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## The Financial Provisions of Florida's New Business Corporation Act-The Model Act with Anti-Takeover Twists

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## **Abstract**

Effective July 1, 1990, the Florida Legislature revamped Florida's corporate law by enacting the Florida Business Corporation Act.<sup>7</sup>

**KEYWORDS:** takeover, act, model

# The Financial Provisions of Florida's New Business Corporation Act—The Model Act with Anti-Takeover Twists

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## I. INTRODUCTION

Effective July 1, 1990, the Florida Legislature revamped Florida's corporate law by enacting the Florida Business Corporation Act.<sup>1</sup> Except for provisions concerning foreign corporations doing business in Florida, the Act generally applies only to corporations incorporated in Florida.<sup>2</sup> The Act repeals the Florida General Corporation Act,<sup>3</sup> and with significant exceptions, adopts the Revised Model Business Corporation Act.<sup>4</sup> This article addresses the financial provisions in chapter VI

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1. Florida General Corporation Act, 1991 Fla. Laws 154, (codified as amended at FLA. STAT. § 607 (1990)) [hereinafter the Act]. The Act arose from a proposal prepared by a subcommittee of the Corporations and Securities Committee of The Florida Bar chaired by Thomas R. McGuigan of Steel, Hector & Davis and Stuart D. Ames of Weil, Gotshal & Manges, which was enacted with few modifications. In 1990, before it became effective, the Act was amended for technical corrections. *See* 1990 Fla. Laws 179.

2. One exception to this general rule is section 607.0902, the control shares acquisitions statute, which covers some corporations that have their principal office or place of business in Florida but are not necessarily incorporated in Florida. *See* FLA. STAT. § 607.0902 (1990).

3. FLA. STAT. § 607 (1989) (repealed 1990) (generally referred to as the "prior" or "former" law).

4. REVISED MODEL BUSINESS CORP. ACT (1984) [hereinafter RMBCA]. The

of the Act—those governing capital structure, issuances of equity securities, and distributions.<sup>5</sup>

The Act's financial provisions principally are set forth in sections 607.0601 through 607.06401.<sup>6</sup> These provisions are a credit to the Act's drafters and the drafters of sections 6.01 through 6.40 of the RMBCA, on which they are based, because they are more simple, logical, and flexible, and better attuned to commercial and economic reality than the former law.<sup>7</sup> The Act scraps complex, cumbersome, and unnecessary concepts and limitations of the former law, adopts current scholarly thoughts on corporate capital structure, and brings Florida the benefits of conforming to the RMBCA, which is likely to be widely adopted among the states. One commentator notes the benefits of adopting the RMBCA as follows:

The advantages of following the national model are obvious. The provisions have been thoroughly considered by a number of very prominent practitioners and scholars. The Official Comments to each section of the Model Act should serve as a guide to the inter-

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RMBCA reflects a complete revision of the Model Business Corporation Act developed over a five-year period by the Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association and completed in 1984. The RMBCA is "designed to be a convenient guide for revision of state business corporation statutes, reflecting current views as to the appropriate accommodation of various commercial and societal interests involved in modern business corporations." MODEL BUSINESS CORP. ACT ANN. xxiii (1990) [hereinafter MBCAA].

This article occasionally refers to the official comment that accompanies the RMBCA (the "official comment") and to the commentary to the Act that was prepared by its drafters. The official comment is set forth in the MBCAA, *supra*, and the drafters' commentary on the Act are compiled in T. O'BRIEN, FLORIDA LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS (1990).

5. To limit its scope and length, this article does not address in detail the following matters that the author considered more or less peripheral to the principal subjects: fractional shares, subscriptions for shares, shareholders' preemptive rights, restrictions on transfers of shares, form and content of certificates, share voting rights (including voting groups), and directors' fiduciary duties in connection with the corporation's issuance and its repurchase of shares. This article also generally does not address other state and federal laws that apply to these matters, such as the laws governing the sale of securities and the corporation's repurchase of its securities.

6. FLA. STAT. § 607.0601-.06401 (1990).

7. Persons following the federal tax "simplification" efforts of the 1980's might be skeptical, but please continue reading. Except for section 6.22, which is based on the former law and concerns shareholders' liability for shares issued before payment, the Act generally adopts the RMBCA, *supra* note 4. As discussed in this article, the Act modifies those provisions in some respects.

pretation of the Revised Statute's provisions. The evolving case law from jurisdictions having substantially the same provisions can be persuasive authority in the interpretation and application of the Revised Statute.<sup>8</sup>

The Act also facilitates the adoption of anti-takeover measures by Florida corporations. Corporations considering Florida incorporation should evaluate the Act favorably.

The changes affecting the financial provisions that are discussed in this article were part of revolutionary amendments to the Model Business Corporation Act made in 1980 and 1984.<sup>9</sup> In particular, these amendments: (a) eliminated the established concepts of par value, stated capital, and treasury shares; (b) eliminated limitations on acceptable consideration for sales of shares; (c) eliminated specific references to "common" and "preferred" shares in recognition of the blurring between those types of shares that has occurred in the market place; and (d) adopted uniform rules governing all transactions in which consideration is paid to shareholders with respect to their shares, called distributions. The objectives of most of the changes were to eliminate obsolete and ineffective restrictions, and to allow the corporation, its creditors, and shareholders to freely determine their relationship through negotiation and contract. This article analyzes these and other more subtle changes, their policy underpinnings and practical implications, and several omissions and inconsistencies in the financial provisions of the Act that are proposed for revision in a bill pending before the Florida Legislature.

Although the Act's financial provisions are derived from the RMBCA, the provisions actually enacted by the Florida Legislature in the Act vary in significant respects from the RMBCA. The most important substantive variances are in section 607.0601(1) and section 607.0624(2). Section 607.0601(1) omits a sentence requiring that all shares of a class be granted equal rights, limitations, and preferences, except for variations caused by series.<sup>10</sup> Section 607.0624(2) confirms

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8. Murphy, *The New Virginia Stock Corporation Act: A Primer*, 20 U. RICH. L. REV. 67 (1985).

9. The premier authority on the legal guidelines governing corporate capital structures observes that following these changes, the new law "is substantially at variance with the learning that today's judges and practitioners gained when they were in law school." Manning, *Assets In and Assets Out: Chapter VI of the Revised Model Business Corporation Act*, 63 TEX. L. REV. 1527 (1985).

10. FLA. STAT. § 607.0601(1) (1990).

the validity of poison pill devices involving rights that discriminate against persons acquiring more than a certain number of shares.<sup>11</sup> Both modifications facilitate use of anti-takeover defenses.

## II. WHAT'S AVAILABLE ON THE SHELF—AUTHORIZED SHARES AND BLANK CHECK AUTHORIZATION (SECTION 607.0601 AND SECTION 607.0602)

Authorized shares are the shares of all classes that the corporation is authorized to issue as set forth in its articles of incorporation.<sup>12</sup> The Act generally requires that shareholders approve amendments to the articles of incorporation that increase the number of authorized shares or change the terms of any shares that have been issued.<sup>13</sup> Consequently, authorized shares are the limit of what is available "on the shelf" for directors to issue to raise capital for the corporation.<sup>14</sup> The number and terms of authorized shares vitally concern shareholders because each authorized share represents potential dilution of their interests in the corporation (voting, dividends, liquidation rights) and will reduce their share value if earnings from the capital raised do not offset the increase in the number of shares.

Section 607.0601 prescribes what may be in the articles of incorporation concerning authorized shares.<sup>15</sup> Section 607.0602 permits a corporation to delegate to the board of directors authority to establish the terms of classes and series of shares before they are issued.<sup>16</sup>

### A. Authorized Shares (Section 607.0601)

Following the precepts of the RMBCA, the Act does not limit rights, preferences, and limitations that the corporation may specify for its shares, except in the one respect discussed below, and except for

11. *Id.* at § 607.0624(2).

12. *Id.* at § 607.0601(2).

13. *See id.* at § 607.1004(1).

14. *See id.* at §§ 607.0601, .0621. The one exception to this rule is an amendment to increase the corporation's authorized shares to accommodate a stock split or stock dividend if the corporation has only one class of stock outstanding. *Id.* at § 607.1002(5).

15. FLA. STAT. § 607.0601 (1990). Section 607.0202 generally specifies all matters to be covered by the articles, including authorized shares while section 607.0601 concerns only authorized shares. *See id.* at §§ 607.0202, .0601.

16. *Id.* at § 607.0602.

provisions that are inconsistent with other provisions of the Act.<sup>17</sup> Section 607.0601 allows the corporation and its shareholders to freely agree on all the terms of the corporation's capital stock.<sup>18</sup> These terms include voting rights, redemption and conversion rights (at any person's option), shareholder distributions, and relative preferences among classes with respect to distributions.<sup>19</sup> The official comment calls the terms on this list the "principal features that are customarily incorporated into classes of shares."<sup>20</sup> The official comment also sets forth illustrative examples of "innovative" classes of shares that are permitted by the RMBCA, including classes authorized to elect a specified number of directors, classes entitled to vote as a separate voting group on certain transactions, variations of voting rights among shares (including nonvoting, fractional, and multiple votes per share), and variations among classes in dividend rights and rights on dissolution.<sup>21</sup> To cover terms that they might have missed and to encourage market innovation, the drafters add for good measure in subsection four that this list "is not exhaustive."<sup>22</sup> The Act specifically does not limit a corporation's ability to differentiate among classes with respect to voting rights, clearly authorizing nonvoting shares and shares with fractional or multiple voting rights.<sup>23</sup> However, other regulations, such as stock exchange requirements, might restrict a corporation's discretion in this respect.<sup>24</sup>

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17. An example of a provision that would be inconsistent with other provisions of the Act is the elimination of the voting protections to which all shares are entitled pursuant to Florida Statutes section 607.1004 (1990).

18. *Id.* at § 607.0601.

19. *Id.* at § 607.0601(1), (3).

20. MBCAA, *supra* note 4, at 357.

21. *Id.* at 360.

22. *Id.*

23. FLA. STAT. § 607.0601 (1990). Section 607.0601(3)(a), concerning voting rights provisions, states that the articles of incorporation may authorize shares that "[h]ave special, conditional, or limited voting rights, or no rights, or no right to vote, except to the extent prohibited by this act . . ." *Id.* at § 607.0601(3)(a) (emphasis added). The emphasized language was added in error to text taken from section 6.01(c) of the RMBCA, *supra* note 4, and is proposed for deletion pursuant to the Second Corrections Bill, because shares with "no rights" are worthless. Authorization to issue shares with no voting rights is covered by the next clause, "or no right to vote." *Id.*

24. *See, e.g.,* NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 313.00 (1990) (generally requiring that an exchange listed issuer not have a class of shares with voting rights not in proportion to the class equity interests).

Section 607.0601 is basically *enabling* rather than *restrictive*.<sup>25</sup> The Act recognizes that each corporation and its shareholders face their own unique financial and control circumstances and should be permitted to structure the corporation's capital structure to accommodate those particular circumstances. Implicitly, the Act completes the shift in emphasis away from restrictive and protective corporate statutes to reliance on the following elements:

(a) the interest and sophistication of informed parties to the security purchase transaction in vigorously defending their own interests;

(b) full disclosure requirements and anti-fraud rules mandated by the state and federal securities laws, to ensure that the buyer is completely and accurately informed before it makes the purchase and that the transaction itself is not subject to manipulation by the issuer; and

(c) fiduciary duties of directors that require them to act reasonably and in good faith, especially in transactions in which they are interested, which involve the greatest potential for abuse.

The Act completes the deregulation of corporate law governing the specifications of capital stock.

Practically, this new law concerning authorized shares is not revolutionary, because the former law permitted most types of equity securities, either expressly or implicitly. The Act more clearly welcomes innovation, and permits some kinds of equity and hybrid securities which had unclear status under the former law.<sup>26</sup> Section 607.0601(2) im-

25. See FLA. STAT. § 607.0601 (1990) (emphasis added).

26. By implication, the former law provided broad authorization to the corporation to issue shares with a wide range of attributes. Under this former law, FLA. STAT. § 607.044(1) (1989) (repealed 1990) provided that "shares may be divided into one or more classes, any or all of which may consist of shares . . . with such designations, preferences, limitations, and relative rights as shall be stated in the articles of incorporation." Subsection two of this section listed permitted terms for "special and preferred" classes of shares, but prefaced the list by stating that it did not limit the foregoing general authority of section 607.044(1). *Id.* at § 607.044(2). By implication, section 607.044(1) granted the corporation broad plenary authority to create a wide range of equity securities. The corporation's plenary authority under the Act is confirmed more clearly, however, with the "not exhaustive" provision in section 607.0601(4). See FLA. STAT. § 607.0601(4) (1990).

The former law listed specifically permitted terms for "special and preferred shares" but left unclear whether common shares could be subject to those terms. FLA. STAT. § 607.044(2) (1989) (repealed 1990). Whether the term "special" classes included common shares was unclear, because that term was not defined. The former law did not expressly address whether common shares could be redeemed by the corporation. Also, unlike the Act, the former law did not expressly permit (a) shares converti-



poses a blanket limitation that was not expressly established under the former law.<sup>27</sup> The corporation must authorize one or more classes of shares that together have unlimited voting rights and one or more shares that together have rights to the net assets of the corporation upon dissolution. These attributes are associated with traditional common stock.

Unlike corporate law in many states, the Act does not restrict the corporation from: (a) creating shares that are convertible at the shareholder's option into cash (shares with a "put option"), into other classes of shares that have preferential financial rights, or into debt securities of a corporation (shares with "upstream" conversion privileges); or (b) creating a class of voting shares without preferential financial rights that is callable by the corporation (redeemable common shares).<sup>28</sup> The official comment to section 6.01 of the RMBCA reasons that this change has little practical effect because the corporation and its shareholders generally could agree separately in a buy-sell agreement to redemption of the shares at either person's option.<sup>29</sup>

An upstream conversion feature eliminates the permanence associated with common shares that favors the corporation. Because the

ble into debt or debt convertible into shares, or (b) shares subject to conversion or redemption at the option of a third person or on the occurrence of a designated event. Finally, the blank check provision of the former law, section 607.047, limited to a list the particular terms that could be the subject of variations between series, but its counterpart in the Act, section 607.0602(1), refers back to the relatively unlimited provisions of section 607.0601 of the Act.

27. FLA. STAT. § 607.0601(2) (1990).

28. RMBCA, *supra* note 4, at § 6.01 (official comment). The former law expressly permitted conversions of "preferred or special classes" to any other class of shares and redemption of "preferred or special classes" at the shareholder or corporation's option, but did not expressly address redeemable or puttable common stock. See FLA. STAT. § 607.044(2).

29. The comment states: "If it is possible to create what is essentially a callable voting share by agreement, there is no reason why such provisions should not be built directly and publicly into the capital structure of the corporation if that is desired." RMBCA, *supra* note 4, at § 6.01 (official comment). In Florida, this statement might understate the practical effect of the change, because nothing in the former law expressly addressed the enforceability of an agreement granting the corporation a right to call its common stock in the absence of a proposed transfer by the shareholder. Even section 607.0627, which was added by the Act and governs agreements restricting a shareholder's right to transfer his shares, does not expressly state that an agreement between the corporation and its shareholder may authorize the corporation to simply call its common shares, even if the shareholder does not initiate a transfer. See FLA. STAT. § 607.0627 (1990).

holder might cash out or convert to a relatively more senior security when the corporation's prospects dim and the corporation most needs cash or equity. Conversely, by agreeing to redemption at the corporation's option, the common shareholder forfeits the relatively permanent nature of his interest in the corporation and the prospect of benefitting to an unlimited extent from future value appreciation. Even without redemption provisions, the shareholder might be squeezed out by a merger, reverse stock split or similar event, but these are extraordinary events and typically invoke dissenters' rights. The Act permits the common shareholder to agree in advance to redemption of his shares precisely when the corporation's prospects become favorable, although the corporation's exercise of power to redeem common stock might be restricted by securities laws or fiduciary duty principles.<sup>30</sup>

The Act permits creation of "hybrid securities" that have mixed debt and equity attributes, for example, convertible debt (debt to equity or equity to debt) and debt that is entitled to participate in earnings or dividends.<sup>31</sup> However, the official comment to section 6.01 of the RMBCA states that only securities characterized as "shares" may be given the right to vote.<sup>32</sup> Therefore, a corporation could not issue a debt security that entitles the holder to vote on a default, although a debt security that is convertible into an equity security on default is permitted.

The RMBCA does not generally define or use the terms "common" and "preferred" stock. The official comment explains this policy decision:

Traditional corporation statutes work from a perceived inheritance of concepts of "common shares" and "preferred shares" that at one time may have had considerable meaning but that today often do not involve significant distinctions. It is possible under modern cor-

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30. See, e.g., *Zahn v. Transamerica Corp.*, 162 F.2d 36 (3d Cir. 1947) (controlling shareholder breached fiduciary duty by causing directors to redeem minority shareholders' stock following a rise in the market value of raw materials manufactured by the corporation); *Green v. Hamilton Int'l Corp.*, 437 F. Supp. 723 (S.D.N.Y. 1977) (redemption constitutes "purchase" for purposes of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder); *Tillis v. United Parts, Inc.*, 395 So. 2d 618 (Fla. 5th Dist. Ct. App. 1981) (majority shareholder and corporation breached fiduciary duty to minority shareholders by purchasing majority shareholders' shares at a premium); see generally Note, *Partial and Selective Reacquisitions of Corporate Securities*, 15 CAL. W.L. REV. 264 (1979).

31. FLA. STAT. § 607.0601(3)(b) (1990).

32. RMBCA, *supra* note 4, at § 6.01.

poration statutes to create classes of "common" shares that have important preferential rights and classes of "preferred" shares that are subordinate in all important economic aspects or that are indistinguishable from common shares in either voting rights or entitlement to participate in the assets of the corporation upon dissolution. The [RMBCA] breaks away from the inherited concepts of "common" and "preferred" shares and develops more general language to reflect the actual flexibility in the creation of classes of shares that exists in modern corporate practice.<sup>33</sup>

The former law did not define those terms or expressly refer to common and preferred shares in describing share attributes, so this change is not revolutionary in Florida.<sup>34</sup> In a slight variance from the RMBCA, the Act still uses these terms in one confusing reference in section 607.0202, discussed below,<sup>35</sup> and in the following sentence of section 607.0601(5): "Shares which are entitled to preference in the distribution of dividends or assets shall not be designated as common shares, shares which are not entitled to preference in the distribution of dividends or assets shall be common shares and shall not be designated as preferred shares."<sup>36</sup> This text was derived from the former law, section 607.044(4),<sup>37</sup> not from the RMBCA. Apparently, the Act's drafters were not willing to rely on federal and state securities laws to deter misleading characterizations of common and preferred stock.

The elimination of statutory definitions of share rights causes the share descriptions in the articles of incorporation to assume great importance. These descriptions constitute the shareholders' "contract" with respect to their shares.<sup>38</sup> The official comment states that in some limited circumstances, shares still may be described simply.<sup>39</sup> A capital structure consisting of only a single class of "common shares" may be described as such; all voting and residual equity financial interests will vest in that class, without further delineation. Additionally, for a capital structure consisting of two classes, one with a liquidation preference, "it is necessary to specify only the preferential liquidation rights

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33. *Id.*

34. *See, e.g.,* FLA. STAT. §§ 607.097, .137 (1989) (repealed 1990) (voting and dividends, respectively).

35. *See infra* note 46 and accompanying text.

36. FLA. STAT. § 607.0601(5) (1990).

37. FLA. STAT. § 607.044(4) (1989) (repealed 1990).

38. RMBCA, *supra* note 4, at § 6.01 (official comment).

39. *Id.*

of that class; in the absence of a contrary provision in the articles, the remaining class would be entitled to receive the net assets remaining after the liquidation preference has been satisfied.”<sup>40</sup> Otherwise, all preferences and special rights of shares should be well described, because those rights are not spelled out in the Act and exist only to the extent specifically stated in the articles of incorporation.<sup>41</sup> Each class must be given a “distinguishing designation,” for example, “nonvoting common shares” or “class A preferred shares.”

In section 607.0601, the Act varies from the RMBCA by omitting the following sentence: “All shares of a class must have preferences, limitations, and relative rights identical with those of other shares of the same class except to the extent otherwise permitted by section 6.02.”<sup>42</sup> The purpose of omitting this sentence was to facilitate anti-takeover measures that involve securities discriminating against hostile bidders, but its omission leaves a gap. Generally, the RMBCA contemplates uniformity of share attributes within the class except for variations between series within the class. The omission of the sentence, however, permits the corporation to vary the rights, preferences, and limitations of shares within a class, *even if the corporation does not use series*. The Act does provide in section 607.0602(3) that each share of a *series* be identical and that it be identical with the other shares of the class, except to the extent distinguished by the terms of the series. However, this provision would not apply if the corporation does not have series.

The omission of the foregoing sentence supports the conclusion that corporations may vary share attributes within classes without using series. This raises several issues. Did the drafters of the Act contemplate that a corporation might issue numerous shares within a single class, each share with different rights, preferences, and limitations? Why should a corporation use series at all, if it can otherwise establish shares with variable rights within the class? Does not the RMBCA’s scheme contemplate that variations within a class will take the form of series? What unintended results might follow from tinkering with this

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40. *Id.*

41. *See, e.g.,* Judah v. Delaware Trust Co., 378 A.2d 624 (Del. 1977) (the provisions of the articles of incorporation control the rights of preferred shareholders, and those shares have only those rights granted or provided in the articles); *see generally* Buxbaum, *Preferred Stock—Law and Draftsmanship*, 42 CAL. L. REV. 243 (1954) (an excellent discussion of drafting points for preparation of preferred stock provisions).

42. RMBCA, *supra* note 4, at § 6.01.

traditional scheme of classes with uniform share attributes? Might the new scheme facilitate new, as yet unseen, versions of the poison pill? For example, a corporation seemingly may provide in its articles that any shareholder owning more than a certain number of shares automatically loses the benefits of its share ownership, including voting rights, dividends, and liquidation rights. This discrimination among the holders of shares (not just rights or options as contemplated by section 607.0624(2)) of a single class might be considered authorized by the Act.<sup>43</sup>

### B. *Blank Check Authority (Section 607.0602)*

Section 607.0602 confirms that the articles of incorporation may give "blank check" authority to the board of directors to determine the preferences, limitations, and relative rights of any class or series of shares before the shares are issued.<sup>44</sup> The Act provides for extension of blank check authority to common shares as well as preferred. The former law referred only to designations of "preferred" and "special" shares, and left unclear whether "special" classes included common shares.<sup>45</sup> The Act also permits extension of blank check authority to

43. The drafters' commentary to section 607.0601 does not address these issues. See FLA. STAT. § 607.0601 (1990). The commentary states, briefly and incorrectly, that the proposed provision does not differ materially from the former law. The former law provided for equality among the shares of a class, as follows: "[A]ll shares of the same class shall be identical except as to the following relative rights and preferences, as to which there may be variations between different series . . ." FLA. STAT. § 607.047(1) (1989) (repealed 1990). Professor Stuart Cohn, a member of the drafting committee, told the author that the modification omitting the share equality sentence occurred after preparation of the commentary.

Other states adopting the RMBCA have not adopted this modification. See, e.g., ARK. STAT. ANN. § 4-27-601A (1989); CAL. CORP. CODE § 400(b) (1989); GA. CODE ANN. § 14-2-601(a) (1989); IND. CODE ANN. § 23-1-25-1(a) (1989); KY. REV. STAT. ANN. § 271B.6-010(1) (1989); MISS. CODE ANN. § 79-4-6.01(a) (1972); OR. REV. STAT. § 60.131(1) (1989); S.C. CODE § 33-6-101(a) (1976); TENN. CODE ANN. § 48-16-101(a) (1989); VA. CODE § 13.1-638A (1950).

44. FLA. STAT. § 607.0602 (1990). Before issuing blank check shares, the corporation must deliver to the Department of State "articles of amendment" to the articles of incorporation that set forth the terms of the class or series of shares and become part of the corporation's articles of incorporation. Once shares of the class or series are issued, the terms can be changed only with shareholder approval. *Id.* at § 607.1004(1)(d). Conversely, the terms may be changed without shareholder approval before the shares are issued. *Id.* at § 607.0602(1).

45. FLA. STAT. § 607.047.

classes. Prior law permitted authorization of the directors to establish the terms of series only. The Act's intent on these matters is clear, although the Act mistakenly retains vestiges of the former law in section 607.0202(1)(d) and (e) that seem to contemplate limiting blank check authority to series and to "preferred" and "special" shares.<sup>46</sup>

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46. FLA. STAT. § 607.0202(1)(d), (e) (1990). The drafters added potentially confusing language in section 607.0202(1), which provides in part:

"The articles of incorporation must set forth: . . .

(d) If the shares are to be divided into classes, the designation of each class and the statement of the preferences, limitations, and relative rights in respect of the shares of each class; . . . [and]

(e) If the corporation is to issue the shares of any preferred or special class in series, the designation of each series and a statement of the variations in the relative rights and preferences as between series insofar as the same are to be fixed in the articles of incorporation and a statement of any authority to be vested in the board of directors to establish series and fix and determine the variations in the relative rights and preferences between series . . . .

*Id.* at § 607.0202(1) (Section 607.0202 is derived from section 2.02 of the RMBCA, *supra* note 4, except for these subsections, and section 607.0202(f), concerning preemptive rights, which were added by the Act.). The quoted text is confusing because it is derived from the former law, which allowed blank check provisions for series, but not classes. Part (d) does not clarify that in some cases terms of classes might not be established when the articles are initially filed. This language might confuse, because it seems to require that the articles initially spell out the terms of each class, rather than leaving them for future determination by the board of directors. Compare section 607.0601(1) (derived from the RMBCA) which states as follows: "If more than one class of shares is authorized, the articles of incorporation must prescribe a distinguishing designation for each class, and *prior to the issuance of shares of a class*, the preferences, limitations and relative rights of that class must be described in the articles of incorporation. *Id.* at § 607.0601(1) (emphasis added). This language clarifies that only the class designation initially must be stated in the articles and that specification of the terms of each class can be reserved for later determination pursuant to blank check power, to be evidenced by articles of amendment filed before issuance. Section 607.0202(1)(d) also does not refer to any requirement that the terms of *series* must be described in the articles of incorporation, even though similar to classes, their terms eventually must be described in an amendment to the articles. *Id.* at § 607.0202(1)(d).

Part (e) furthers this confusion by referring to the delegation to the board of authority to "establish series and fix and determine the variations in the relative rights and preferences between series." *Id.* at § 607.0202(1)(e). This subsection does not refer to blank check authority for classes, again inconsistently with section 607.0602, which grants authority to directors to establish the terms of not only series but also of classes. Also, subsection (e) refers to blank check provisions for "preferred and special series," reintroducing language of the former law that left unclear whether blank check authority could be extended to common shares. The Second Corrections Bill proposes deletion of parts (d) and (e), which would eliminate the inconsistencies and make section

This change probably will have little practical significance because classes and series are not inherently different, and the board of directors may do little more with blank check classes than with blank check series.<sup>47</sup> A series is simply a subset of a class, but with the same potential attributes. An exception is the requirement in Florida that shares of the same series be identical, but apparently not shares of the same class.

Blank check authority historically has served two important purposes: to enhance capital-raising efforts; and to facilitate adoption of anti-takeover measures. For its capital-raising efforts, the board of directors receives broad and instant flexibility to determine share attributes without prior shareholder approval. This flexibility facilitates transactions that involve last-minute negotiations between the issuer and share purchasers concerning the securities' attributes.

Blank check authority enables the issuer to quickly take advantage of favorable changes in market variables such as stock prices, interest rates, and currency trading rates. Typically, the class of shares is described in the articles with key market-dependant economic terms left open. The terms of each series within the class are determined according to market conditions when shares of the series are issued. For example, the market-dependant terms of a series of preferred stock might include the dividend rate (variable or fixed—if variable, the formula for determination), timing for payment of dividends, conversion and redemption rights, and special voting rights. Generally, all shares of the series are issued concurrently, because changes in market conditions quickly make the these market-dependant terms obsolete.

Existing shareholders might be concerned with the potential dilutive effect of blank check shares on their shares. Each existing shareholder must rely on the good business judgment of the corporation's directors not to issue shares on more favorable terms, and then only to suit real capital needs. In normal circumstances (no self dealing or interest in the transaction), the business judgment rule will insulate directors from shareholder challenges to their actions in issuing blank check shares. Therefore, shareholders might desire to restrict directors'

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607.0202(1) basically consistent with the RMBCA, *supra* note 4.

47. Manning, *supra* note 9, at 1532. The official comment to section 6.02 of the RMBCA states: "This section recognizes that in some contexts there is no substantive difference between a 'class' and a 'series within a class', and that the labels are often a matter of convenience." RMBCA, *supra* note 4, at § 6.02 (official comment).

blank check authority by negotiating restrictions on that authority as part of their purchase of shares.

### III. SHARE OPTIONS (SECTION 607.0624)

Section 607.0624(1) of the Act conforms to section 6.24 of the RMBCA, and confirms that, unless otherwise provided in its articles of incorporation, the corporation may issue rights, options, and warrants for the purchase of its shares.<sup>48</sup> The directors establish the terms of these securities and the consideration for which the underlying shares are issued. Generally, shareholder approval is not required.<sup>49</sup>

Section 607.0624(2) expressly permits a corporation to impose conditions or restrictions that deprive specified persons of the options' benefit, including "persons owning or offering to acquire a specified number or percentage of the outstanding common shares or other securities of the corporation . . . ."<sup>50</sup> This provision carries over the provisions of former law, section 607.058,<sup>51</sup> authorizing poison pill rights plans that discriminate against persons acquiring or threatening to acquire the corporation's shares.

### IV. A SPECIAL APPLICATION—POISON PILL PLANS

In recent years, statutes similar to section 607.0602 (blank check authorization) and section 607.0624 (share options) have been used by corporations to implement "poison pill" or "shareholder rights" plans without prior shareholder approval, to the dismay of many institutional investors.<sup>52</sup> The Act includes provisions that are designed to facilitate these plans and to avoid challenges based on grounds that have been

48. FLA. STAT. § 607.0624(1) (1990).

49. Shareholder approval may be obtained as a discretionary matter, to comply with listing requirements, see NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 309.00 (1990), or to obtain the benefits of federal law conditioned on shareholder approval, see S.E.C. Rule 16b-3(a).

50. FLA. STAT. § 607.0624(2) (1990).

51. FLA. STAT. § 607.058 (1989) (repealed 1990).

52. See, e.g., "K-mart Won't Oppose Holder's Bid for Vote on Poison-Pill Plan," Wall Street J., Dec. 7, 1990, at A4 ("The Wisconsin board . . . has campaigned for years against what it sees as the improperly unilateral means by which poison-pill measures are put in place by a simple vote of the board. Implementing other anti-takeover defenses, such as staggered terms for directors, typically requires prior holder approval."). Institutional holders have proposed that the federal proxy rules be amended to require a shareholder vote for adoption of poison pills.



successful in other states.

"Poison pill" or "shareholder rights" plans come in many forms, but generally involve distribution by the corporation of rights or securities that have redemption or conversion provisions. Once triggered by a hostile takeover attempt or a party acquiring a specified percentage of a class of the issuer's securities, the plans make the securities excessively or prohibitively expensive to buy.<sup>53</sup> The principal poison pill provisions are as follows: (a) a "flip-in provision" that grants each shareholder (other than the bidder) an option to purchase the *issuer's* securities at a substantial discount on the occurrence of the triggering event (usually acquisition or tender for a certain amount of shares, such as 20%); (b) a "flip-over provision" that permits each shareholder to purchase the *acquiring corporation's* securities at a discount following a merger or consolidation; and (c) a "back-end" provision that permits each shareholder (other than the bidder) to exchange its shares for a package of the issuer's securities following completion of a hostile takeover.<sup>54</sup>

Reduced to their simplest forms, the flip-in provision grants a shareholder an option to purchase the issuer's shares at a discount, a flip-over provision grants a shareholder an option to purchase the acquirer's shares at a discount in a manner similar to anti-dilution provisions, and a back-end provision grants the shareholder the right to force redemption of his shares on favorable terms. Many plans include combinations of these provisions. The key element of the flip-in and back-end plans is discrimination against the person making the acquisition or takeover attempt. That person is denied the opportunity to exercise option or redemption rights on the same favorable, often financially ruinous to the issuer, terms as other security holders. The practical effect of the poison pill plan is to preclude a hostile tender offer until the plan is canceled by the directors or declared void by a court. Its ostensible purpose is to give directors leverage to negotiate a favorable purchase price with a hostile bidder.<sup>55</sup>

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53. See generally C. SIMON & CO., CORPORATE ANTI-TAKEOVER DEFENSES: THE POISON PILL DEVICE (1989); Note, *Delaware's Attempt to Swallow a New Takeover Defense: The Poison Pill Preferred Stock*, 10 DEL. J. CORP. L. 569 (1985).

54. For an example of a flip-over plan, see *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985).

55. This article does not address the thorny question of whether poison pill plans really benefit shareholders. Compare *City Capital Assoc. Ltd. Partnership v. Interco, Inc.*, [1988-89] Fed. Sec. L. Rep. (CCH) ¶ 94,084 (Del. Ch. 1988) stating:

Even where an offer is noncoercive, it may represent a 'threat' to share-

Most poison pill litigation concerns the directors' proper exercise of their fiduciary duties in adopting and implementing poison pill plans.<sup>56</sup> Underlying this issue, however, is the question whether directors have corporate authority to issue the securities that constitute the poison pill. In Delaware, this issue has been settled in favor of directors.<sup>57</sup> The drafters of the Act evidently were concerned with contrary decisions of courts in other states. For example, in *Amalgamated Sugar Co. v. NL Industries*, a federal district court applying New Jersey law held that a flip-in provision was *ultra vires* and void because it "effects a discrimination among shareholders of the same class or

holder interests in the special sense that an active negotiator with power [conveyed by a poison pill], in effect, to refuse the proposal may be able to extract a higher or otherwise more valuable proposal, or may be able to arrange an alternative transaction or a modified business plan that will present a more valuable option to shareholders.

with *Dynamics Corp. v. CTS Corp.*, 794 F.2d 250, 255 (7th Cir. 1986) (Posner, J.) ("Personally we are rather skeptical about the arguments for defensive measures . . . . We are especially skeptical about the arguments used to defend poison pills.").

56. See, e.g., *Interco, Inc.*, [1988-89] Fed. Sec. L. Rep. at ¶ 94,084; CRTF Corp. v. Federated Dep't Stores, 683 F. Supp. 422 (S.D.N.Y. 1988); *In re J.P. Stevens & Co.*, 542 A.2d 770 (Del. Ch. 1988).

57. In *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985), the Delaware Supreme Court rejected a challenge to a plan based on allegations that the directors lacked authority to implement the plan under the Delaware General Corporation Law. The court accepted the directors' position that they had the requisite authority under section 157 and section 151 of the Delaware General Corporation Law, which are roughly the same as Florida Statutes section 607.0624(1) (1990) (share options) and section 607.0602 (1990) (blank check authority). *Moran*, 500 A.2d at 1346. The court rejected the plaintiffs' argument that those provisions were not intended to be the basis of anti-takeover measures, but rather were limited to corporate financing and other conventional uses. *Id.* at 1352.

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 (Del. 1986), the Delaware court upheld the directors' authority to implement a back-end poison pill that discriminated against the bidder. The court reached this conclusion even though Delaware did not have a counterpart to section 607.0624(2) of the Act, which authorizes discrimination among shareholders with respect to the exercise rights of options. Courts construing Delaware law also have upheld the authority of directors to implement flip-in provisions that discriminate against the bidder, based on *Moran*. See, e.g., *BNS, Inc. v. Koppers Co.*, 683 F. Supp. 458, 474 (D. Del. 1988) (the plaintiffs conceded that the board was authorized to implement the plan); see also *Dynamics Corp. v. CTS Corp.*, 637 F. Supp. 406 (N.D. Ill.), *aff'd*, 794 F.2d 250 (7th Cir. 1986) (Indiana law); but see *Unilever Acquisition v. Richardson-Vicks Inc.*, 618 F. Supp. 407 (S.D.N.Y. 1985) (federal court construing Delaware law before *Moran*, 500 A.2d 1346, invalidated plan because of discrimination effects among shareholders of a series).

series.”<sup>58</sup> Under the plan, the voting rights and equity of the acquiring shareholder are diluted upon the triggering event.<sup>59</sup> The court invalidated the flip-in poison pill despite the existence of blank check and share option provisions under New Jersey law comparable to sections 151 and 157 of the Delaware Code, which were the basis for validating poison pills in that state.<sup>60</sup>

Florida courts have not addressed the authority of a board of directors to establish a poison pill or shareholder rights plan. To preclude future judicial invalidity, the Act addresses these potential challenges to a poison pill plan. Section 607.0624(2) expressly permits issuance of options or rights that discriminate against persons acquiring or offering to acquire more than a certain percentage of shares, validating flip-in plans that involve the issuance of rights. Further, section 607.0601 omits the sentence from section 6.01 of the RMBCA providing that all shares of a class must have identical preferences, limitations, and relative rights.<sup>61</sup> This omission sanctions discrimination among shareholders within a class with respect to share terms, such as plans involving preferred stock with a discriminatory conversion or redemption right. For example, the corporation might distribute to its shareholders a dividend consisting of preferred shares convertible, by all shareholders except the bidder into common shares on favorable terms, based on the occurrence of a triggering stock event.<sup>62</sup> The Act allows discriminatory limitations denying the conversion right to persons holding more than a certain number of shares, which otherwise might run afoul of share equality precepts.

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58. 644 F. Supp. 1224, 1234 (S.D.N.Y. 1986).

59. *Id.* at 1299. The court reasoned that the plan in substance constituted a restructuring of voting and equity rights within the class, which could not be effected without a shareholder vote. *Id.* at 1234-35. The court also found that the plan had a preclusive effect on prospective tender offers. *Id.* at 1239.

60. *Id.* at 1234-35; *see also* *Minstar Acquiring Corp. v. AMF Inc.*, 621 F. Supp. 1252 (S.D.N.Y. 1985) (rights plan that discriminated between shareholders based on date of share acquisition held void under New Jersey law); *Asarco Inc. v. M.R.H. Holmes A Court*, 611 F. Supp. 468 (D.N.J. 1985).

61. FLA. STAT. § 607.0601 (1990).

62. This type of security, commonly known as “poison pill preferred stock,” is discussed at length in Comment, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The “Poison Pill” Preferred*, 97 HARV. L. REV. 1964 (1984).

## V. FUNDAMENTAL CHANGES TO THE FLORIDA CORPORATION'S CAPITAL STRUCTURE

The Act generally eliminates par value, stated capital, capital surplus, and treasury shares. Par value was an arbitrary amount assigned to each share (e.g., \$1.00 per share), below which the corporation was prohibited from selling its shares.<sup>63</sup> Stated capital was generally the sum of the par value of all outstanding shares with par value and the amount assigned by directors to stated capital with respect to no-par shares.<sup>64</sup>

Par value and stated capital were eliminated for well-recognized reasons. Generally, they added complexity without any offsetting benefit.<sup>65</sup> Par value was an arbitrary dollar amount. The former law did not require directors to establish a par value having any particular relation to the shares' actual market value, and par value did not fluctuate with changes in share market value. For this reason, par value misled investors who equated par value and actual share market value or net asset value. Further, the sole restrictive effect of par value—to place a floor on the purchase price of shares—was rendered meaningless by widespread use of nominal par value amounts (e.g., \$.01 per share) that were far below the shares' actual value.<sup>66</sup> Par value did nothing to stop the corporation from selling at a price less than fair value.

Further, the amount of stated capital bore no relationship to the

63. FLA. STAT. § 607.054 (1989) (repealed 1990).

64. FLA. STAT. §§ 607.004(15), .061 (1990). This article does not discuss in detail the provisions of prior law concerning par value, no-par shares, stated capital, and related concepts, because the Act repealed them. For a detailed explanation of these provisions and their history, purpose, and operation, see B. MANNING & J. HANKS, *LEGAL CAPITAL* (3d ed. 1990).

65. See RMBCA, *supra* note 4, at § 6.21 (official comment and historical background). Par value and stated capital have been cannon fodder for many years. See, e.g., B. MANNING & J. HANKS, *supra* note 64, at 91-97 ("The legal capital schemes embedded in the nation's state corporation acts are inherently doomed to a low level of effectiveness (perhaps even zero)."); Cohn, *Capital Structure. Dividends and Redemption—Time for a Change to Florida's Corporate Code*, 56 FLA. B.J. 574 (June 1982) (the Act grants Professor Cohn his fervent wish for change); Hackney, *The Financial Provisions of the Model Business Corporation Act*, 70 HARV. L. REV. 1357 (1957) (describing the difficulties of accurately calculating surplus); Note, *The Inadequacy of Stated Capital Requirements*, 40 CINN. L. REV. 823 (1971).

66. As discussed below, Florida's documentary stamp tax on the par value of shares virtually compels the Florida corporation to set a very low par value such as \$.01 per share, because it is assessed on the shares' par value rather than their market value. See FLA. STAT. § 201.05(1) (1990).

actual amount of capital necessary for the corporation's business operations. Stated capital did not protect creditors by providing an "equity cushion," because nothing required that the amount be sufficient to provide a cushion against operating losses and because the amount could be changed at the shareholders' option, after credit had been extended.<sup>67</sup> Creditors today rely on other mechanisms for credit protection, such as financial covenants in their loan documents, close monitoring of the corporation's financial condition, and legal restrictions (retained by the Act) that limit transfers and distributions if the corporation is insolvent.<sup>68</sup>

Par value and the related concepts of stated capital, capital surplus, and other similar provisions added great complexity to the corporation's capital structure. For example, a stock split required an amendment to the articles of incorporation to change the corporation's par value. The par value and stated capital concepts required three different definitions of surplus—surplus, earned surplus, and capital surplus.<sup>69</sup> Consider the following language of the former law that governed the conversion of a share without par value into a share with par value:

[S]hares without par value shall not be converted into shares with par value unless that part of the stated capital of the corporation represented by such shares without par value is, at the time of conversion, at least equal to the aggregate par value of the shares into which the shares without par value are to be converted, or the amount of any such deficiency is transferred from surplus to stated capital.<sup>70</sup>

The official comment to the Act in the RMBCA clarifies that following this change, a corporation need not differentiate on its balance sheet between stated capital and surplus accounts, even if it elects to

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67. For example, a corporation with the common par value of \$.01 per share and 1,000,000 outstanding shares would have stated capital of only \$10,000, which is insufficient for a corporation with operations of any substance.

68. FLA. STAT. § 607.06401 (1990). With respect to fraudulent transfers, see, e.g., FLA. STAT. § 726.101 (1988) (the Uniform Fraudulent Transfer Act); 11 U.S.C. §§ 546, 548 (1986) (United States Bankruptcy Code).

69. FLA. STAT. §§ 607.004(4), (6), (17) (1989) (repealed 1990). A treatise is devoted to explaining these subjects. See B. MANNING & J. HANKS, *supra* note 64. Significantly, in the 1990 edition, the authors required 176 pages to explain the "labyrinth" of legal capital doctrine and critique its failures, but only 15 pages to explain its repeal and the current provisions of the RMBCA, *supra* note 4.

70. FLA. STAT. § 607.044.

retain par value.<sup>71</sup> The corporation may use a single simple entry, "paid-in capital," to reflect the amounts received for its shares.<sup>72</sup> A corporation may retain the historic classifications of stated capital and capital surplus if it so desires.<sup>73</sup>

Corporations still should consider using a nominal par value (such as \$.01 per share) even though it lacks any legal significance under the Act, because of the Florida documentary stamp tax on shares. This tax is assessed on the shares' par value or, if the share is without par value, on its actual market value.<sup>74</sup> Accordingly, the use of nominal par value will avoid taxation based on the shares' market value. The Second Corrections Bill would amend the documentary stamp tax law to provide that each share without par value will be taxed based on a par value of \$.01 per share. Enactment of this amendment to the documentary stamp tax law should eliminate the last reason for a Florida corporation to use par value.

## VI. THE CORPORATION'S ISSUANCE OF SHARES (SECTIONS 607.0603 AND 607.0621)

According to section 607.0603(3), a corporation must have at all times one or more outstanding classes of shares that together have the attributes associated with common shares—unlimited voting rights and entitlement to receive the net assets of the corporation on dissolution.<sup>75</sup> This provision is the counterpart to section 607.0601(2), which requires that the corporation authorize shares with these attributes.<sup>76</sup> Generally, following the elimination of par value, except for fiduciary duty standards,<sup>77</sup> the only limitations imposed by the Act on a corporation's issuance of shares and the make-up of its capital are that the shares be authorized, that the directors determine that the consideration to be received for the shares is adequate, that the consideration established

71. RMBCA, *supra* note 4, at § 6.21 (official comment).

72. *Id.*

73. *Id.*

74. FLA. STAT. § 201.05(1) (1990). The tax is 32 cents per \$100 of value.

75. *Id.* at § 607.0603(3). Section 607.0603 was adopted verbatim from section 6.03 of the RMBCA, *supra* note 4. In other words, some person must own the residual interests of the corporation.

76. FLA. STAT. § 607.0601(2).

77. The fiduciary standards governing directors' actions are set forth in section 607.0830. *Id.* at § 607.0830.

for the shares be paid, and that one or more classes of outstanding shares together have the traditional attributes of common stock described above.

Section 607.0621 sets forth the terms on which a corporation may sell its shares.<sup>78</sup> Shareholders must rely on the directors' honest and fair judgment to determine (a) the number of shares to be issued and the amount of capital to be raised from time to time, (b) an appropriate price for any additional shares that are issued, and (c) the adequacy of consideration, if non-cash consideration is received. By so providing in the articles of incorporation, shareholders may reserve these rights to themselves<sup>79</sup> or, more practically, limit the board's discretion with respect to these matters. Again, the Act leaves the capital structure to the dynamics of negotiation among the corporation, its shareholders, and its creditors, rather than mandating restrictions or limitations on that structure.

A corporation may issue shares in exchange for "any tangible or intangible property or benefit to the corporation."<sup>80</sup> The official comment to section 6.21 of the RMBCA clarifies that "[t]he term 'benefit' should be broadly construed to include, for example, a reduction of a liability, a release of a claim, or benefits obtained by a corporation by contribution of its shares to a charitable organization or as a prize in a promotion."<sup>81</sup> Significantly, the Act departs from the former law by expressly permitting shares to be issued in consideration of a promissory note and future services, if evidenced by a written contract.<sup>82</sup> The requirement that the contract be written departs from the RMBCA. Although both of these forms of consideration involve future performance, the Act treats the shares as "paid" when the commitment is given, rather than when it is fulfilled (the note is paid or the services

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78. *Id.* at § 607.0621. A separate section, section 607.0623, covers share dividends. *Id.* at § 607.0623.

79. *Id.* at § 607.0621(1).

80. *Id.* at § 607.0621(2).

81. RMBCA, *supra* note 4, at § 6.21 (official comment).

82. FLA. STAT. § 607.0621(2) (1990). Former section 607.054(6) stated: "Future services shall not constitute payment or part payment for the issuance of shares of a corporation." FLA. STAT. § 607.054(6) (1989) (repealed 1990); *see also* Lewis v. Compton, 416 So. 2d 1219 (Fla. 1982). Although not authorized by the statute, a promissory note was acceptable consideration under the former law. Lundquist v. Gulfshore Television Corp., 328 So. 2d 202 (Fla. 2d Dist. Ct. App. 1976). The commentary to section 607.0621 states that the former law was unclear on this point.

rendered).<sup>83</sup>

The official comment to section 6.21 of the RMBCA, on which section 607.0621 is based, notes the real concerns of the former law:

The issuance of some shares for cash and other shares for promissory notes, contracts for past or future services, or for tangible or intangible property or benefits, like the issuance of shares for an inadequate consideration, opens the possibility of dilution of the interests of other shareholders. For example, persons acquiring shares for cash may be unfairly treated if optimistic values are placed on past or future services or intangible benefits being provided by other persons. The problem is particularly acute if the persons providing services, promissory notes or benefits of debatable value are themselves connected with the promoters of the corporation or with its directors.<sup>84</sup>

The RMBCA allows these forms of consideration anyway because: commitments for future performance or payment often have substantial present value;<sup>85</sup> consistently with other provisions, the RMBCA's drafters were prepared to rely on the standards governing directors' actions that are intended to protect against abuses; and the practical problems associated with these forms of consideration can be resolved through skillful structuring of the share sale transaction.<sup>86</sup> Once again, the RMBCA eliminates an "artificial" or "arbitrary" rule in favor of relying on the directors' business judgment. The official comment might have added that the practice of offering incentive stock to employees as consideration for future services is widespread and generally recognized as effective in aligning employees' interests with shareholders' interests. The Act requires that a corporation issuing shares for future services inform its shareholders of the issuance before the corporation's next

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83. Compare FLA. STAT. § 607.0621(4) with RMBCA, *supra* note 4, at § 6.21.

84. RMBCA, *supra* note 4, at § 6.21 (official comment).

85. One author hypothesizes a contract with Barbara Streisand, Doug Flutie, or a promissory note of Morgan Guaranty. Manning, *supra* note 9, at 1533. Of course, that article was written before Flutie retired from football and before the financial institution crisis.

86. The comment to the Act adds another reason—easy avoidance of the prohibition: "[T]he express prohibition in [section] 607.054(6) (1989) against future services as consideration is easily avoided by an advance bonus (immediately repaid to the corporation for the shares), the issuance of a separate class of low or no-par value stock, forgivable loans, or other means limited only by the ingenuity of the parties." RMBCA, *supra* note 4, at § 6.21 (official comment).



annual meeting.<sup>87</sup>

Because the shares will be fully paid when issued, the corporation should assure that the shares do not freely vest before the note is paid or services rendered, to protect against a purchaser default. Section 607.0621(5) provides a mechanism to assure receipt of consideration for the shares through escrow or restriction methods.<sup>88</sup> The shares are issued to the shareholder in escrow or subject to restriction, but if the relevant payments or services are not received, the shares may be canceled. The Act leaves unclear whether an escrow arrangement must be with an independent third party. The Act seems to expressly permit an arrangement in which all escrowed or restricted shares are canceled without any compensation, even though the shareholder partially pays or performs before renegeing: “[I]f the services are not performed, the shares escrowed or restricted and the distributions credited may be canceled in whole or part.”<sup>89</sup> Nothing in the former law expressly provided for a corporation to cancel shares if future payments or services due for them were not received. Indeed, the shares could not be issued at all without up-front payment of all consideration.<sup>90</sup>

The Act subtly changes the former law with respect to the directors’ determinations regarding value and adequacy of consideration, which are important to legal opinions regarding the status of shares as fully paid and nonassessable. The Act provides for directors to use their business judgment to establish adequate consideration for shares, without any floor or other limitation. That adequacy determination is conclusive for purposes of the determination whether shares are fully paid and nonassessable. The former law also provided that the directors must value non-cash consideration received and provided that this de-

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87. FLA. STAT. § 607.1621(2) (1990). Presumably, shareholders then may challenge the issuance as a breach of the directors’ standard of care, if the transaction was abusive.

88. *Id.* at § 607.0621(5).

89. *Id.* These escrow or restriction arrangements should be part of the subscription agreement or other document evidencing the purchase terms. That agreement should clearly provide the extent to which consideration received thus far is refundable on cancellation. Of course, the corporation must carefully note the restriction on the certificate or take care that possession of escrowed shares does not pass to the shareholders to avoid transfer to bona fide purchasers free of the restriction. *See id.* at § 607.0627 (regarding restrictions on transfer); § 607.0622 (regarding the respective liabilities of the transferee and transferor of shares for which full consideration has not been paid (the transferee is not liable if a bona fide purchaser)).

90. FLA. STAT. § 607.054(5) (“Shares may not be issued until the full amount of the consideration therefore has been paid.”).

termination regarding valuation of consideration was “conclusive” in the absence of fraud.<sup>91</sup> However, the Act does not require this value determination at all.<sup>92</sup> The directors’ adequacy determination need not be set forth in a resolution—that conclusion may be inferred from the decision to issue shares for the designated consideration.<sup>93</sup> Following the Act’s elimination of par value and definitive resolution against applying any hindsight evaluation to the directors’ business judgment in establishing appropriate consideration, the lawyer may opine that shares of a Florida corporation are fully paid and nonassessable by confirming that the consideration for the shares established by the board was actually paid.<sup>94</sup> The Act makes the adequacy determination conclusive, eliminating the possibility of hindsight judicial review of that matter.

The conclusive presumption concerning the adequacy of consideration received for shares does not extend to challenges based on self-dealing and other fiduciary duty grounds or fraud of the person receiving the shares.<sup>95</sup> However, directors are entitled to the presumption offered by the business judgment rule with respect to decisions to offer shares in transactions in which they are not interested.<sup>96</sup>

Consistently with the former law, section 607.0622 confirms that a shareholder who pays the consideration due for purchased shares generally has no further liability to the corporation, its creditors, and other

91. *Id.* at § 607.054(7). In some early cases, at creditors’ request, courts objectively appraised the value of consideration paid to determine whether the consideration was worth the value attributed to it by the corporation and adequate given the par value of the shares. Shareholders might be found liable for any deficiency. *See, e.g.,* *See v. Heppenheimer*, 69 N.J. Eq. 36, 61 A. 843 (1905); *Van Cleve v. Berkey*, 143 Mo. 109, 44 S.W. 743 (1898); *see generally* RMBCA, *supra* note 4, at § 6.21 (historical background). This “true value” rule was reversed by the former law which presumed the directors’ judgment of value to be correct. FLA. STAT. § 607.054(7).

92. *See* RMBCA, *supra* note 4, at § 6.21 (official comment) (“Of course, a specific value must be placed on the consideration received for the shares for bookkeeping purposes, but bookkeeping details are not the statutory responsibility of the board of directors.”).

93. *Id.*

94. FLA. STAT. § 607.0621(3), (4) (“When the corporation receives the consideration for which the board of directors authorized the issuance of shares, the shares issued therefor are fully paid and nonassessable.”).

95. *See, e.g.,* *Biltmore Motor Corp. v. Roque*, 291 So. 2d 114, 115-16 (Fla. 3d Dist. Ct. App. 1974) (ordering directors to revoke and rescind recapitalization plan that involved sale of new stock at considerably less than market value because the transaction lacked any business purpose and violated the directors’ fiduciary duties).

96. FLA. STAT. § 607.0831(1) (1990).

shareholders with respect to those shares.<sup>97</sup> With the elimination of the legal significance of par value, shareholders are no longer subject to alleged liability for the difference between the par value and the consideration that they actually paid for their shares, or "watered stock liability." This is true even if the corporation elects to retain par value, because the statutory connection between par value and the amount due for shares is eliminated.

In a departure from the RMBCA, Florida rejected the RMBCA's section 6.22, and instead adopted verbatim, as section 607.0622, the provisions of the former law, section 607.074, except for the addition of a five-year limitation period on actions to collect consideration due for shares.<sup>98</sup> Section 607.0622(1) retains provisions spelling out who may sue a shareholder who fails to pay full consideration (the corporation, another shareholder, and creditors). Section 607.0622(2), (3), and (4) clarify transferor, transferee, pledgor, and pledgee liability for consideration due for unpaid shares (transferor and pledgor liable; pledgee not liable; transferee not liable if bona fide purchaser of the shares).

Presumably, despite the broad statutory language of section 607.0622(1),<sup>99</sup> the shareholder remains potentially liable for the corporation's actions pursuant to equitable theories such as piercing the corporate veil, even though the Act in section 607.0622 rejects, as to open ended, the language of section 6.22(b) of the RMBCA confirming the validity of such actions.<sup>100</sup> In cases decided before the Act, Florida courts have upheld actions based on veil-piercing theories notwithstanding this statutory language.<sup>101</sup> These decisions were probably based on reasoning that the action is not "with respect to the . . . shares," but rather based on the shareholder's conduct.<sup>102</sup>

97. *Id.* at § 607.0622(a).

98. *Id.* at § 607.0622(5). The limitations period is measured from the earlier of the date of stock issuance or the date of the subscription on which the assessment is sought.

99. *Id.* at § 607.0622(1) ("A holder of . . . shares . . . shall be under no obligation to . . . creditors with respect to such shares . . . other than to pay the full consideration.").

100. RMBCA, *supra* note 4, at § 6.22(b) provides as follows: "Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct."

101. *See, e.g.,* Vantage View v. Bali East Dev. Corp., 421 So. 2d 728, 235 (Fla. 4th Dist. Ct. App. 1982).

102. *Id.*

## VII. SHARE DIVIDENDS (SECTION 607.0623)

Share dividends are governed by section 607.0623, which adopts the text of section 6.23 of the RMBCA.<sup>103</sup> The Act simplifies the law governing share dividends and stock splits: all distributions of the corporation's shares are treated as share dividends; share dividends are not subject to restrictions on ordinary dividends and share repurchases; and with the elimination of par value, stated capital, and capital surplus, no reallocations among various capital accounts need follow a share dividend and no adjustments to par value amounts need follow a stock split.<sup>104</sup>

The principal distinction between a stock split and a share dividend under the former law was that a share dividend involved a book transfer from capital surplus to stated capital, and a stock split required a change to the corporation's par value per share.<sup>105</sup> A share dividend was treated similarly to a cash dividend, and subject to the restriction that the corporation have adequate surplus to cover the aggregate par value of distributed shares.<sup>106</sup> The current modifications recognize that share dividends differ fundamentally from cash dividends and the transactions characterized as "distributions" under the Act. A share dividend is a paper transaction without economic effect on the corporation, its shareholders, or its creditors.<sup>107</sup> Nothing happens to the corporation's assets and the shareholders' interests in the corporation remain the same, only evidenced by more shares.<sup>108</sup>

The Act does recognize the dilutive impact on a class or series of shares when shares of its class or series are distributed as a share dividend to shareholders of another class or series.<sup>109</sup> The Act permits those transactions only if the articles of incorporation authorize them, a majority of the relevant class or series approves the transaction, or no shares of the relevant class or series are outstanding.<sup>110</sup>

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103. See FLA. STAT. § 607.01401(8) (1990) (expressly excluding share dividends from the definition of "distributions" to shareholders).

104. *Id.* at § 607.0623.

105. FLA. STAT. § 607.137(4), (6) (1989) (repealed 1990).

106. *Id.* at § 607.137(4).

107. RMBCA, *supra* note 4, at § 6.23 (official comment).

108. *Id.*

109. FLA. STAT. § 607.0623 (1990).

110. *Id.* at § 607.0623(2).

### VIII. THE CORPORATION'S DISTRIBUTIONS TO ITS SHAREHOLDERS (SECTION 607.06401)

Many commentators call the distribution provisions the most significant of the extensive amendments to the Model Act's financial provisions that were effected in the 1980s.<sup>111</sup> In a significant departure from the former law, the Act adopts a uniform definition for distributions and modifies the restrictions on distributions so that they do not consider the corporation's relative amounts of surplus and stated capital following the distribution.<sup>112</sup>

Instead of a single definition and standard for distributions, the former law provided different standards for redemptions, consensual repurchases, and ordinary dividends.<sup>113</sup> Redemptions were subject only to the limitation that they not render the corporation insolvent in the equity sense (unable to pay its debts as they became due in the ordinary course of business).<sup>114</sup> Dividends and consensual repurchases were subject to this equity insolvency limitation and also to the limitation that they could be made only from unreserved and unrestricted surplus (the portion of the corporation's capital other than stated capital).<sup>115</sup> Generally, the Act modifies this surplus-based limitation (assets must equal the sum of liabilities, stated capital, and reserved or restricted surplus) to a net worth limitation (assets must equal liabilities plus liquidation preferences), because the surplus-based limitation was complex and ineffective in protecting creditors.<sup>116</sup> The Act applies this net worth limitation and the equity insolvency limitation to all shareholder "distributions," including dividends, redemptions, and consensual

111. See, e.g., Manning, *supra* note 9, at 1534 ("Section 6.40 is the centerpiece that controls asset distributions to shareholders."); Murphy, *supra* note 8, at 82 ("[Section 6.40] is probably the capstone of the financial provisions in the Revised Statute.").

112. FLA. STAT. § 607.06401. This discussion focuses on the tests adopted for distributions. Full treatment of the subject should consider fraudulent transfer law and the fiduciary duties of directors. See *id.* at §§ 607.0834, .0830 (each of which is discussed cursorily here).

113. For a thorough explanation of the scheme governing distributions under the former law, see B. MANNING & J. HANKS, *supra* note 64, at 63-90.

114. FLA. STAT. §§ 607.004(9), .017(3)(d) (1989) (repealed 1990).

115. *Id.* at §§ 607.017(1), .137; see also *Baxter v. Lancer Indus., Inc.*, 213 F. Supp. 92, 96 (E.D.N.Y. 1963); *Coast Cities Coaches, Inc. v. Whyte*, 102 So. 2d 848 (Fla. 3d Dist. Ct. App. 1958) ("Obviously, corporate funds other than those lawfully allocable to dividends could not be used to pay for the purchase of the stock from Whyte and Hickling.").

116. RMBCA, *supra* note 4, at § 6.40 (official comment).

repurchases.<sup>117</sup>

The purpose of the law governing distributions is to protect the relative priority status of creditors and senior equity holders. Shareholders are subordinate to these persons with respect to their claim to the corporation's assets in liquidation.<sup>118</sup> Assets are supposed to be available to fund the payment of liabilities and liquidation preferences, if necessary. As stated by one commentator:

If the hierarchical relationship of creditor to shareholder is to have any meaning at all, then the management must not be left free to shovel all the assets in the corporate treasury out to the shareholders when the corporation has insufficient assets to pay its creditors or when the shareholder distribution itself renders the corporation unable to pay its creditors. The central point is to avoid insolvency.<sup>119</sup>

The Act is carefully structured to achieve this purpose, but no more. The Act abandons the concept of mandating an asset cushion over and above the amount of liabilities to be available if assets prove insufficient to pay them.

The principal significance of these provisions governing distributions is the directors' potential liability "to the corporation" for distributions made improperly pursuant to section 607.0834 of the Act. Generally, a director is potentially liable for an improper distribution only if he voted for or assented to the action and the director need only comply with the usual standard of conduct for his actions, which is described in section 607.0830.<sup>120</sup> The director has available all defenses typically associated with his actions, including the common law business judgment rule.<sup>121</sup> The statute and case law leave unclear whether and how this liability "to the corporation" may be enforced by creditors, directly or derivatively by shareholders, or by a bankruptcy trustee succeeding to the corporation's rights.<sup>122</sup>

This new standard governing distributions varies from the stan-

117. FLA. STAT. § 607.06401 (1990).

118. *Id.*

119. B. MANNING & J. HANKS, *supra* note 64, at 63.

120. FLA. STAT. § 607.0830 (1990).

121. *Id.* at § 607.0834; RMBCA, *supra* note 4, at § 8.33 (official comment).

122. *See* B. MANNING & J. HANKS, *supra* note 64, at 88-90 (noting "the almost complete absence of cases imposing liability on directors or shareholders").

dards governing fraudulent transfers in Florida.<sup>123</sup> For example, one of the standards for a fraudulent transfer focuses on the intent of the transferor,<sup>124</sup> which is irrelevant under section 607.0834.<sup>125</sup> The official comment to section 6.40 of the RMBCA acknowledges the difference and justifies it based on the different purposes for which the various statutes are intended.<sup>126</sup> The fraudulent transfer statute is designed to permit the trustee to recover for the benefit of creditors transfers made to others (such as shareholders), but section 6.40 was intended to determine the potential liability of directors to the corporation for improper distributions.<sup>127</sup> The laws governing fraudulent transfers apply to the corporation's distributions to its shareholders and must be reviewed by the corporation planning an unusual distribution.

The Act conveniently defines "distribution" to include any transfer of money or other property or incurrence of indebtedness by the corporation to or for the benefit of its shares.<sup>128</sup> Only the corporation's distributions of its own shares (stock dividends) are excluded and treated in a separate section, because those transfers do not cause any real change in the corporation's capital structure from the creditors' standpoint.<sup>129</sup> For this reason, a conversion of an outstanding security into an equity security typically would not be considered a distribution, because the issued security constitutes a share of the corporation. Examples of distributions include cash dividends, special dividends of property (including stock of other companies or subsidiaries), liquidating distributions, repurchases and redemptions of the corporation's shares, and distributions of indebtedness.<sup>130</sup>

The Act relies on a deceptively simple two-pronged test to determine whether a distribution is permitted:

No distribution may be made if, after giving it effect: (a) The corporation would not be able to pay its debts as they become due in the usual course of business; or (b) the corporation's total assets would be less than the sum of its total liabilities plus (unless the

123. See FLA. STAT. §§ 726.101-.201 (1989).

124. *Id.* at § 726.105(1)(a), (2); see also 11 U.S.C. § 548 (1986) (concerning fraudulent transfers under the Bankruptcy Code).

125. FLA. STAT. § 607.0834 (1990).

126. RMBCA, *supra* note 4, at § 6.40 (official comment).

127. *Id.*

128. FLA. STAT. § 607.01401(8) (1990).

129. *Id.* at § 607.0623.

130. RMBCA, *supra* note 4, at § 6.40 (official comment).

articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.<sup>131</sup>

The first prong of the test carries over from the former law the "equity insolvency" test. The second prong adopts what is commonly referred to as a "balance sheet" or "net worth" insolvency test.

The equity insolvency test requires that following the distribution, the corporation must be able to pay its debts as they become due in the usual course of business.<sup>132</sup> Older versions of the comment to section 6.40 of the RMBCA stated that the equity insolvency test was the "most important and fundamental test for the permissibility of distributions."<sup>133</sup> This prong of the test is unfortunately subjective and if not applied carefully, might subject the director to hindsight judicial re-evaluation of his actions if the corporation soon fails. The official comment to section 6.40 of the RMBCA provides some comfort and clarification.<sup>134</sup> It states that the existence of significant shareholder equity and continuation of normal operations typically will be sufficient to establish that the equity insolvency test is satisfied.<sup>135</sup> The absence of a going concern qualification in the company's financial statements is called "normally decisive."<sup>136</sup>

131. FLA. STAT. § 607.06401(3).

132. "Insolvent" is generally defined in the definitions section of the Act to mean inability of a corporation to pay debts as they become due in the usual course of its business. *Id.* at § 607.01401(15). The Act inadvertently uses this full statement, rather than using the defined term and simply stating that the distribution must not render the corporation "insolvent."

133. *Changes to the Model Business Corporation Act—Amendments to Financial Provisions*, 34 BUS. LAW. 1867, 1881 (1979).

134. RMBCA, *supra* note 4, at § 6.40 (official comment).

135. *Id.*

136. *Id.* The official comment states that: "Indeed, in the case of a corporation having regularly audited financial statements, the absence of any qualification in the most recent auditor's opinion as to the corporation's status as a 'going concern,' coupled with a lack of subsequent adverse events, would normally be decisive." This issue certainly will not arise unless subsequent adverse events occur—the author assumes that the drafters meant a lack of subsequent adverse events before the measuring date of the distribution, because the directors should not be accountable for unforeseeable events subsequent to that date. *See also Current Issues on the Legality of Dividends from a Law and Accounting Perspective: A Task Force Report*, 39 BUS. LAW. 289, 306 (1983) (suggesting a presumption against insolvency if the corporation receives an au-



If the corporation is "encountering difficulties, or is in an uncertain position concerning its liquidity and operations," the directors should carefully document the basis for their decision as they would other potentially controversial actions.<sup>137</sup> The comment emphasizes that, consistent with the standard for their actions in section 8.30 of the RMBCA (section 607.0830), directors may rely on reports from management, accountants, and other persons and may make judgments or assumptions regarding the corporation's future that are "customarily justified, absent clear evidence to the contrary."<sup>138</sup> The comment states that having made these judgments and relied on information made available to them, directors "should not, of course, be held responsible as a matter of hindsight for unforeseen developments."<sup>139</sup>

The comment contains somewhat helpful examples of assumptions regarding product demand, short-term indebtedness, and contingent liabilities that may be made by directors in evaluating whether a distribution will render the corporation insolvent and that should be reviewed carefully by counsel advising the corporation on this issue.<sup>140</sup> For example, with respect to contingent liabilities, it states: "[t]o the extent that the corporation may be subject to asserted or unasserted contingent liabilities, reasonable judgments as to the likelihood, amount, and time of any recovery against the corporation, after giving consideration to the extent to which the corporation is insured or otherwise protected from loss, may be utilized."<sup>141</sup> The obvious problem, notwithstanding the comment, is that directors' judgments might look unreasonable to a trier of fact if the contingent liabilities that were thought unlikely to result in liability become real liabilities.

The second prong is a balance sheet test, a limitation based on a comparison following the transfer of the corporation's assets to its liabilities plus the amount of any liquidation preference of senior equity holders.<sup>142</sup> Simply stated, the corporation may make distributions to its shareholders only to the extent of its net worth, plus the liquidation preferences. For distributions payable to any but the most senior class of stock, the preferential amount payable to relatively more senior clas-

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ditor's opinion not subject to a going concern opinion).

137. RMBCA, *supra* note 4, at § 6.40 (official comment).

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*

142. FLA. STAT. § 607.06401(3)(b).

ses of preferred stock must be added to liabilities to determine whether the distribution is permitted.<sup>143</sup> In comparison, the former law compared liabilities to assets *plus stated capital* and reserved and restricted surplus. The Act eliminates the amount of stated capital, and reserved and restricted surplus from the formulation, and adds the liquidation preference. The Act accords flexibility; the balance sheet may be “prepared on the basis of accounting practices and principles that are reasonable in the circumstances or on a fair valuation or other method that is reasonable in the circumstances.”<sup>144</sup> The Act does not mandate generally accepted accounting principles (GAAP) and continues to allow a fair market valuation.<sup>145</sup>

Again, the official comment to section 6.40 of the RMBCA clarifies that directors may rely on opinions, reports, or statements, including audited financial statements and other financial data in making this prong of the determination.<sup>146</sup> The comment introduces a safe harbor to assure those troubled by the uncertainty of the “reasonableness” standard—use of GAAP is always reasonable under the circumstances.<sup>147</sup> Also, the corporation may rely on its last balance sheet “unless the board is then aware that it would be unreasonable to rely on the financial statements because of newly-discovered or subsequently arising facts or circumstances.”<sup>148</sup>

The comment recognizes that use of GAAP, or other accounting principles, might result in an overstatement of assets’ value:<sup>149</sup>

Accordingly, the revised Model Business Corporation Act contemplates that generally accepted accounting principles are always ‘reasonable in the circumstances’ and that other accounting principles may be perfectly acceptable, under a general standard of rea-

143. *Id.* at § 607.06401.

144. *Id.* at § 607.06401(4).

145. The former law also allowed a fair market valuation. FLA. STAT. § 607.137(7) (1989) (repealed 1990).

146. RMBCA, *supra* note 4, at § 6.40 (official comments 2, 4).

147. *Id.* (official comments 3, 4).

148. *Id.*; see also *Baxter v. Lancer Indus., Inc.*, 213 F. Supp. 92 (E.D.N.Y. 1963). The *Baxter* court considered the former law and held that a corporation could not base the balance sheet determination whether dividends were permitted solely on its financial statements. The court stated that “[w]hat little authority there is suggests that actual values, albeit conservatively applied, rather than book values, are determinative of the existence of surplus.” *Baxter*, 213 F. Supp. at 95. Certainly, this holding is no longer good law.

149. RMBCA, *supra* note 4, at § 6.40 (official comments 2, 3, 4).

sonableness, even if they do not involve the 'fair value' or current value concepts that are contemplated by section [607.06401(4)].<sup>150</sup>

The RMBCA thereby avoids forcing directors to evaluate whether the financial statements were overstating value at the time of each distribution and inserting judicial oversight into accounting practice.<sup>151</sup> Even though the comment seems to sanction systems that overvalue assets based on a cost rather than fair value system, directors of corporations with financial statements not within the GAAP safe harbor might be wise to confirm that the fair value of assets roughly approximates book value, to avoid a charge that the accounting method was not reasonable under the circumstances. Although ordinarily not a concern, this point might be especially relevant in this time of declining asset prices.

The official comment also confirms that asset valuations may be made using a going concern valuation rather than a liquidation valuation, unless the corporation is selling its assets.<sup>152</sup> This conclusion might not follow from a reasoned assessment. Typically, going concern values will be difficult to attain if the corporation's financial condition is seriously troubled and it needs to sell assets quickly. Yet, this point is the only one at which creditors will look to asset values for recovery of amounts due them. The going concern valuation test virtually assures that actual asset recoveries will be insufficient, unless the going concern valuations substantially exceed liabilities. To the extent that a distribution is based on a current asset valuation, this fact must be specifically identified and the amount per share paid on the basis of the valuation disclosed to shareholders when the distribution is made.<sup>153</sup>

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150. *Id.* (emphasis added).

151. See *Current Issues on the Legality of Dividends from a Law and Accounting Perspective: A Task Force Report*, 39 BUS. LAW. 289 (1983). The article recommended creation of the safe harbor for GAAP principles:

It appears to the task force that when it comes to applying statutory financial tests to dividend declarations, corporate directors are in the same position as the courts: they are generally not trained or competent to be responsible for accounting standards that represent extremely complex assumptions and judgments . . . . [W]e question whether it is reasonable for the statute to require a director to make a judgment among accounting principles.

*Id.* at 300.

152. RMBCA, *supra* note 4, at § 6.40 (official comments 2, 3, 4).

153. FLA. STAT. § 607.06401(4). This identification language was added to the Act based on language from the former law. FLA. STAT. § 607.137 (1989) (repealed 1990).

Section 607.06401(6) and (8) sets forth straightforward rules for determining the dates on which the effect of a distribution should be measured.<sup>154</sup> These dates depend on the nature of the distribution (dividend or repurchase) and the consideration paid (cash/property or debt).<sup>155</sup> In the case of stock repurchases for debt, the effect of the transaction generally will be measured when the transaction occurs (the earlier of the date the debt is incurred or the date the shareholder ceases to be a shareholder) and not when the debt is paid.<sup>156</sup> This result reverses Florida precedent that precluded a corporation from paying debt incurred in connection with a share purchase if the corporation was insolvent when payment of the debt was due.<sup>157</sup> Section 607.06401(8) provides that indebtedness may be disregarded for purposes of determining whether a distribution is permitted, if expressly made payable only to the extent that its payment at that time would be a permitted distribution. In that instance only, each payment of principal and interest of the indebtedness will be considered a separate distribution, the effect of which is measured on the date that it is made. This provision facilitates an agreement to repurchase significant blocks of shares with deferred payments at a price that exceeds the corporation's net worth, without violating the balance sheet restriction. However, the corporation must be able to comply with both elements of the restrictions on distributions when the payments are actually made.

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154. FLA. STAT. § 607.06401(6), (8) (1990).

155. *Id.*

156. *Id.*

157. One court has held:

Promises to repurchase, such as that involved in the instant case, must be viewed as conditioned by the requirement that, at the time the corporation is called on to perform, it must have sufficient funds so that disbursement for the repurchase will not involve the use of funds not authorized to be so used by the applicable state law.

*Baxter*, 213 F. Supp. at 96 (applying Florida law); *see also In re Charter Co.*, 68 Bankr. 225 (Bankr. M.D. Fla. 1986) (applying Florida law); *In re Charter Co.*, 63 Bankr. 680 (Bankr. M.D. Fla. 1986) (applying Florida law). The court essentially held in the two *Charter Co.* cases that the corporation must be solvent both when the debt is incurred and when it is paid. *Cf. Williams v. Nevelow*, 513 S.W.2d 535 (Tex. 1974) (payment considered made when note delivered; secured note enforceable even though corporation insolvent when note payment due).

## IX. SHARE ACQUISITIONS AND TREASURY SHARES (SECTIONS 607.0603 AND 607.0631)

Section 607.0631, concerning share reacquisitions, departs from the former law in two significant respects: it revises the rules governing the corporation's repurchases of its own shares; and it generally eliminates "treasury shares" and characterizes reacquired shares as authorized but unissued shares.<sup>158</sup> Share repurchases are now governed by the general rules set forth in section 607.06401 applicable to all shareholder distributions, which scrap limitations based on the preservation of stated capital in favor of the much simpler equity insolvency and net worth insolvency tests.<sup>159</sup>

Shares that are reacquired or redeemed generally will be simply designated as authorized but unissued shares, with no distinction from shares that have never been issued.<sup>160</sup> The Act also adds clarifying language from the Virginia corporate statute providing that acquired shares constitute authorized but unissued shares *of the same class*, but undesignated as to series.<sup>161</sup> This rule makes sense; the shares should not be designated as part of the same series, because series terms are usually established when shares of the series were initially issued, based on market conditions at that time. Treasury shares were generally eliminated under the RMBCA because the drafters perceived no substantive difference between reacquired shares and shares that had never been issued.<sup>162</sup>

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158. FLA. STAT. § 607.0631 (1990).

159. *Id.* at § 607.06401. The restrictions on share repurchases and redemptions under the former law were set forth in section 607.017. *See* FLA. STAT. § 607.017 (1989) (repealed 1990). Generally, the corporation's right to repurchase its own shares is subject to restrictions imposed by federal and state securities laws and fiduciary duty obligations.

160. FLA. STAT. §§ 607.0603(1), .0631(1).

161. VA. CODE ANN. § 13.1-652.A (1950).

162. RMBCA, *supra* note 4, at § 6.03 (official comment). Under the former law, "treasury shares" were issued and outstanding shares that the corporation reacquired, but did not cancel and restore to the status of authorized but unissued shares. FLA. STAT. § 607.004(18) (1989) (repealed 1990). Until canceled, the shares were considered issued (but not outstanding) and their aggregate par value included in stated capital. *See* B. MANNING & J. HANKS, *supra* note 64, at 84-86 (briefly discussing the complexities and problems caused by reacquired shares before the RMBCA, note 4. "The entire topic of share reacquisition, treasury shares, resale, retirement and the like is technical and sorely vexed under the legal capital statutes and under accounting practice and generalization is not reliable.").

The historical notes accompanying section 6.03 observe that the concept of treasury shares initially arose as a mechanism to evade restrictions on share issuance, such as those associated with par value and preemptive rights. With the elimination of the legal significance of par value and the general decline in the use of preemptive rights, treasury shares no longer serve these purposes. This change eliminates an entry on the corporation's balance sheet for "treasury shares," unless use of treasury shares is retained.

In section 607.0631, the Act adds to the core text of section 6.31 of the RMBCA provisions that the corporation may retain treasury shares in two instances: through an express provision to that effect in its articles of incorporation; or by not canceling or disposing of shares that constituted treasury shares before July 1, 1990, the effective date of the Act.<sup>163</sup> A corporation might elect to retain the status of acquired shares as treasury shares to avoid paying listing fees again when it reissues them.<sup>164</sup>

In one instance, the corporation's authorized shares are reduced by the number of repurchased shares — if the corporation's articles of incorporation prohibit reissue of acquired shares. This reduction becomes effective when an amendment to the articles of incorporation is filed with the Department of State. According to the comment to 6.31 of the RMBCA, during the interim period before this amendment is filed, the shares may be issued and if issued will constitute valid shares in the hands of purchasing shareholders.<sup>165</sup> However, any such issuance would violate the prohibition on reissue in the articles of incorporation and probably constitute an improper action by the board of directors.<sup>166</sup>

## X. CONCLUSION

Chapter VI of the Act simplifies and clarifies Florida law gov-

163. FLA. STAT. § 607.0631(1), (4).

164. *Id.* at § 607.0603(1). This section concerns the same matter, and was derived without modification from § 6.03 of the RMBCA. It states, inconsistently with section 607.0631, that without any exception, issued shares are "outstanding shares until they are reacquired, redeemed, converted, or canceled." *Id.* A proposal to amend this section to clarify that this general rule is subject to the exceptions for treasury shares in section 607.0631(1) and (4) is pending as part of the Second Corrections Bill.

165. RMBCA, *supra* note 4, at § 6.31 (official comment).

166. *Id.* at § 6.31 (official comment 2) (The author would not render an opinion concerning the "validly issued" status of shares issued in violation of the prohibition on reissue.).

erning capital structure, share issuances, and distributions. The Act adopts the RMBCA, except for several instances in which it diverges from the uniform provisions, principally to facilitate anti-takeover measures. The result—a much improved law that should make Florida an attractive place of incorporation.