative constituency statutes is much murkier. There is no question that the Reporters to the Corporate Governance Project—primarily academics but also including one well-known practitioner—agree entirely with the Committee on Corporate Laws in this regard.[16]

At the plenary annual meeting of the ALI in the Spring of 1990, however, the body of the Institute adopted an amendment to language of a later Tentative Draft that appears to authorize consideration of non-shareholder interests in formulating policies with respect to takeover attempts. The amendment changed the test for de-

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15. Committee on Corporate Laws, *supra* note 5, at 2253. A more elaborate analysis of these statutes reaching the same conclusion appears in John Hanks, *Non-Stockholder Constituency Statutes: An Idea Whose Time Should Never Have Come*, INSIGHTS, Dec. 1989, at 20. Mr. Hanks is a member of the Committee on Corporate Laws.

16. The Reporters of the Corporate Governance Project have suggested that most of these alternative constituency statutes may be construed as being consistent with the principle that the primary obligation of the directors is to benefit the shareholders, and alternative constituencies may be considered only when doing so creates no conflict with this primary duty. *See* CORPORATE GOVERNANCE PROJECT (Tent. Draft No. 10, 1990).

fensive actions in the takeover context from "the best interests of the shareholders" to "the best interests of the *corporation and its* shareholders."[17] The vote that adopted this amendment was relatively close; immediately following the vote, the Reporters announced that they could not support the amendment and did not know how a standard could exist for the benefit of "the corporation" in contradistinction to the benefit of its "shareholders." The ALI then approved a motion referring the entire matter to the Reporters for further consideration and requested that the issue be reconsidered at its next plenary session in May, 1991. At this session, however, the Reporters accepted the formulation approved at the plenary session the previous year.

I was present at the very confusing discussion in 1990 (and indeed I voted with the majority, much to the surprise of some of my academic colleagues). I do not view this vote as a general endorsement of the "alternative constituencies" approach, and indeed, it is not at all clear what the language that was adopted really means. So far as I personally am concerned, I viewed my vote in 1990 as extending no further than the takeover context, and then as doing no more than rejecting the notion that the directors always have a duty to accept the highest price in the contested takeover context. I do not know what motivated the other 200 plus members who voted the way I did. Indeed, no one will know what this vote portends until it is codified in a written ALI study, report, or recommendation. Indeed, with the collapse of the takeover movement in the 1990's the whole issue seems increasingly academic.

V. MISCELLANEOUS QUESTIONS

I am turning now briefly to miscellaneous questions that have been presented to me today by Mississippi lawyers. I will set forth each question or issue directly, and then give my reaction to it. It must be understood, obviously, that I am speaking as an individual, and these comments are in no sense comments by the Committee on Corporate Laws, the ABA, or anyone else with any authority in the matter.

A. What are the Practical Effects of the Elimination of Traditional Terminology, Such as "Common", "Preferred", "Treasury Shares, etc. When Accounting for Equity on a Corporation's Balance Sheet?

I do not think the elimination of these terms in the statute has any necessary practical effects at all on accounting for equity. For many years, Generally Accepted Accounting Principles ("GAAP") principles and accounting conventions resulted in financial statements departing widely from the language of the state

17. As amended, § 6.02(a) of the CORPORATE GOVERNANCE PROJECT reads as follows: "(a) The board of directors may take an action that has the foreseeable effect of blocking an unsolicited tender offer [§1.32(a)], unless the action would materially disfavor the long-term interests of the *corporation and its* shareholders." *Id.* (emphasis added).

corporation statutes that specified a set of rules for accounting for equity, e.g., "stated capital," "capital surplus," and "earned surplus." The elimination of the traditional terminology in the statute obviously does not mean that one cannot use the description, e.g., "preferred stock" if one wants to, particularly if the stock has designated preferences. The elimination of these terms in the RMBCA was designed to increase flexibility – to permit the creation of novel types of securities that might not fit neatly into the common/preferred categories. It should have no effect at all on traditional common or preferred shares, or how they are accounted for in financial statements.

I think that the most important practical effects of the RMBCA on accounting for equity do not lie in the elimination of these traditional terms, but rather in the elimination of par value, authorization of the issuance of shares for promissory notes or contracts for future services, and Section 6.40, amending the limitations on dividends and distributions. I do not think these changes have any significant impact on the substance of what could lawfully be done under earlier statutes, but they should simplify preparation of financial statements.

The elimination of the concept of treasury shares – they are treated as authorized but unissued shares under the RMBCA – should simplify accounting for equity since it is no longer necessary to show treasury shares as a contra item on the right hand side of the balance sheet, and to show a restriction on surplus. Rather surplus or capital may be directly reduced by the amount of the consideration paid to reacquire the shares. Again, I do not think that the RMBCA changes the substance of what could be done before, though the accounting for it should be different.

B. What Triggers Class Voting?

Class voting in the RMBCA is called "voting by voting groups."[18] It basically is triggered either by an amendment to the articles of incorporation, or by a merger or share exchange, that changes the rights of some shareholders in any of the ways designated in Section 10.04 of the RMBCA.[19] Class voting is not required in connection with sales of all or substantially all the assets of the corporation not in the ordinary course of business.

Voting by voting groups is available only for entire classes or series of shares. This type of voting is not available, for example, to those who are "cashed out" in a transaction in which some of the common shareholders are cashed out.

Class voting, of course, may always be granted as a matter of contract by appropriate provisions in the articles of incorporation.

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18. This change in terminology was made because of drafting considerations following the decision to recognize series (as well as classes) as having the right to vote separately in some circumstances. To use "class voting" when referring to a series voting separately when the series was part of a "class" that did not have the right to vote separately was just too confusing.

19. While Section 10.04 of the RMBCA only relates to amendments to articles of incorporation, the same voting pattern is required for mergers and related transactions by Section 11.03(f).

C. How do Directors' Elections Work?

The reason for the plurality requirement is to take into account the possibility that three or more factions may each be seeking to elect a slate of directors, so that no single candidate will get a majority of the votes cast.[20] The rule is simply that the candidates with the greatest number of votes are elected independently of whether voting is straight or cumulative; in the absence of a tie, there is no run-off in the event no one gets a majority. The ones with the most votes are elected.

Presumably, the form of ballot will reflect the names of the candidates who have been nominated by the various factions of shareholders. There must also be instructions as to how the total number of votes each shareholder may cast may be divided among the candidates by each voting shareholder: if the voting is cumulative, each shareholder may spread the total number of votes he or she has (the number of shares multiplied by the number of positions to be filled) over one or more candidates; if the voting is straight, a shareholder may vote the number of shares he has for one or more candidates but may not cast more votes for any one candidate than the number of his shares.[21] For example, in a straight election, a shareholder with 100 shares may place 100 votes on as many candidates as there are positions to be filled; a shareholder owning fifty shares may cast fifty votes for each of three candidates. Since candidates are elected on the basis of those with a plurality of votes, in a straight election, a majority shareholder will elect the entire board and the minority shareholder will be entirely deprived of representation.

D. Does a Court of Equity have the Power to Impose Remedies Other than Actual Dissolution or Some Form of Custodianship?

As approved in 1984, the RMBCA basically only recognized involuntary dissolution as a remedy for oppression, deadlock, abuse of power, fraud, or waste of corporate assets.[22] A much broader list of available remedies appeared in the Close Corporation Supplement, but that statute has not been adopted in Mississippi (or in most other states, for that matter). So far as I know, no consideration was given by the Committee on Corporate Laws in 1984 to the question of whether other remedies short of involuntary dissolution might be appropriate in specific cases.

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20. All elections for directors are run on an "at large" basis– one votes in favor of candidates (much as in a political election) rather than a slate of directors. If there are three contending factions, and each votes for their own candidates, the plurality rule determines who is elected without the need for a runoff. If there are three directorships to be filled, the top three vote getters are elected. Where only two factions are contending for places on the board of directors, the plurality language becomes virtually identical to the older "majority" language in earlier statutes.

21. For example, if a shareholder owns 100 shares and there are three directors to be elected, in cumulative voting the shareholder may cast up to 300 votes for one candidate, or he may divide up the votes among more than one candidate as he or she wishes. In straight voting, the shareholder may cast a maximum of 100 votes for any one candidate, and may cast 100 votes for each of three candidates.

22. REVISED MODEL BUSINESS CORP. ACT § 14.30 (1984).

In 1991, the Committee on Corporate Laws approved major amendments to the RMBCA dealing with judicial dissolution. As you may know, courts in a number of states have judicially determined that they have power to grant relief other than dissolution in cases of oppression, etc., even under statutes that expressly authorize only dissolution or custodianship.[23] The remedy usually granted in these cases is a mandatory buyout. The 1991 RMBCA amendments expressly create a buyout remedy after a lawsuit seeking involuntary dissolution is filed. Involuntary dissolution is still the ultimate remedy if the terms of the buyout cannot be worked out.

I might observe that the original RMBCA merely says that the court "may" grant dissolution in cases of oppression, etc., and there is certainly nothing in the statute that expressly precludes alternative remedies that may be less disruptive than dissolution, if the court wishes to consider such remedies. I assume, therefore, that a court is not precluded from doing so under the RMBCA, whether or not the state has adopted the new section 14.34.

E. Why is There No Specified "Drop Dead" Date in the Dissolution Process?

I personally argued in favor of a "file only at the end of the dissolution process" rule in order to establish a fixed date at which the voluntary dissolution process has ended. At this time, the corporate existence would end, the time period for post-dissolution suits would begin to run, and the corporate name would again become available for general use. The Texas statute handles dissolution in this way, but I was unable to persuade the subcommittee that this was the best way to go, since some subcommittee members were familiar with "file at the beginning of the process" statutes. The "file at any old time" provision in the present RMBCA was basically an acceptance of the notion that one first filed and then completed the dissolution process. I later raised this issue before the full Committee, but was unable to persuade them that the subcommittee had made a mistake. I should add, this issue arose very near the end of the process of reviewing comments, and the Committee was rushing to complete its review of the proposed statute. I think the present RMBCA is less than satisfactory in this respect.

F. What is the Effect of Reinstatement for an Administratively Dissolved Corporation? Why Does the Model Act not Contain a Similar Provision for a Foreign Corporation that has had its Qualification to do Business Administratively Revoked?

The theory of the RMBCA is to encourage reinstatements (since the goal is to get state taxes paid, annual reports filed, etc.) and not to punish negligent conduct. If reinstatement occurs, "it relates back to and takes effect as of the effective date of the administrative dissolution and the corporation resumes carrying on its busi-

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23. *E.g.*, McCauley v. Tom McCauley & Son, Inc., 724 P.2d 232 (N.M. Ct. App. 1986); Balvik v. Sylvester, 411 N.W.2d 383 (N.D. 1987); Davis v. Sheerin, 754 S.W.2d 375 (Tex. Ct. App. 1988).

ness as if the administrative dissolution had never occurred."[24] I assume that this language means that shareholders are not personally liable for corporate obligations incurred in the interim, that actions by directors and officers in the interim are viewed as corporate actions rather than individual ones, and so forth.

The fact that the RMBCA does not contain a similar provision for foreign corporations is an oversight. The omission was never raised or discussed, so far as I know.

G. Are There Any Practical Problems Arising from the Fact that the Same Individual May Serve as Both President and Secretary of the Corporation?

I believe that a majority of the states provide today that an individual may serve simultaneously in several different corporate offices, including President and Secretary. I am not aware that this has given rise to any particular problem. The only problem I can foresee arising is if one is dealing with a title examiner, bank officer, or other person who was brought up in the old school and believes that a document is not valid unless it is signed on behalf of the corporation by two different persons.

It is my impression, on the other hand, that it is common in multi-person corporations to have the President and Secretary be different persons, even in states that permit the two offices to be held by the same person. After all, why do something that might create a hassle when it is not necessary to do so?

H. Is There Any Difference Between a Certificate of Existence and a Certificate of Good Standing?

As I recall, the decision was made to use the phrase "Certificate of Existence"[25] rather than "Certificate of Good Standing" in order to make clear that the Secretary of State who issues that certificate was doing so only upon an examination of his or her own records and was not making a government-wide survey of all legal requirements for a corporation (as a "Certificate of Good Standing" arguably implies). In many states, for example, no procedure exists by which the Secretary of State may routinely determine from the comptroller or organization charged with collection of taxes other than franchise taxes that the corporation is "in good standing" under those other tax statutes. The change in name was made only to reflect the reality of what such certificates in fact cover in many states.

I. May Incorporators Issue Stock Under Section 2.05(a)(1), or May the Issuance of Shares Only be Accomplished by Action of the Board of Directors (Which Seems to be Contemplated by Section 6.21)?

The intention was that only directors may authorize the issuance of stock. If the persons forming a corporation wish to have the incorporator authorize the issu-

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24. REVISED MODEL BUSINESS CORP. ACT § 14.22(d) (1984).

25. REVISED MODEL BUSINESS CORP. ACT § 1.28 (1984).

ance of stock, the incorporator must also be named as the sole initial director under Section 2.02(b)(1), and the initial director should organize the corporation under Section 2.05(a)(1), during which "meeting" he can authorize the issuance of stock. The theory of this is that the issuance of stock should be made by a person or group who owes fiduciary duties to the shareholders, and that therefore directors should do it rather than incorporators. The flexibility of the organization provisions of the RMBCA permit this to be done at a single meeting.

J. How Does the RMBCA Handle "Fairness" Issues in Cash-Out Mergers and Share Exchange?

The RMBCA does not refer expressly to fiduciary duty or fairness requirements in connection with these transactions, which clearly have abusive or oppressive potential. However, the official comment to Section 11.01 does refer specifically to the case law holding that in some circumstances these transactions may constitute breaches of fiduciary duty. The expectation certainly is that these fiduciary duties will be held to apply under the RMBCA as part of the rules relating to self-dealing transactions, but I do not believe there is any case yet that has addressed this issue.

There is also a right of dissent and appraisal in connection with most of these transactions, and that provides an alternative protection to minority shareholders in many cases.

K. What is the Relationship Between Section 16.02 and the Common Law on Shareholder Inspection Rights?

The extent to which common law shareholder inspection rights exist at all, and the extent to which they continue to exist under present corporation statutes, are both very unclear questions in most states. These issues were discussed at some length by the subcommittee considering Chapter 16 of the RMBCA, and the conclusion was reached that whatever common law right existed should not be affected by Chapter 16 of the RMBCA. In other words, a common law right is not preempted by the RMBCA, but that statute also does not expressly recognize such a common law right. This rather Olympian conclusion is rather neatly (I think) set forth in section 16.02(e).

This section does not affect:

> (a) the right of a shareholder to inspect records under section 7.30 or, if the shareholder is in litigation with the corporation, to the same extent as any other litigant; or
>
> (b) the power of a court, independently of this Act to compel the production of corporate records for examination.

VI. Conclusion

Since 1984, the Committee on Corporate Laws has continued the process of revising and updating the RMBCA. Mississippi has adopted many though not all of these amendments. The principal amendments are:

1) Subchapter F, dealing with self dealing transactions. Mississippi has enacted this provision.

2) Amendment to section 2.20(b) authorizing articles of incorporation to limit the monetary liability of directors. Mississippi has enacted this provision.

3) Amendment to section 6.40, excluding certain subordinated indebtedness from the rules relating to distributions. Mississippi has enacted this provision.

4) Subchapter D, relating to derivative proceedings. Mississippi has not enacted these new sections designed to clarify the need for demand on directors and the preclusive effect to be given to recommendations of litigation committees.

5) Section 7.32, relating to shareholder's agreements in closely held corporations. Mississippi has not enacted this provision which was approved by the Committee in the Spring of 1991, and has not been widely distributed.

6) Section 14.34, relating to an option to purchase shares in lieu of involuntary dissolution. Mississippi has not enacted this provision which was also approved by the Committee in the Spring of 1991, and has not been widely distributed.

I believe that relatively small states (such as Mississippi) are well served in the corporate area by the Revised Model Business Corporation Act. The Committee on Corporate Laws has continued to address major problems of corporate law and has provided statutory language that is well-drafted and carefully reviewed to make sure that it strikes a reasonable balance among the various interests within a corporation.