

The Mississippi

# Business Law Reporter

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## Section Chair's Corner

By William S. Mendenhall

February 2010

It has been my privilege to serve as your Chairperson for the 2009-2010 year. With the start of a new year, it seems appropriate to take a few moments to reflect on 2009 and its tremendous effects upon the business and legal communities in our state. The last two years have been perhaps the most challenging, and at the same time fascinating, years that I have witnessed in my 26 years of practice. We have approached and come back from the brink of financial disaster. We have all observed sobering developments within the legal profession in our state, which we hope are never repeated. Yet, despite these serious difficulties, we have witnessed many examples of inspirational leadership, volunteerism, and community spirit all across Mississippi. As we complete this extraordinary year and move into 2010, we should applaud the role of our Bar in general, and our section members in particular, in moving our state forward during these very difficult times.

The spirit of community that has proven so important during the past year is best exemplified by the Mississippi Volunteer Lawyers Project. During 2009, the Project provided representation to more than 11,000 Mississippians in 60 counties across the state. Services were provided in the areas of domestic relations, child support, child custody, adoptions, employment law, bankruptcy, and many others. More than 200 members of The Mississippi Bar participated in the Project, all, of course, without compensation.

Business lawyers across the state continue to assume leadership roles in our churches, charities, and other community organizations. Because of the training and experience of our section members, we are frequently called upon to lead and guide these groups in their important work. We should all be proud of our members' contributions of time and talents.

Of course, the recent earthquake in Haiti brings to the forefront the importance of charity and volunteerism and the vital role that we all play in the lives of our neighbors.

Thousands of Mississippians have generously given time and money toward the Haitian relief effort. Many members of the Business Law Section are actively involved in providing aid to this desperate country, whether by service in the National Guard, volunteer work with charitable or other relief organizations, or donating much needed money to relief organizations.

Just as each of you support your communities and state, the Business Law Section exists to provide support to you. With the help and guidance of The Mississippi Bar staff, the Business Law Section will continue the tradition of providing educational and social activities for our state's business lawyers. In the Spring of this year, the Business Law Section will again host or co-host an annual professional social event for all members. Likewise, the Business Law Section will again conduct its annual meeting and CLE seminar at this year's Bar convention in Sandestin, Florida. And, of course, we will continue to hold an annual ethics CLE event in late July, to accommodate members of the Bar who may need a last minute hour of ethics credit before the end of the reporting period. Finally, the Business Law Section will award annual scholarships to deserving students at the Ole Miss and Mississippi College Law Schools. On behalf of the Business Law Section leadership, we welcome your ideas for any other services or events that we might organize to assist our members.

In conclusion, I would like to thank our very dedicated section Officers and Executive Committee, each of whom continues to contribute greatly toward the success of our section: Bill McLeod, Vice-Chair, Jimmy Milam, Secretary/Treasurer, Henry Dick, Executive Committee, Joyce Hall, Executive Committee, Cheryn Baker, Executive Committee, and Ken Farmer, Newsletter Editor. All of these Officers and Executive Committee members have been faithful and active members of the Business Law Section for many years. Ken Farmer deserves particular thanks for pulling together the Business Law Section's newsletter for the benefit of all of us. These individuals are outstanding examples of leadership within The Mississippi Bar.

## Section News

### SECTION SCHOLARSHIPS

#### *Clay Baldwin*

The Business Law Section awarded a \$750.00 scholarship to second year law student Clay Baldwin at Mississippi College School of Law. Dean Rosenblatt presented the award to Mr. Baldwin on behalf of the Business Law Section. Mr. Baldwin was nominated for the scholarship by Professor Cecile Edwards, who teaches several business related courses. Mr. Baldwin is from Mount Olive, Mississippi and attended the University of Southern Mississippi.



#### *Steven Woodliff*

The Business Law Section awarded a \$750.00 scholarship to second year law student Steven Woodliff at The University of Mississippi School of Law.

### ✪ CORPORATE ANNUAL REPORT FEE CHANGE FOR 2010 ✪

Effective January 4th, 2010, the Mississippi Secretary of State's Office reduced the fee for filing corporate annual reports online from \$25.00 to \$22.00. The reduction in fees applies only to those annual reports filed using the Secretary of State's online filing system. In addition, the Department of Finance Administration has agreed to reduce their online filing convenience fee for this transaction from \$2 to \$1.25. This means that corporations can file their 2010 report online for only \$23.25 versus \$25 through the mail. Filing the Annual Report online has significant advantages over paper filing. The Annual Report will be instantly filed and will be available for viewing almost immediately. Customers will receive an electronic confirmation that their report was filed which they can print and keep for their corporate records. Payment may be made using electronic check, Visa, Master Card, or American Express. Annual Reports may be filed online by going to the Business Services section of the Secretary of State's website at [www.sos.ms.gov](http://www.sos.ms.gov).

# Alphabet Soup: Low-Profit Limited Liability Company (L<sup>3</sup>C)

By David M. Allen, Esq.

## INTRODUCTION

Over the past several years, an entity known as the low-profit limited liability company, or “L<sup>3</sup>C”, has entered the business realm. This new hybrid non-profit/for-profit form of limited liability company first saw light of day in Vermont following the enactment of House Bill 0775 on April 30, 2008. Legislation authorizing the L<sup>3</sup>C was conceptualized by Robert M. Lang, Jr., CEO of Mary Elizabeth & Gordon Mannweiler Foundation. It was Lang’s idea to streamline the process of obtaining approval for grants and donations made by non-profit, charitable foundations for what are known as Program Related Investments (“PRI”). With the help of Marcus Owens of the Caplin & Drysdale law firm, legislation was drafted and then submitted to the Vermont legislature. Since that time, several states have passed, or have considered, legislation designed to authorize the use of this unique funding vehicle. See “Status of L<sup>3</sup>C Legislation” below. This article will address some of the unique elements of the L<sup>3</sup>C, briefly review the federal response, suggest possible uses for the L<sup>3</sup>C, and reasons why L<sup>3</sup>C legislation should be considered in the State of Mississippi.

## ATTRIBUTES OF L<sup>3</sup>C’S

The L<sup>3</sup>C is a hybrid of for-profit and non-profit entities, blending the attributes of both organizations in a limited liability

company format. The Vermont L<sup>3</sup>C model differs from the standard limited liability company in several ways. First, an L<sup>3</sup>C’s operating agreement must set forth the primary business objectives as one or more charitable or educational purposes, as defined by Section 170 of the Internal Revenue Code (“I.R.C.”). Additionally, the term “low-profit” (the third “L”) must appear in the title to serve as notice that the entity is motivated first and primarily by a social mission, but not necessarily to the exclusion of making money.

L<sup>3</sup>C’s are designed to address funding-related challenges of non-profit, eleemosynary entities, providing a vehicle to support charitable missions with market-oriented methods. One of the major benefits would be qualification of the new entity to receive PRI treatment under Section 4944 of the I.R.C. The Vermont legislation was specifically designed such that it would mesh with existing Internal Revenue Service (“IRS”) regulations relevant to foundations making program-related investments.

## L<sup>3</sup>C’S IN VERMONT

Deborah Markowitz, Vermont’s Secretary of State, describes the L<sup>3</sup>C on Vermont’s corporate division website as a cross between a non-profit organization and a for-profit organization but with charitable or educational goals. In order to qualify as an L<sup>3</sup>C in

Vermont, Vermont Stat. Ann. Title 11, § 3001(27) requires that:

1. The company significantly further the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the IRS Code of 1986, 26 U.S.C. Section 170(c)(2)(B), and (ii) would not have been formed but for the company’s relationship to the accomplishment of charitable and educational purposes.

2. No significant purpose of the company is the production of income or appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

3. No purpose of the company is to accomplish one or more political or legislative purposes within the meaning of Section 170(c)(2)(D) of the IRS Code of 1986, 26 U.S.C. Section 170(c)(2)(D).

According to Gene Takagi (“Takagi”), a California non-profit attorney and contributing editor and publisher of the Nonprofit Law Blog, the initial L<sup>3</sup>C was L<sup>3</sup>C Advisors, L<sup>3</sup>C, which

was organized for the purpose of helping others to set up and obtain funding for L3C's. Takagi has noted that there are slight differences in the enabling legislation in several states. For example, Illinois and Utah amended their individual limited liability company acts to allow for the creation of L3C's as hybrids of standard non-profit and for-profit entities. North Dakota, on the other hand, amended its code relating to limited liability companies to expressly allow for the creation of non-profit limited liability companies.

### FEDERAL APPROACH

It is estimated that private letter rulings from the IRS concerning a PRI can cost as much as \$50,000 or more. The fees, together with the amount of time necessary to receive a private letter ruling, make this an extremely inefficient way to deal with and obtain PRI approval. It was the intent that the L3C would become a structure for easy-to-make PRI's, in that they would be built on the limited liability structures currently in place in all fifty states and by providing a flexibility of membership in organizations needed to cover a wide variety of social enterprise situations that has arisen in America.

On the federal level, Takagi reports that following the passage by Vermont of its L3C enabling legislation, Robert M. Lang, Jr., together with Robert Collier, President and CEO of the Council of Michigan Foundations, and Steve Gunderson, President and CEO of the Council on Foundations, worked with congressional leaders to introduce a federal L3C bill. This bill, originally entitled The Program-Related Investment Promotion Act of 2008, was intended to facilitate PRI's by private foundations through an

amendment of Section 4944(c) of the I.R.C. Basically, the legislation would provide a safe-harbor process which would expedite and streamline the approval process. In addition, it would establish a rebuttable presumption that below-market rate investments in L3C's by private foundations would be deemed PRI's.

To accomplish this, the proposed act included:

1. A Determination Process, establishing a process whereby an entity seeking to receive PRI's could receive a determination by the IRS that below-market foundation investments would qualify as PRI's. Foundations would continue to rely on this IRS determination until revoked.

2. A Rebuttable Presumption, establishing that below-market foundation investments would qualify as PRI's. The L3C would have a stated purpose to achieve a charitable objective, with profit a secondary goal. The L3C must be organized and operated at all times to satisfy the IRS requirements for PRI's and, thus, to qualify as a recipient thereof. The L3C's proposed structure would allow members to make different types of investments with varying levels of risk, with the highest-risk investments being borne by the PRI's and the hope that non-charitable investors would earn market returns at acceptable levels of risk thereby bringing new pools of funds to bear on social issues

traditionally addressed by non-profits.

This legislation died in Congress in 2009.

### FUNDRAISING CHALLENGES

Those who have served on boards of non-profit foundations and charitable organizations realize that fundraising is a continuous problem for nearly all non-profits. In today's economy, the problems are exacerbated. Many in the non-profit world would say that their hands are tied as a result of federal tax laws that restrict non-profits from accessing traditional forms of equity and, therefore, these entities must rely on grants, governmental support, and, to a limited extent, fees arising from services provided. Some non-profits have turned to separate social enterprise business guidelines as an additional way in which to raise funds. The problems are aggravated in that federal tax laws either restrict or prohibit non-profits from accessing traditional forms of capital, as well as limiting commercial debt.

A for-profit entity with a charitable desire or with social goals faces similar challenges. The IRS restricts private business entities from accessing foundation grants and government assistance. Investors almost always expect market rate returns on investments. Obviously, these expectations do not align well with the non-profit sector. The L3C is an effort to bridge the gap between the profit and non-profit sectors, with the result that it would eliminate the need for investment minded entrepreneurs to either choose between for-profit and non-profit business models or create and manage both.

## PRI'S AND L3C'S

Those familiar with Sections 4940 through 4949 of the I.R.C., which deal with private foundations, will recognize that the Vermont L3C requirements closely track the provisions of I.R.C. Section 4944(c) of the I.R.C., which establishes PRI's as a safe-harbor exception to taxes imposed on investments which jeopardize charitable purposes of foundations. If the investment fails to satisfy the requirements necessary to be granted the exception, a tax, equal to 5% of the amount so invested for each year, is imposed. Additionally, the foundation's manager, who normally is responsible for the investment, is liable for an additional 5%. There are additional adverse consequences on both the foundation and its management if, once the foundation investment is determined to be in jeopardy and is not immediately removed, then the tax is levied.

PRI's are at the heart of the L3C structural concept. The Ford Foundation made the initial PRI in 1968. Thereafter PRI's were authorized pursuant to the Tax Reform Act of 1969, which allows a PRI to be an investment that a foundation makes in a non-profit or for-profit venture to support a charitable purpose, but with a potential for return of the foundation's capital over a period of time. PRI's can be any type of investment vehicle such as a loan or loan-guaranteed line of credit, asset purchase, or covers a grant or active investment. Foundations can even use PRI's to meet their federally-mandated 5% minimum payout obligation. Such investments must meet the three-prong test under Section 4944(c) of the I.R.C. in order to qualify. Specifically, they must possess the following characteristics:

(a) primary purpose to further tax-exempt objectives; (b) production of income cannot be a significant purpose; (c) cannot be used for political lobbying or campaigning.

## POSSIBLE L3C USES

Several uses for the L3C entity have been suggested. Takagi recently reported on a proposal from North Carolina, a state with its furniture manufacturing industry suffering from increased global competition. This proposal would have L3C's buy factories in the state, modernize them, and then lease them to furniture manufacturers at a low rate. Citing Robert Lang of the Mannweiler Foundation, Takagi further suggests a multi-tiered L3C structure, allowing various entities to meet charitable or social goals or internal rate-of-return requirements. Another possibility for L3C use was highlighted by Takagi's report on an article by Sally Duros as reported in *Huffington Post* issues of February 9 and February 26, 2009. Therein, Duros proposed federal regulations which would make newspapers eligible for PRI's by expanding charitable purpose definitions to include newspapers. Again, according to Takagi's report, the goal would be a newspaper as a self-sufficient entity, not as a high-profit entity. Another use reported by Takagi again concerns Marc Lane's recommendation that L3C investors can offer low-interest loans to needy students, finance low-income housing projects, provide credit to disadvantaged business owners, combat community deterioration, and help alleviate other social strains.

Cassady V. Brewer, a partner in the Tax, Exempt Organizations, and the Wealth Planning Practices section of

Morris, Manning & Martin, LLP, in Atlanta, has written and spoken extensively on the L3C. In a presentation entitled "THE L3C: A FOR-PROFIT WITH A NON-PROFIT SOUL", Mr. Brewer suggests recent trends that seem to favor utilizing L3C's. Brewer suggests that L3C's capitalized with PRI's have a tremendous potential to fill the desire to grow social enterprise organizations. He also cites several IRS private letter rulings that suggest that such program related investments would work. See PLR 200603031 (I.R.S. 2005) and PLR 200610020 (I.R.S. 2005).

Several commentators, including Brewer, have suggested a multi-layered structure for membership in the L3C, similar to Takagi's approach mentioned above. The initial layer would be the founders of the entity. The middle layer would be tax-exempt charities or private foundations. The final tier would be for-profit organizations with a requirement for a rate of return.

## OPPOSING VIEWS

As with most things, there are opposing views as to the need for L3C's. J. William Callison, a partner at Faegre & Benson, LLP, in Denver, addressed L3C's in the American Bar Association's Business Law Section Blog in November and December of 2009. In his article entitled "Non-Binding Opinion, L3C's: Useless Gadgets?", Callison opined that L3C's are useless gadgets, adding nothing to the LLC package and which run the risk of giving "unsuspecting users the unfounded belief that difficult tax problems have been solved." His objections are that, with the failure of Congress to pass

the Program Related Promotion Act, no special presumptions concerning PRI treatment have been adopted on a federal level. Says Callison: “Thus, L3C’s are in no better position to receive PRI treatment than the LLC’s out of which they emerged. LLC’s are already flexible entities and nothing prevents an LLC from receiving a PRI when its articles of organization and operating agreement provide for the LLC to significantly further a charitable or educational purpose and for no significant purpose of the LLC to be income production or property appreciation.”

Cassady Brewer has also raised concerns. He feels that reliance on the L3C entity alone will not ensure that a foundation has made a valid PRI. He further opines that only compliance with federal law, not a state L3C statute, will ensure that a PRI is valid. Until there is active support by the federal government, uncertainties will remain a factor in decisions. The Program-Related Investment Promotion Act of 2008, as cited above, would have allowed this by creating a safe harbor for PRI’s. However, this has not passed.

#### ARE L3C’S WORKABLE IN MISSISSIPPI?

Mississippi would seem ripe for adoption of the L3C entity. Of particular interest would be the utilization of such multi-tiered entities in rebuilding after natural disasters such as hurricanes on the Gulf Coast or floods or tornadoes in all parts of the state. It is interesting to note that several entities which arose or were established after Hurricane Katrina were able to achieve their social objectives through a partnership of non-profit organizations and profit organizations.

An additional result has been facilitated by corporate entities wishing to take advantage of New Market Tax Credits, which has resulted in the development of downtown Jackson, i.e., King Edward Hotel. Had Mississippi had enabling legislation for the L3C, this might have been the vehicle for these transactions.

The question that remains for Mississippi legislators, as well as those dealing with LLC’s, is whether amending Mississippi’s Limited Liability Company Act to provide for L3C’s would be beneficial. Although there appears to be ample opportunities to achieve certain social objectives in certain areas of the state, the jury is still out. As Callison stated, it is possible to tailor an existing LLC for social purposes and, through proper compliance with state statutes and federal tax regulations, to qualify the entity for PRI’s. However, it is good to know that such a tool exists and, should the need arise, that it could be adopted fairly quickly and put into effect.

#### STATUS OF L3C LEGISLATION

**Arkansas:** Introduced as House Bill 2102; subsequently withdrawn and submitted for study by Joint Interim Committee on Insurance & Commerce-House.

**Crow Indian Nation:** Legislation adopted January 13, 2009.

**Illinois:** Enacted August 4, 2009 and will take effect January 1, 2010

**Michigan:** Legislation signed January 16, 2009, as MCL § 450.4102(M).

**Missouri:** House Bill 817 introduced February 19, 2009; referred to Special Standing Committee on General

Laws. Voted do pass (H); no further action reported.

**Montana:** In 2009, introduced as House Bill 235. Died in standing committee on April 28, 2009.

**North Carolina:** Senate Bill 308 passed Senate in July 2009 and sent to North Carolina House for consideration.

**North Dakota:** Legislation adopted in 2009 as Nonprofit Limited Liability Company Act, N.D. Cent. Code, § 10-36-01 et seq.

**Oregon:** Legislation pending.

**Oglala Sioux Tribe:** Legislation adopted July 2, 2009.

**Tennessee:** Legislation pending.

**Utah:** Legislation signed March 23, 2009. Utah Code Ann. § 48-2c-102 et seq.

**Vermont:** Legislation signed April 30, 2008. Vermont Stat. Ann. Title 11, § 27 (2009).

**Wyoming:** Legislation signed February 26, 2009, eff. July 1, 2009. Wyo. Stat. Ann § 17-15-102 et seq.

The following sources were utilized for this article:

1. Gene Takagi, Esq., various posts, The Nonprofit Law Blog, [www.nonprofitlawblog.com](http://www.nonprofitlawblog.com) (Used with permission of Mr. Takagi).
2. J. William Callison, Esq., “NONBINDING OPINION: L3C’S: USELESS GADGET”, American Bar Association, volume 19, number 2, November/December 2009 (Used with permission of Mr. Callison).
3. Cassady Brewer, Esq., presentation entitled “A FOR PROFIT WITH A NON PROFIT SOUL” (Used with permission of Mr. Brewer).

# Risk Taking by Managers – Recent Developments

By Wulf A. Kaal, Assistant Professor of Law

## INTRODUCTION

The recent credit crisis has demonstrated that excessive risk taking by management can contribute to the downfall of major corporations and the destruction of markets for financial instruments. Risk aversion, on the other hand, can lead to suboptimal allocation of resources and detriments to shareholders who demand high returns on capital. Corporate directors are mandated to take sufficient risk to generate optimal returns while preventing excessive risk and losses.

The “business judgment rule” is an attempt to find equilibrium between excessive risk and risk aversion, taking into account the interests of shareholders and corporate directors. The business judgment rule precludes judicial review of most decisions by corporate directors and protects directors from potential liability for “good faith” decisions that ultimately end in failure. The rule creates a rebuttable presumption that directors, while independent and disinterested, acted on an informed basis, with a proper business purpose and acted for the best interest of the corporation. Courts and legal commentators have long emphasized the importance of the rule in promoting the kind of risk-taking by corporations that results in new ideas, new technologies and new markets. Delaware courts have traditionally shown much deference to risk-taking by management.

Recent legislative proposals, however, go beyond the scope of the business

judgment rule and attempt to substantively tighten the standard of care. This article highlights recent developments in Delaware law pertaining to risk taking under the business judgment rule and analyzes the potential impact of legislative proposals that attempt to tighten the substantive standard of care.

## RECENT DEVELOPMENTS

Recently, in an opinion that provided the first detailed analysis of potential liability of directors for losses incurred as a result of substantial exposure to subprime debt, the Delaware Court of Chancery in *In re Citigroup Inc. Shareholder Derivative Litigation*, No. 3338-CC, 2009 WL 481906 (Del. Ch. Feb. 24, 2009), upheld the business judgment rule and its protection of directors’ business decisions in the face of worldwide economic losses, finding that *Caremark* duties were not designed to impose oversight liability for business risk. Shareholder plaintiffs alleged (1) breach of fiduciary duties for failing to properly monitor and manage the risk that Citigroup faced concerning problems in the subprime lending market, and (2) failure to properly disclose the company’s exposure with respect to subprime assets. According to the complaint, starting in May 2005, “red flags” should have immediately alerted the defendant to problems in the real estate and credit markets. Therefore, by ignoring these warning signs, the defendant allegedly overemphasized short-term profits

and, thus, sacrificed the long-term viability of Citigroup. According to the Delaware Chancery court, oversight liability can only be established if the plaintiff can show that “the directors *knew* that they were not discharging their fiduciary [duties] or that the directors demonstrated a *conscious* disregard for their responsibilities [...]”. In summary, the inability to predict the future and an incorrect evaluation of business risk was not an oversight of director responsibilities. Risk is inherent in maximizing shareholder value and losses, in and of themselves, do not suffice to hold directors personally liable for taking risks that lead to losses.

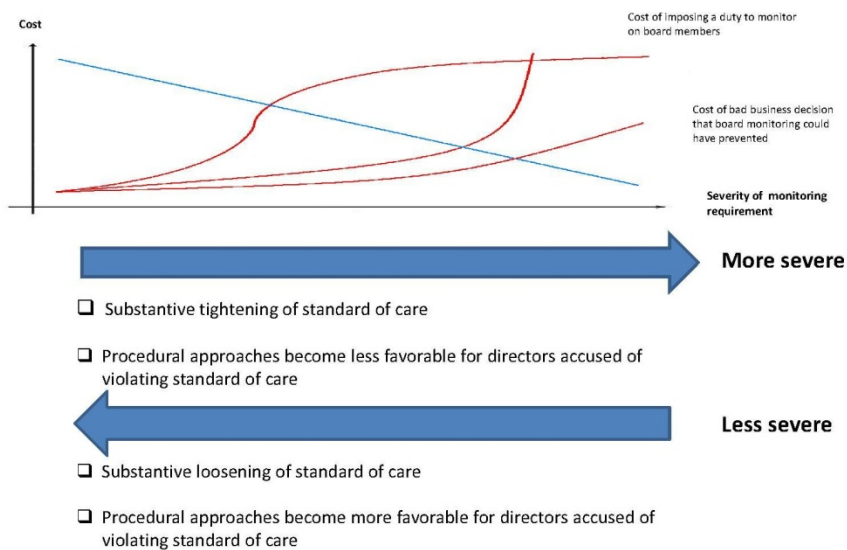
In the wake of the *Citigroup* decision, recent legislative proposals addressing risk taking by managers go beyond confirming existing law and attempt to reform perceived shortcomings. Recognizing a “widespread failure of corporate governance” and acknowledging that “executive management and boards of directors have failed in their most basic duties, including to enact compensation policies that are linked to the long-term profitability of their institutions, to appropriately analyze and oversee enterprise risk, and most importantly, to prioritize the long-term health of their firms and their shareholders;” New York Sen. Chuck Schumer (D-NY) proposed the Shareholder Rights Act of 2009 (the “proposed Act”). The proposed Act sets out corporate governance standards (sec. 5), requires shareholder input in board elections (sec. 4) and, most

importantly, shareholder vote on executive compensation disclosures (sec. 3). As part of its corporate governance standards, the proposed Act would require that each public company board of directors establish a risk committee (sec. 5(5)(A)). Such a risk committee would be comprised entirely of independent directors and would be responsible for the establishment and evaluation of risk management practices.

Other legislative proposals that were referenced in conjunction with the proposed Act include the “TARP Reform and Accountability Act of 2009” (H.R. 384), which was introduced by Barney Frank (D-MA), the Chairman of the House Financial Services Committee, to harmonize and broaden the executive compensation standards applicable to companies accepting government financial assistance. (1766 PLI / Corp. 85). A more expansive version of the proposed Act, known as the “Shareholder Empowerment Act of 2009”, was introduced by Representative Gary Peters (D-MI), on June 12, 2009.

### COST ANALYSIS

The graph attempts to illustrate the cost structure in relation to changes in the severity of monitoring requirements imposed by substantive and procedural rules. It shows the basic tradeoff between the cost and the benefit of imposing a duty to monitor risk on board members. The more severe the monitoring requirement under existing or new substantive and procedural rules, the higher the monitoring and agency costs on board members. At the same time, as monitoring requirements increase, the cost of inappropriate business decisions that



board monitoring could have prevented decreases.

Accordingly, if substantive standards of care are tightened and procedural approaches become less favorable for directors accused of violating the standard of care, the severity of the monitoring requirement increases and the cost of imposing a duty to monitor on board members of a corporation may increase in several ways. The three upward sloping red lines attempt to illustrate these potential cost changes. Costs could increase very quickly and then level off at a later point but could also slowly but gradually increase. At the same time, if the substantive standards of care are tightened and procedural approaches become less favorable for directors accused of violating the standard of care, the cost of bad business decisions that could have been avoided by monitoring decreases. The blue downward sloping line shows this effect on costs. Conversely, if substantive standards of care are loosened and procedural approaches

become more favorable for directors accused of violating the standard of care, the severity of the monitoring requirement decreases and the cost of imposing a duty to monitor on board members of a corporation may decrease. In turn, the cost of bad business decisions that could have been avoided by monitoring increases.

Presumably, the total costs involved would be a combination of upward and downward sloping lines, i.e. wherever the costs and benefits lines meet would be the lowest point of the total cost curve. Due to a multitude of unknown elements, the author dispensed with showing a total cost line.

### CONCLUSION

Delaware law does not currently impose a duty to monitor risk. Recent legislative proposals such as the Shareholder Bill of Rights Act of 2009, however, could mandate new

corporate governance requirements in the not too distant future. The proposed Act introduces a mandatory risk committee (sec. 5(5)(A)) in recognition that most boards delegate risk oversight to the audit committee and only about three percent of the S&P 500 companies have so far established a standing risk committee. The proposed Act constitutes a federally mandated approach to corporate governance which, if adopted, would eliminate a corporation's ability to choose corporate governance approaches that are appropriate for the particular circumstances of the corporation. Corporations would no longer be able to structure the risk oversight according to their needs but would be required by law to institute a board risk committee. This could lead to additional changes such as an increase

in the size of the board or new staff for the committee.

If adopted, the proposed Act could make meritorious and unmeritorious suits more likely as plaintiff's lawyers have incentives to use the federally mandated risk committee, or the lack thereof, as a basis for filing additional suits. The assessment of management risk taking by a special risk committee could also lead to more shareholder derivative suits and securities disclosure suits over whether the committee did its job appropriately.

By requiring new corporate governance elements, the proposed Act adds new substantive rules. This tightens the substantive standard of care and increases monitoring and agency costs. It is unclear if these costs will be offset by a decrease in

the costs of bad business decision that would be avoided due to the introduction of the risk committee. The tightening of the substantive standard of care could also lead to additional strike suits. This, in turn, could further increase costs. Depending on the cost of additional litigation and government interference, the tradeoff between the cost and the benefit of imposing a duty to monitor risk on board members may or may not be "worthwhile" from the company's perspective. However, the corporation's perspective may not matter as much given the current political climate and social externalities of business failure. The severity of monitoring requirement may increase in the US regardless of net costs to the company.

**For a comprehensive analysis of risk taking by managers in a comparative context, please see "Directors and Officers Liability for Taking Excessive Risks in Germany and the US", (forthcoming – with Richard W. Painter).**

## The Contractor's License

By Edwin Stephen Williams, Esq.

Most people in the construction business understand the importance of having what is commonly known as a "Contractor's License." Indeed, many contractors proudly advertise that they are "*licensed* and bonded." The license is issued by the Mississippi State Board of Contractors ("Board"), which regulates the construction profession, including both commercial and residential contractors.

In 2009, the Mississippi appellate courts decided several cases involving the "Contractor's License" which highlight the importance of ensuring clients are properly licensed. As background and as most contractors know, Mississippi law requires anyone who performs commercial construction to hold a *certificate of responsibility* (a "License") issued by the Board when a contract (or subcontract at any tier) equals or exceeds \$50,000.00 on a public project or \$100,000.00 on a private project. Miss. Code Ann. §31-3-1. Residential builders and remodelers, on the other hand, are required to be licensed by the Board when residential projects exceed \$50,000.00 or remodeling projects exceed \$10,000.00. Miss. Code Ann. §73-59-1.

Although there are many interesting aspects of the licensing laws, the statutory framework for both the commercial and residential areas contains similar restrictions for those who work without a License or without the "proper" license.

In the commercial area, for example, Miss. Code Ann. §31-3-15 provides that:

No contract for public or private projects shall be issued or awarded to any contractor who did not have a current certificate of responsibility issued by said board at the time of the submission of the bid, or a similar certificate issued by a similar board of another state which recognizes certificates issued by said board. Any contract issued or awarded in violation of this section shall be null and void. (emphasis added).

In the residential and remodeling area, Miss. Code Ann. §73-59-9(3) provides:

A residential builder or remodeler who does not have the license provided by this chapter may not bring any action, either at law or in equity, to enforce any contract for residential building or remodeling or to enforce a sales contract. (emphasis added).

There have been three recent decisions by the Mississippi appellate courts underscore that these provisions mean exactly what they say ... or at least they do most of the time.

### NOT JUST ANY LICENSE WILL DO

On July 21, 2009, the Mississippi Court of Appeals decided *United Plumbing & Heating v. AmSouth Bank*, 2009 Miss. App. LEXIS 443. In that case, United Plumbing was hired as a general contractor to build a day care center. As is customary, United hired several subcontractors to perform various tasks on the project.

When the project owner went bankrupt, United and the other contractors sued the project lender and others for, among other things, breach of contract. At the time of the project, United held a current certificate of responsibility from the Board for plumbing and HVAC work, but not for construction management or general building construction. The trial court and the appeals court held that United's contract with the owner was null and void because United "failed to possess the appropriate certificate of responsibility for the type of work it undertook to perform." *Id.* (emphasis added).

Not only did the court hold that United's contract was void for not having the appropriate License for general construction work, it also concluded that any contractual obligations that "may have [been] owed the subcontractors are also void."

## NO LICENSE, NO MONEY

On August 18, 2009, the Mississippi Court of Appeals decided *Puckett v. Gordon*, 16 So.3d 764 (Miss. App. 2009), a colorful case involving repairs to a century old Natchez residence which was damaged by Hurricane Katrina. Gordon, a roofer, was hired to make the repairs which were estimated to exceed \$100,000.00.

Things went smoothly for Gordon whose first invoice in the amount of \$9,128.81 was paid without incident. However, the owner became unhappy with Gordon's work and refused to pay his second invoice in the amount of \$17,603.65. When Gordon and his friend, Antoine, showed up at the project site (which happened to be the owner's residence) to collect his bill, the owner felt threatened and pulled a .38 caliber handgun on Gordon who promptly left.

After resolving the aggravated assault charge in favor of Gordon (no one said residential construction work was easy), the appellate court reversed the trial court's award of the contract balance to Gordon who performed work on the house without a license. The court held that "Gordon acted as a remodeler within the meaning of Mississippi Code Annotated section 73-59-1(c) and is barred from recovery by section 73-59-9(3) because he did so without a [L]icense." *Id.* at 770.

## A LICENSE TO SUE

On August 20, 2009, the Mississippi Supreme Court decided the case of *Lutz Homes, Inc. v. Weston*, 19 So.3d 60 (Miss. 2009) which was the last of the licensing cases for the year. In this case, Mr. Lutz obtained a residential

builder's License in 1999 while conducting his business as a sole proprietor. In 2001, he converted his business to a corporation and included this information in his annual license renewals to the Board. However, no License was issued in the name of the corporation until much later.

In 2006, Lutz developed a dispute with a home owner who refused to pay him \$118,125. When Lutz, through his corporation, filed a lien to recover the money that was due for his work, the homeowner responded with a lawsuit asking the court to cancel the lien and to declare the contract with Lutz to be null and void since the corporation had no license at the time the contract was entered into. Lutz filed a counterclaim to recover his money. The trial court decided that the residential licensing statute quoted above, Miss. Code Ann. §73-59-9 (3), meant what it said and dismissed the contractor's claims.

On appeal, the Mississippi Supreme Court noted that Lutz asked the Board to name the corporation as the License holder and that the Board granted his request before Lutz filed his claim in the owner's lawsuit. Under these circumstances, the Court interpreted that Lutz could sue even though his corporation technically did not have a License when it entered into the contract. The Court stated:

We agree that Lutz Homes, Inc., was unlicensed at the time it entered into the construction contract with the [owners]. Nevertheless, Section 73-59-9(3) does not bar its counterclaim or lien....

As previously discussed, under Section 73-59-9(3), a corporation must be licensed prior to asserting an

"action."... The plain language of Section 73-59-9(3) requires only that a residential builder obtain a license prior to bringing an action.... Unlike similar statutes found in Title 73 of the Mississippi Code, Section 73-59-9(3) does not require that a residential builder be licensed at the time of performance or at the time the cause of action accrued.... Once a [L]icense has been obtained, the disqualification is removed and an action may be brought to enforce a residential building or sales contract, regardless of whether the contract was made before or after the [L]icense was acquired...19 So.3d at 63-64.

While the Court was unanimous in its decision to reverse the trial court and to allow Lutz to proceed with his claims, the justices were not unanimous in their reasoning. One concurring justice wrote:

Finding that Lutz Homes, Inc., was unlicensed at the time the contract was entered into and performed, the majority opinion goes on to reason that the corporation may still pursue a counterclaim through an interpretation of the statute that, with respect, I find highly problematic and strained. The majority holds that a residential builder may file a civil action seeking to collect payment for work done without a [L]icense, as long as that builder obtains a license prior to filing suit. Reading Mississippi Code Section 73-59-9 (3) in the

context of the entire statutory scheme, I believe this interpretation to be erroneous.

The pertinent language provides, “[a] residential builder or remodeler who does not have the [L]icense provided by this chapter may not bring any action, either at law or in equity, to enforce any contract for residential building or remodeling or to enforce a sales contract.” Miss. Code Ann. § 73-59-9(3) (Rev. 2008), *extended by* 2009 Miss. Laws ch. 556. The immediately preceding subsections make it a misdemeanor, punishable by a fine of up to \$ 5,000 and/or imprisonment of thirty to sixty days, to build or remodel a residence without a license. Miss. Code Ann. § 73-59-9(1)-(2), *extended by* 2009 Miss. Laws ch. 556.

This strong prohibition against residential

construction work by unlicensed corporations, partnerships, or individuals, which clearly is penal in nature, is simply reinforced by the additional penalty of prohibiting unlicensed builders or remodelers from using the state’s courts to try to collect unpaid bills for residential construction work performed without benefit of the required License. Such an interpretation is consistent with the majority’s conclusion that the intent of the statute is “to protect [consumers] against the dangers associated with unlicensed builders.” Yet, following the majority’s reasoning, an unlicensed builder could utilize Mississippi’s courts to enforce a contract for work illegally performed if only the builder obtained a License in advance of filing suit. Surely the Legislature could not have intended such a patently

perverse course of events. 19 So.3d at 65.

The concurring justices would have allowed the contractor to proceed with his claims since he had dutifully informed the Board of his corporate status with each annual renewal of his License.

## CONCLUSION

So what can we conclude from these three cases? If you have a client that performs commercial or residential construction, be sure that they are properly licensed by the State Board of Contractors. And contrary to some of the discussion in the *Lutz* case above, it would probably be wise to advise your client to procure their License before they bid or contract to do any construction work. In the commercial arena, the statute clearly makes a contract void if the contractor does not have the appropriate License at the time a bid is submitted or the contract entered into.

# Mississippi Secretary of State Supports Recommended Business Reform Legislation

By Cheryn N. Baker, Assistant Secretary of State for Policy and Research Division, and  
Doug Jennings, Senior Attorney, Policy and Research Division

## INTRODUCTION

In the summer of 2008, the Mississippi Secretary of State's Office formed volunteer groups to study Mississippi's business laws with the goal of making them more business-friendly. The study groups' recommended changes to the laws dealing with trademarks, charities, corporations and securities regulation were adopted during the 2009 legislative session. This past summer, the Secretary of State again organized study groups to focus on our state's laws regarding registered agents laws, the Uniform Commercial Code, limited liability companies, trade names and trust laws. Below is a brief summary of the proposed legislation.

For more information on the proposed limited liability company legislation, see the accompanying article "Secretary of State's Office Supports Adoption of Revised Limited Liability Company Act" on page 16.

For more information on all business reform legislation supported by the Secretary of State's Office please visit our website at [http://www.sos.state.ms.us/Policy\\_Research/ProposedLeg.asp](http://www.sos.state.ms.us/Policy_Research/ProposedLeg.asp).

## UCC UPDATES

The Uniform Commercial Code Study Group recommended the adoption of Revised Articles 1,

3 and 4 (Senate Bill 2419). Article 1, General Provisions, narrows the scope of the substantive rules in Article 1 and clarifies when the UCC controls over other laws. Conforming amendments were drafted for all the articles of the Mississippi UCC to conform them to Revised Article 1. The Study Group recommended a non-uniform provision that generally limits the choice of law in the case of implied warranties to consumer transactions.

Article 3, Negotiable Instruments, and Article 4, Bank Deposits and Collections, have been updated to deal with payment by checks and other paper instruments to provide essential rules for the new technologies and practices in payment systems. Non-uniform provisions have been recommended by the study group for Article 3 to conform to federal banking regulations.

## MODEL REGISTERED AGENTS ACT

The Model Registered Agents Act Study Group has recommended the adoption of the Mississippi Registered Agents Act, based upon the Group's review of the Model Act. The Model Act, which was adopted by the Uniform Law Commission (formerly known as the National Conference of Commissioners on Uniform State Laws (NCCUSL)) in 2006, has been

endorsed by NCCUSL, the American Bar Association's Business Law Section, the International Association of Commercial Administrators, and the National Association of Secretaries of State. In addition, ten states have adopted a form of the Model Act.

The Mississippi Registered Agents Act (Senate Bill 2681) will create one uniform body of law to govern the registered agent process for all types of business entities. The proposed Act standardizes and creates one filing process and one set of forms and fees for registered agents of all types of business entities. This Act will also clarify and make consistent service of process procedures for all business entities. At the same time it will clear up diversity questions among the various business entity laws and allow registered agents to represent their clients in the same manner as they do under current law.

## TRADE NAME REGISTRATION

The Fictitious Business Name Registration Act (Senate Bill 2003, House Bill 1127) will allow businesses to voluntarily register their names and contact information with the Secretary of State. This information will be placed in a searchable database on the Secretary of State's website that will be freely available to the public. The proposed Act would provide

consumers with a free, simple way to find out who owns a particular business, enabling them to make better decisions about the entities with which they do business. In addition, while registering a business name under this Act will not confer trademark or other rights on the owner, registration can put other parties on notice that the owner is using a particular name. Further, SB 2003 should help banks and small businesses by preventing the fraudulent creation of accounts in the name of a business or to cash checks made out to that business. Adopting this Act will bring Mississippi in line with the 45 other states which allow or require registration of fictitious names.

## TRUST LAWS

The Trust Laws Study Group was formed to consider a wide range of laws aimed at modernizing the state's laws governing trusts and estates. Among the topics considered by the group were: whether to recognize so-called asset-protection trusts (also known as self-settled spendthrift trusts); whether to allow perpetual trusts; and whether to recommend for adoption a number

of uniform acts of the Uniform Law Commission, including the Uniform Prudent Management of Institutional Funds Act (Senate Bill 2657), the Uniform Principal and Income Act (Senate Bill 2425), and portions of the Uniform Trust Code (Senate Bill 2403). These uniform laws have been adopted in many other states and adoption of them in Mississippi would make Mississippi's laws uniform with these other states. Ultimately, the group recommended proposed legislation to adopt the uniform acts mentioned above, updating and modernizing the state's existing trust and investments laws in these areas.

The study group also recommended proposed legislation that, if passed, would recognize asset-protection trusts. The proposed Mississippi Qualified Disposition Act (Senate Bill 2416, House Bill 1181) will provide a boost to Mississippi's economy by validating so-called self-settled spendthrift trusts, which are now recognized in 11 other states including Tennessee, Delaware, and Alaska. Such trusts are commonly used for estate and marital planning, to protect gifts and inheritances, and to protect assets belonging to young or otherwise vulnerable persons. States opting to recognize self-settled

spendthrift trusts have done so to boost their economies, and currently Mississippi residents that want to establish them must set them up in other states, resulting in the trust dollars being deposited outside Mississippi. By adopting the Qualified Disposition Act, the legislature can ensure that these funds are kept in the state and also potentially attract funds from other nearby states which do not recognize self-settled spendthrift trusts.

The proposed bills should make Mississippi a premiere destination for trust dollars, as this legislation will create a more positive investment environment within the state, as well as a clearer set of laws for banks, charities and other trustees.

## CONCLUSION

The Secretary of State's Office will be monitoring these bills as they proceed through the legislative process. If you are interested in receiving updates on the status of this legislation, please contact Cheryn Baker at [cheryn.baker@sos.ms.gov](mailto:cheryn.baker@sos.ms.gov).

# Secretary of State's Office Supports Adoption of Revised Limited Liability Act

By Cheryn N. Baker, Assistant Secretary of State for Policy and Research Division

## INTRODUCTION

The limited liability company (LLC) has become the preferred business entity type in the country and in Mississippi. Currently there are 82,051 domestic limited liability companies and 10,313 foreign limited liability companies registered with the Secretary of State's Office compared to 34,202 domestic corporations and 17,319 foreign corporations. Last year in 2009, 11,839 new limited liability companies were formed in Mississippi versus 5,107 new corporations. (See "Report from the Mississippi Secretary of State regarding Business Entity Filings, January 15, 2010") on page 25.

One reason for the multitude of LLCs is that the current LLC laws have no mechanism to administratively dissolve defunct LLCs. Corporations are required to file annual reports and are subject to administrative dissolution for failure to file such reports. This gives the Secretary of State's Office a way to remove corporations that are no longer operating from the list of registered corporations. It also frees up the names of these corporations, which can then be used by new entities. Approximately 4,000 to 6,000 corporations (or 8% to 11 % of the total corporations registered) are administratively dissolved each year for failure to file annual reports or for other grounds, such as failure to maintain a registered agent.

In the spring of 2008, the Secretary of State's Office formed a study group to review the state's limited liability company laws. This group recommended a bill to require LLCs to file annual reports, similar to the annual reports filed by corporations. This bill was proposed in the 2009 General session, but did not pass.

In 2009, the group re-convened to study comprehensive changes to the act. A small group of members met in numerous work sessions in October, November and December to conduct an intensive review and re-write of the current LLC Act. This group, with the assistance of Secretary Hosemann and Policy and Research Division staff, went through the act section by section, comparing it to Delaware's LLC Act and the revised Uniform LLC Act. In many cases the group chose to use language from the Delaware act. The goal of the re-write was to make the LLC act more business-friendly, especially to small businesses that may not have a written operating agreement. The proposed revised act provides for ways to handle many situations when an LLC does not have an operating agreement in place or is silent.

The bill to adopt the act (House Bill 1354/Senate Bill 2981) provides that the Revised Act will apply to all LLCs formed or registered after January 1, 2011. For domestic or registered LLCs that are in existence or registered prior to the effective date

("existing LLCs"), the annual report requirements of the Revised Act will apply on January 1, 2011, but the rest of the Revised Act will not apply until January 1, 2012. This waiting period has been established to give existing LLCs time to revise their organizational documents as needed before the Revised Act applies to them. If an existing LLC wants to come under the Revised Act before 2012, it can elect to adopt the act early by complying with some filing requirements. If the bill is passed, the Secretary of State will begin requiring LLCs to file annual reports (\$25 fee (or \$22 for online filing) for domestic LLCs and \$100 for foreign LLCs) beginning in 2011 with the same due dates as for corporations.

Under current LLC law, LLCs can be formed by organizers who, in most cases, are not members or managers of the LLC; and LLCs are not required to file with the SOS Office the name of any member, manager or officer. The revised act will provide the public with current information on who owns or manages LLCs registered with our office by requiring all LLCs to file annual reports and to be subject to administrative dissolution for failure to file. This will allow the Secretary of State's Office to administratively dissolve defunct LLCs. Annual reports for LLCs are the norm in the United States, with over 40 states requiring LLCs to file some kind of periodic report to maintain their good standing status. The reports will also require LLCs to disclose the names

and addresses of the individuals who manage the LLC as well as officers.

The House Bill (714) has been referred to both the Apportionment and Elections Committee and the Judiciary A Committee, and the Senate Bill (2981) has been assigned to the Judiciary A Committee. Below is a bullet point summary of the Revised Act and how it compares to the existing act as applicable.

### IN GENERAL

□ Revises and clarifies existing laws to make them easier to read and understand.

□ Adds many new sections and revisions to the current laws including provisions from the Delaware LLC Act, which is regarded as having the best business laws in the country.

□ Other new sections have been added from the Revised Uniform LLC Act (“RULLCA”).

□ Re-numbered and re-located existing sections and added new sections.

□ Gender-specific terms have been revised to be gender-neutral.

### KEY FEATURES OF REVISED ACT NOT CONTAINED IN CURRENT ACT

□ Requires LLCs to file annual reports and pay a fee (\$25 for domestic LLCs and \$100 for foreign LLCs) similar to the annual reports filed by corporations. Authorizes the Secretary of State to administratively dissolve LLCs for failure to file such annual reports.

□ Allows LLCs to have officers.

□ Sets forth things that must be in a written operating agreement to be enforceable and provisions in the Revised Act that cannot be varied by the LLC.

□ Adds default rule that the LLC must obtain the members’ approval by a majority decision of an agreement to sell its assets outside the ordinary course of business.

□ Eliminates concept of dissociation.

□ Provides that heirs of a deceased member become members as a default rule.

□ Provides for “in-name” only members (members who don’t vote or share in the profits).

□ Provides as a default rule that member voting is based on profit sharing – under current act each member gets one vote regardless of their profit sharing percentage.

□ Provides for ways to add new members when there are no members to avoid dissolution of LLC for not having any members.

□ Adds new provision regarding enforceability of limitations on assignments of financial interests which prevails over the MS UCC (which currently renders such limitations unenforceable).

□ Transition provisions which provide that annual reports and new fees become effective for existing LLCs on January 1, 2011, but the rest of the Revised Act will become effective January 1, 2012; also permits existing LLCs to elect to come under

the Revised Act before this date if they take certain steps to do so.

### ARTICLE 1 GENERAL PROVISIONS

□ § 79-29-105. Added many new definitions and renamed and re-numbered definitions.

▪ Changed “limited liability company interest” to “financial interest”.

▪ Added the term “officer” – which will allow LLCs to have officers and to use officer titles.

▪ Changed “limited liability company agreement” to “operating agreement”.

▪ Added “governance interest” as a defined term.

▪ Clarified that members have both governance interests and financial interests or a combination of all or neither.

▪ Added more detail to definitions of “operating agreement” and “member,” such as LLC can have members that do not have governance rights or financial rights (“in name only” members).

□ § 79-29-107. Added new provision addressing notices and written consents in lieu of meetings which permits notices and consents in electronic form.

□ § 79-29-123. Added new section on construction and application of operating agreement and general standards of conduct.

▪ This section lists in one place the things that must be in a

written operating agreement in order to be enforceable. § 79-29-123(7).

- It also lists in one place the provisions of the act that the LLC cannot vary or eliminate by its operating agreement or by its certificate of formation. § 79-29-123(3). The addition of this new section allowed all the default rule lead in language to be removed from other provisions of the act, except for where the provision must be contained in a written operating agreement.

- This section also sets forth the applicable fiduciary duties for members, managers, officers and other persons who are parties to or otherwise bound by the operating agreement and how they can be modified. The fiduciary duties are the same as under the current act, except fiduciary duties for officers have been added, which mirror the fiduciary duties of managers. § 79-29-123(6).

- Clarifies that the implied contractual covenant of good faith and fair dealing cannot be eliminated with respect to any party to an operating agreement. § 79-29-123(3)(g).

- Provides as a default rule that all members must approve an amendment to the operating agreement, except in the case of a merger (which is a majority vote default rule). § 79-29-123(2)(b).

- Moved indemnification provisions to this section and revised them to read more like Delaware's laws. Indemnification is permissive and must be provided for in the certificate of formation or the operating agreement. The existing restrictions on indemnification have been retained. § 79-29-123(5).

## ARTICLE 2 FORMATION AND CERTIFICATE OF FORMATION

- § 79-29-201. Eliminates the current "check the box" item in the certificate of formation that a LLC must check to specify whether the LLC is member-managed or manager-managed. LLCs can still include this in the certificate of formation as optional language.

- LLC can make this designation now in their operating agreement. If the operating agreement (and certificate of formation) is silent on this issue, then the default rule is that the LLC is member-managed.

- § 79-29-205. Deleted req. to make two separate filings to dissolve an LLC. Only one filing will be required, which will be similar to a dissolution filing for a MS corporation.

- § 79-29-211. Clarified and explained the existing process for the handling of refused documents and added a right to appeal similar to the corporation act.

- § 79-29-213. Added new provision addressing when it is necessary to correct a filing and how to correct filings.

- § 79-29-219. Added new provision to allow the public to request certificates of existence for domestic LLCs.

- §§ 79-29-221 – 79-29-229. Eliminated requirement to have a plan of merger or file a copy of the plan of merger or merger agreement with the Secretary of State's Office. Also eliminated requirement to file a copy of the successor's operating

agreement with the Secretary of State's Office.

- § 79-29-231. Revised appraisal rights section to provide the certificate of formation or the written operating agreement may eliminate, expand or restrict these rights and may vary, modify, eliminate or expand any of the provisions of this section. Confusing language has been revised or deleted.

- § 79-29-215. Annual report. Requires LLCs to file an annual report which requires LLCs to report on information which is similar to the annual reports filed by corporations. Manager-managed LLCs must disclose names and addresses of all managers. Member-managed LLCs must disclose the name and address of at least one member. LLCs must also disclose in this report whether they have a written operating agreement.

- § 79-29-233. Added default rule that the LLC must obtain the members' approval by a majority decision of an agreement to sell its assets outside the ordinary course of business.

## ARTICLE 3 MEMBERS

- Eliminates the concept of dissociation.

- § 79-29-301. Clarifies when and how certain types of persons are admitted as members of the LLC upon the happening of various events, such as in connection with a merger, acquiring the interest from the LLC, and in the case of assignee of a financial interest.

- Provides that if a member dies, the heirs become members of the LLC as a default rule. § 79-29-

301(2)(d). Under current law if a member dies, the death is an event of dissociation causing the deceased member to cease to be a member and causing the heirs receive a financial interest in the LLC but not to become members as a default rule.

□ § 79-29-301(2)(e). Provides that if a corporate member merges into another entity, the surviving entity becomes the member. Under current law if a member merges into another entity, this is an event of dissociation, and the surviving entity receives a financial interest, but does not become a member.

□ Provides that a person may be admitted as a member (even a sole member) without making a contribution to the LLC or being obligated to make a contribution to the LLC.

□ Provides that a person may become a member (even a sole member) without having a financial interest or a governance interest in the LLC.

□ § 79-29-303. Provides that a written operating agreement may allow a person to withdraw from the LLC and/or may give the LLC the power to expel a member.

□ § 79-29-303. Clarifies that any member who has been expelled or withdrawn from membership in the LLC ceases to be a member and ceases to have any governance rights.

□ § 79-29-305. Provides for a default rule that the management of the LLC is vested in the members based on their percentage held in the profits of the LLC. Under the current law the default rule is each member gets one vote and decisions are made by majority vote.

□ § 79-29-305. Clarifies that members may choose to be managed by managers and if they decide to be managed by managers they must include this in their operating agreement.

□ § 79-29-305. Adds a new provision that the members of a member-managed LLC may delegate their management rights to agents, officers and employees of a member or the LLC. Such delegation shall not cause the delegates to become members or managers and shall not cause the members to cease to be members.

□ § 79-29-307. Adds an agency power for officers, similar to the agency power for managers under the current law.

□ § 79-29-309. Voting, classes and meeting.

▪ Provides that the vote of each member is based on their percentage held in the profits of the LLC.

▪ Provides a default rule of greater than 50% (current default rule is majority vote, each member gets one vote).

▪ Provides that the LLC can have members that have no voting rights if it provides for this in a written operating agreement.

▪ Provides for actions to be taken by written consent without a membership meeting. Members who did not sign the written consent must be provided with notice of the signed consent within 20 days.

▪ Provides for meetings and notices by electronic means and for voting by proxy.

▪ Provides that if a meeting has not been held in 15 months, a 20% member may call a membership meeting.

□ § 79-29-311. Provides for the same liability to third parties as under the current act, except adds reference to “officers”.

□ § 79-29-313. Clarifies that a person who has ceased to be a member shall continue to have any financial rights that such person had at the time of the cessation but shall cease to have any governance rights or any other rights.

□ § 79-29-313. Reduces the number of default events by which a member ceases to be a member of an LLC to the following:

▪ A member: (i) makes an assignment for the benefit of creditors; (ii) files a voluntary petition in bankruptcy; (iii) is adjudicated a bankrupt or insolvent; (iv) files a petition or answer seeking for the person any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any statute, law or regulation; (v) files an answer or other pleading admitting or failing to contest the material allegations of a petition filed against the member in any proceeding of the nature described above; or (vi) seeks, consents to or acquiesces in the appointment of a trustee, receiver or liquidator of the member or of all or any substantial part of the member’s properties; or

▪ If one hundred twenty (120) days after the commencement of any proceeding against the member seeking reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar

relief under any statute, law or regulation, the proceeding has not been dismissed, or if within ninety (90) days after the appointment without the member's consent or acquiescence of a trustee, receiver or liquidator of the member or of all or any substantial part of the member's properties, the appointment is not vacated or stayed or within ninety (90) days after the expiration of any stay, the appointment is not vacated.

- Under the current law the incompetency of a member is an event of dissociation. Incompetency is not an event of bankruptcy or dissolution under the new act.

□ § 79-29-315. Adds new section on access to information.

- Allows those in control of the LLC's business to limit access to certain information from its members and managers.

- Allows those in control to set reasonable standards by which they disclose information to members and officers.

- Provides for the ability to enforce rights arising under this section in chancery court.

#### **ARTICLE 4 MANAGEMENT**

□ § 79-29-401. Retains the same provisions as in the management of LLC by manager or managers section under the current act, except for the addition of language that managers may also serve as officers to the extent provided in the operating agreement.

□ § 79-29-401. Provides that operating agreement may set forth

provisions concerning manager meetings, provides for notices and meetings by electronic means, and actions that can be taken without meeting with written consent.

□ Reliance on reports and information. This section was re-written to make it easier to read and understand.

□ § 79-29-405. Added new section regarding delegation of rights and powers to manage.

- Provides that the managers can delegate to other persons the manager's rights and powers to manage and control the business and affairs of the limited liability company, including to delegate to agents, officers and employees of: (a) a member, (b) a manager or (c) the limited liability company, and to delegate by a management agreement or another agreement with, or otherwise to, other persons.

- Such delegation shall not cause the manager to cease to be a manager of the limited liability company or cause the person to whom any such rights and powers have been delegated to be a manager of the limited liability company.

□ § 79-29-407. Added new provision addressing resignation of manager.

#### **ARTICLE 5 FINANCE**

□ Retains the same language as in the current act, no substantive changes.

□ § 79-29-509. Added provision that defense of usury is not available.

#### **ARTICLE 6 DISTRIBUTIONS**

□ § 79-29-603. Added new provision on distribution on withdrawal of a member to take the place of the current section on distribution upon dissociation.

- Section provides that upon withdrawal the withdrawing member is entitled to receive distributions and the fair value of his financial interest based on his rights to share in the distributions from the LLC.

- Provides a default rule for how to calculate fair value of the financial interest.

□ § 79-29-605. Distribution in kind. Adds a default rule that the LLC can require a member to accept a distribution in kind to the extent that the percentage of the asset distributed is equal to a percentage of that asset which is equal to the percentage in which the member shares in distributions from the limited liability company.

□ § 79-29-609. Limitations on distributions. Add language that the term "distribution" shall not include amounts constituting reasonable compensation for present or past services or reasonable payments made in the ordinary course of business pursuant to a bona fide retirement plan or other benefits program.

□ Liability for wrongful distribution.

- § 79-29-611(2). New language added which provides for liability of a member who knowingly receives a wrongful distribution (regardless of whether the members voted for or against it or did not vote).

**ARTICLE 7  
ASSIGNMENT OF  
FINANCIAL INTEREST**

□ § 79-29-703(1). Adds a default rule that the assignee of a member's financial interest shall have no rights to participate in the management of the LLC.

□ § 79-29-703(2). Provides as a default rule that an assignment of a financial interest does not dissolve the LLC or entitle the assignee to exercise any rights or powers of a member.

□ § 79-29-703(2). Clarifies that a member ceases to be a member and ceases to hold a governance interest and ceases to have any powers of a member upon the assignment of the member's entire financial interest.

□ Adds new language which states that a member's interest in the LLC can be evidenced by a certificate issued by the LLC. § 79-29-703(3).

□ Adds new language which states that an LLC can acquire by purchase, redemption or otherwise interests in the LLC, similar to a corporation buying back its stock. § 79-29-703(5).

□ § 79-29-705. Charging Orders.

- Clarifies the charging order provisions and rights of creditors to get them.

- Provides that a charging order constitutes a lien on the judgment debtor member's financial interest.

- Provides that a charging order is the creditors' exclusive remedy by which the creditor can

satisfy a judgment out of the judgment debtor's financial interest.

- Provides that chancery court has jurisdiction over these matters.

□ § 79-29-707. Rights of assignee to become member if assignment would cause the LLC to have no members. Adds a new default rule whereby if an assignee has been assigned a member's entire financial interest, in which immediately following the assignment, the LLC would have no members, then the assignee can become a member of the LLC, provided the assignee agrees to become a member.

□ § 79-29-709. Clarifies powers of personal representative of deceased, incompetent or dissolved member.

- If a member is adjudged incompetent, the member's personal representative may exercise all rights until such time that the member's competency is regained, including the member's governance rights, on behalf of the member and any power under an operating agreement of an assignee to become a member.

- If a member dies, a personal representative of the member's estate may exercise all rights for the purpose of settling such estate, including the governance rights that were held by such member at the time of the member's death and any power under an operating agreement of an assignee to become a member.

- If a member is a corporation, trust or other entity and such entity is dissolved, terminated or liquidated, the personal representative of the entity may exercise all rights and powers of that member until a

successor is established, including the member's governance rights.

□ § 79-29-711. Adds new provision regarding enforceability of limitations on assignments of financial interests which prevails over the MS UCC.

The provisions of the MS UCC do not apply to a member's financial interest in a domestic limited liability company, including the rights, powers and interests arising under the limited liability company's certificate of formation or operating agreement or under this chapter. To the extent of any conflict or inconsistency between this section and §§ 75-9-406 and 75-9-408, this section prevails. It is the express intent of this section to permit the enforcement, as an agreement among the members of a limited liability company, of any provision of an operating agreement that would otherwise be ineffective under §§ 75-9-406 and 75-9-408.

**ARTICLE 8  
DISSOLUTION**

□ § 79-29-801. Voluntary (nonjudicial) dissolution.

- Added provision to authorize dissolution when there are no members.

- Removed provisions on dissolution upon events of dissociation, since this concept has been removed from the act.

- Allows for ways for new members to be admitted when there are no members if certain steps are followed in a timely manner to avoid dissolution of an LLC due to no members.

- Provides that certain events will not cause dissolution of the LLC

□ § 79-29-803. Judicial Dissolution.

□ Provides for the same events of judicial dissolution as under the current act.

□ Also provides for judicial dissolution in a proceeding by the LLC to have its voluntary dissolution continued under court supervision.

□ Provides that an officer, manager, assignee or owner of financial interest can apply to the chancery court to judicially dissolve the LLC if the LLC has no members and there is no mechanism in its operating agreement to admit a member.

- If none of these persons exist then any creditor of the LLC or the Secretary of State can apply for judicial dissolution.

- Provides that the court may appoint receivers to wind up the LLC or custodians to manage the LLC and describes their powers. The court may also order that these persons be paid compensation for their services.

□ Provides for court to enter a dissolution decree and how to file the decree with the Secretary of State's office.

□ § 79-29-807. Provides that assets of a dissolved LLC that are unclaimed will be deposited into the state treasury for safekeeping, similar to assets of a dissolved corporation.

□ § 79-29-809. Sets forth who can wind up the LLC, and how persons can apply to chancery court to

have the LLC wound up by the court or by a liquidating trustee appointed by the court.

□ § 79-29-811. Agency powers of members and managers during dissolution is the same as under the current law, except reference to officers was added.

□ § 79-29-813. Distribution of assets. Provides the same method of distribution of assets as in the current law but also requires the LLC to:

- Pay or make reasonable provision to pay all known claims, including contingent, conditional or unmatured contractual claims;

- Make provisions to provide compensation for any claims which are the subject of pending litigation to which the LLC is a party;

- Make provisions for unknown claims which are likely to arise within 3 years after dissolution;

- States that claims will be paid according to their priority if there is not sufficient assets.

□ Provides liability for members who knowingly receive distributions that violated the above requirements, with a 2 year statute of limitations.

□ § 79-29-815. Authorizes the chancery court to appoint managers of the LLC to be trustees or appoint persons to be receivers to take charge of the property and collect the debts owed to the LLC.

□ §§ 79-29-817 and 79-29-819. Retains the existing provisions dealing with notifying known and unknown claimants, except the statute of limitations to state a claim under the

unknown claims section has been reduced from 5 to 3 years.

□ §§ 79-29-821 – 79-29-827. Administrative Dissolution.

- Added new provisions to authorize the Secretary of State to administratively dissolve LLC's for failure to file their annual reports, failure to pay fees, failure to have a registered agent, etc., similar to the grounds for administrative dissolution of a corporation.

- Sets forth the procedure for administrative dissolution, which is similar to procedure for corporations

- Provides for a way to reinstate an administratively dissolved LLC and a way to appeal any denial of reinstatement, similar to the procedure for corporations.

- States that reinstatement relates back and takes effect as of the date of the administrative dissolution, the same as for reinstatement of corporations.

□ § 79-29-829. Voluntary Revocation of Dissolution. Added new section that authorizes an LLC which has filed its certificate of dissolution to voluntarily dissolve to revoke the filing if the LLC decides it does not want to dissolve. Currently corporations can revoke their dissolution, but LLCs cannot.

□ § 79-29-831. New provisions on effect of dissolution.

- Clarifies that an administrative dissolution does not impair the validity of contracts or prevent the LLC from defending any actions in state court.

- Clarifies that a member, manager or officer is not liable for the debts or obligations of the LLC solely by reason of administrative dissolution of a LLC.

- Clarifies that an administratively dissolved LLC may not maintain any action in state court until the LLC is reinstated.

- Provides that an LLC which is voluntarily or judicially dissolved maintains its legal existence but may carry on business necessary to wind up and liquidate its business and affairs.

## **ARTICLE 9 PROFESSIONAL LIMITED LIABILITY COMPANIES**

This article will be substantively reviewed at a later date along with the other professional business entity statutes. Minor changes have been made to conform it to the rest of the Revised Act.

## **ARTICLE 10 FOREIGN LIMITED LIABILITY COMPANIES**

□ § 79-29-1003. Requires foreign LLCs that register to do business in Mississippi to have their application signed by a member, manager or officer and they must provide a certificate of good standing from their home state of formation.

□ § 79-29-1015. Clarifies that a foreign LLC is not considered to be doing business in this state solely because it is a shareholder in a corporation that transacts business in this state.

□ §§ 79-29-1023 – 79-29-1027. Administrative Revocation. Provides for administrative revocation of registration for foreign LLCs for failure to file an annual report (as well as for other grounds), very similar to the administrative dissolution provisions for domestic LLCs, including procedures to reinstate after administrative revocation.

□ § 79-29-1025. Provides for the effect of administrative revocation, similar to the provisions for effect of administrative dissolution of domestic LLCs.

□ § 79-29-1029. Provides for persons to obtain a certificate of authorization for a foreign LLC.

## **ARTICLE 11 DERIVATIVE ACTIONS**

□ § 79-29-1101. Clarifies that a member or an owner of a financial interest can bring a derivative action in chancery court to recover a judgment in its favor if managers or members with authority do so have refused to bring the action or if an effort to cause them to bring the action is not likely to succeed.

□ § 79-29-1103. Requires that the plaintiff must be a member or owner of financial interest at the time of bringing the action and at the time of the transaction of which the plaintiff complains.

□ Eliminated requirement under current laws to make a written demand on the LLC and the 90-day waiting period for the LLC to respond to the written demand.

□ § 79-29-1113. Provides for the court to pay the plaintiff's expenses (including reasonable

attorneys' fees) if the plaintiff wins the action, and also provides for the court to require the plaintiff to pay the defendant's expenses if it finds that the proceeding was commenced without reasonable cause or for an improper purpose.

□ § 79-29-1115. Requires Mississippi law to govern the rights of any foreign LLC derivative actions brought in the state court of Mississippi.

## **ARTICLE 12 MISCELLANEOUS**

□ § 79-29-1203. Fees. Changes fee for application for registration of a foreign LLC to add \$10 for each day, not to exceed a total of \$1,000 for each year, the foreign LLC transactions business in the state without registering with the state.

- Fees for annual reports are \$25 domestic LLC's and \$100 for foreign LLCs.

- New \$25 fee to file service of process on the Secretary of State's Office, same as the fee charged for corporations.

- Authorizes Secretary of State to adopt rules to provide for discounts of fees to encourage online filing of documents and to provide for expedited filings services.

□ § 79-29-1211. Added provision that a manager, member or officer may consent in writing to be subject to the nonexclusive jurisdiction of the courts of, or arbitration in, a specified jurisdiction, or the exclusive jurisdiction of the courts of this state, or the exclusivity of arbitration in a specified jurisdiction or in this state, and to be

served with legal process in the manner prescribed in such operating agreement or other writing. Except by agreeing to arbitrate any arbitrable matter in a specified jurisdiction or in this state, a member who is not a manager may not waive its right to maintain a legal action or proceeding in the courts of this state with respect to matters relating to the organization or internal affairs of a limited liability company.

### **ARTICLE 13 (NEW) TRANSITION PROVISIONS**

Provisions Applicable to pre-existing and new LLCs. § 79-29-1303. Provides that the following provisions become effective on January 1, 2011

(the “Effective Date”) for pre-existing LLCs and for new LLCs.

- fees;
- requirement to file annual reports; and
- administrative dissolution and revocation provisions and related reinstatement provisions

Provisions applicable to New LLCs. § 79-29-1301. Provides that the entire Revised Act (including the above provisions) will apply to all new LLCs formed or registered after January 1, 2011(Effective Date).

Provisions applicable to pre-existing LLCs.

▪ § 79-29-1305. Provides that the rest of the new Revised Act will become effective January 1, 2012 (the “Mandatory Application Date”) for pre-existing LLCs, but allows LLC’s to elect to come under the new law before that date.

▪ §§ 79-29-1305 and 79-29-1307. Sets forth the procedures as to how a pre-existing LLC can elect to come under the new law before the Mandatory Application Date, by amending their organizational documents and making a filing with the Secretary of State’s office.

For more information on the Revised Mississippi Limited Liability Company Act, including text of the the proposed legislation, please visit the [Policy & Research Division](http://www.sos.state.ms.us/Policy_Research/) at [http://www.sos.state.ms.us/Policy\\_Research/](http://www.sos.state.ms.us/Policy_Research/)

# Report from the Mississippi Secretary of State Regarding Business Entity Filings

By Tom Riley, Assistant Secretary of State, Business Services

The chart below demonstrates some of the filing trends in Mississippi. Limited liability companies have been the entity of choice for new businesses in this state for more than five years. There are currently more than 92,000 limited liability companies organized or registered in the state. There are only about 51,000 corporations. New limited liability companies are being formed in Mississippi at a two-to-one rate over corporations. Similarly, while professional corporations still outnumber professional limited liability companies, that advantage will likely disappear as three new PLLCs are being formed for every PC.

The formation of new business entities in general has declined across the board the last few years, reflecting the downturn in the economy. Domestic limited liability company formations for 2009 were down 6.3% over 2008. Corporate formations were down 2.3% over the same period. Hardest hit were limited partnerships and limited liability partnerships, which were down 36% and 46%, respectively. Interestingly, the formation of nonprofit corporations has grown by 11% over the last two years. This trend was also reflected in an increase in foreign nonprofit corporations seeking Certificates of Authority to conduct operations in Mississippi. The general decline in new formations in 2009, however, is less than the decline that occurred between 2007 and 2008.

## BUSINESS ENTITIES REGISTERED AS OF DECEMBER 31, 2009

	Total Registered		
	<i>Domestic</i>	<i>Foreign</i>	<i>Combined</i>
Limited Liability Companies (LLCs)	82,051	10,313	92,364
Business Corporations (FPC)	34,202	17,319	51,521
Non-profit Corporations (NPC)	43,617	1,507	45,124
Professional Corporations (PCs)	5,040	395	5,435
Limited Partnerships (LPs)	5,211	3,207	8,418
Professional LLCs (PLLCs)	2,577	89	2,666
Limited Liability Partnerships (LLPs)	383	141	524
<b>Totals</b>	<b>173,051</b>	<b>32,971</b>	<b>206,052</b>

	New Registered											
	<i>New Domestic</i>				<i>Foreign</i>				<i>New Combined</i>			
	2009	2008	Diff.	% Change	2009	2008	Diff.	% Change	2009	2008	Diff.	% Change
LLCs	11,898	12,699	-801	-6.3%	13	23	-10	-43.5%	11911	12,722	-811	-6.4%
FPC	5,107	5,226	-119	-2.3%	138	136	+2	+1.4%	5,245	5,362	-117	-2.2%
NPC	1,830	1,650	+180	+11%	138	135	+3	+2.2%	1,968	1,785	+183	+10.2%
PCs	78	89	-11	-12.3%	18	43	-25	-58.1%	96	132	-36	-27.3%
LPs	117	184	-67	-36.4%	64	94	-30	-32%	181	278	-97	-3.5%
PLLCs	224	230	-6	-2.6%	11	16	-5	-31.5%	235	246	-11	-4.5%
LLPs	7	13	-6	-46%	15	14	+1	+0.4%	32	27	+5	+18.5%
<b>Totals</b>	<b>19,261</b>	<b>20,091</b>	<b>-830</b>	<b>-4.1%</b>	<b>397</b>	<b>461</b>	<b>-64</b>	<b>-13.8%</b>	<b>19,668</b>	<b>20,552</b>	<b>-884</b>	<b>-4.3%</b>

## About the Editor

Kenneth D. Farmer, a native of Pascagoula, Mississippi, is an associate at YoungWilliams P.A. in Jackson, Mississippi. He is a member of the firm's Business Opportunities Group, and concentrates his law practice in the areas of real estate, commercial transactions and general business/corporate law. Mr. Farmer began his law career in Florida at the law firm of Clayton-Johnston, P.A. Mr. Farmer also served in the United States Army. Mr. Farmer earned his Bachelor's of Business Administration in Management Information Systems at the University of Southern Mississippi, his Master's of Science in Real Estate at the University of Florida, and his Juris Doctor at the University Of Florida Levin College Of Law.



## How to Contribute

Persons interested in submitting news, a proposal or an article for publication in The Mississippi Business Law Reporter should submit it by e-mail to the Editor, Kenneth D. Farmer, at [kfarmer@youngwilliams.com](mailto:kfarmer@youngwilliams.com). All news, proposals and articles are subject to review and approval by the Editor and Section Leadership.

When submitting an article, the article should be the original work of the author and must not have been previously published (unless proof of consent to reproduction can be provided). Articles shall not, to the best of the author's knowledge, contain anything which is libelous, illegal, or otherwise infringes upon anyone's copyright or other rights. Authors are responsible for the accuracy of all citations and quotations.

Articles should be arranged in the following order: (i) article title, (ii) author's name, (iii) acknowledgement of assistance, if applicable or desired, and (iv) text of the article. All contributions should be submitted in MS Word format.

A short biographical statement should also be provided at the time the article is submitted. The statement should include, at minimum, the author's (i) current position, (ii) practice areas, (iii) professional affiliations. A head and shoulder photograph of the author(s) in black and white or color is requested, but not required.

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**The views and opinions expressed in the articles published in The Mississippi Business Law Reporter are the authors' only and are not to be attributed to the Editor, the Business Law Section, or The Mississippi Bar unless expressly stated. Authors are responsible for the accuracy of all citations and quotations.**

## Contributors to This Issue

### William S. Mendenhall

Bill Mendenhall is a shareholder with the law firm Baker, Donelson, Bearman, Caldwell & Berkowitz, PC. Mr. Mendenhall concentrates his practice in general corporate law, business transactions and commercial real estate. He regularly represents clients in business acquisitions, commercial lending transactions and insurance regulatory matters. He has represented real estate developers, banks and other commercial institutions in real estate developments, financings, foreclosures and dispositions. He has



also served as borrower's counsel and lender's counsel in acquisitions of nursing homes, assisted living facilities, office buildings,

restaurants, hotels, and apartment developments. For many years, he served as corporate and regulatory counsel to one of the state's largest domestic insurance companies.

### Edwin Stephen Williams

Steve Williams is a principal with the law firm of YoungWilliams P.A. In 35 years of practice, Steve has gained extensive experience in general business litigation, construction law,



contract negotiations, and arbitration, among other things. He represents a number of Mississippi contractors, subcontractors, suppliers and project owners.

### Wulf A. Kaal

Professor Wulf A. Kaal is an Assistant Professor of Law at Mississippi College School of Law in Jackson, Mississippi.

Professor Kaal teaches Contracts, Business Associations, Securities Regulation and a seminar on Hedge Funds.

Professor Kaal's areas of expertise include securities and market regulation, hedge funds, corporate finance and law and economics. Professor Kaal earned his Ph.D. from Humboldt Universität zu Berlin, magna cum laude, his M.B.A., from Durham University, with distinction, and an LL.M. and J.D., from the University of Illinois College of Law.



### David M. Allen

David Allen is a member of Brunini, Grantham, Grower & Hewes, PLLC. Mr. Allen was admitted to the bar in 1978 and has experience in a variety of positions, both in private practice and with two Fortune 500 energy firms. He currently is a resident partner in the Gulf Coast office of Brunini. His practice focuses in the area of real estate and corporate matters, with concentrations in the

representation of both lenders and developers in commercial real estate projects, commercial title insurance matters and condominium development. He is a fellow in the American College of Mortgage Attorneys. He has also served as an adjunct professor in business law for Tulane University and the University of Southern Mississippi.

David is also an active participant in community activities. He has served as member and treasurer with the Board of Directors for the Walter Anderson Museum of Art in Ocean Springs, and has provided legal services to the Board of Trustees for the Ohr-O'Keefe Museum of Art in Biloxi.



### Cheryn N. Baker

Cheryn N. Baker joined the Mississippi Secretary of State's Office in March of 2008 and currently serves as the Assistant Secretary of State for the Division of Policy and Research. This Division works with over volunteers from across the State to reform the State's Business Laws. A magna cum laude graduate of University of Mississippi in 1988, Ms. Baker has been practicing law in the Jackson area since she graduated from the University of Denver College of Law in 1991.

Ms. Baker's legal experience includes business and corporate law, mergers and acquisitions, securities law, health care law and gaming law. She has

previously worked in both private practice and as in-house counsel.

Active in many bar and civic groups, currently Ms. Baker serves as a director of the Hinds County Bar Association, the State Liaison to the ABA Committee on Corporate Laws, a Board Member of the Mississippi Corporate

Counsel Association and a member of the Executive Committee of the Business Law Section of the Mississippi Bar. She also serves on the MS Bar Women in the Profession Committee and was recently elected to



the Mississippi Board of Bar Commissioners to serve a three year term beginning in July 2010. She is a member of the Mississippi Woman Lawyers Association and served as the Chair of the Health Law and Business Law Sections of the Mississippi Bar and as Chair of the Hinds County Bar Association Charitable

Grant Committee. She also serves on various business-related sections of the American Bar Association. She is also a member of the Downtown Exchange Club and the Magnolia

Ballroom Dancers Association and is a past president of both organizations.

### **Thomas H. Riley, III**

Thomas H. Riley, III is currently the Assistant Secretary of State in charge of the Business Services Division for the state of Mississippi. Mr. Riley is responsible for all business formation and filing, Notaries, trademarks and athlete agents in the state. Mr. Riley is a native of Chicago and a graduate of the University of Notre Dame and The John Marshall Law School.

## **A Special Thank You**

Rene' Garner  
Section and Division Coordinator  
Phone: 601-355-9226  
Fax: 601-355-8635  
Email: rgarner@msbar.org

## Section Leadership

### Chair

**William S. Mendenhall**

Baker Donelson Bearman Caldwell & Berkowitz  
P O Box 14167  
Jackson, MS 39236-4167  
Phone: (601) 969-4647  
Fax: (601) 714-9947  
Email: bmendenhall@bakerdonelson.com

### Vice-Chair

**William E. McLeod**

McLeod & Mars P A  
10 Professional Pkwy  
Hattiesburg, MS 39402  
Phone: (601) 545-8299  
Fax: (601) 545-8298  
Email: bmcleod@eptaxlaw.com

### Secretary/Treasurer

**James T. Milam**

Phelps Dunbar  
P O Box 1220  
Tupelo, MS 38802-1220  
Phone: (662) 690-8141  
Fax: (662) 842-3873  
Email: milamj@phelps.com

### Past Chair

**Bridgforth R. Rutledge**

Phelps Dunbar  
PO Box 23066  
Jackson, MS 39225-3066  
Phone: (601) 352-2300  
Fax: (601) 360-9777  
Email: bridgforth.rutledge@phelps.com

### Executive Committee Members

**Henry N. Dick III** (08/2007 – 07/2010)

Page Mannino Peresich & McDermott  
P O Drawer 289  
Biloxi, MS 39533-0289  
Phone: (228) 374-2100  
Fax: (228) 432-5539  
Email: henry.dick@pmp.org

**Joyce Hall** (08/2008 – 07/2011)

Watkins & Eager PLLC  
P O Box 650  
Jackson, MS 39205-0650  
Phone: (601) 965-1982  
Fax: (601) 965-1901  
Email: jhall@watkinseager.com

**Cheryn N. Baker** (08/2009 – 07/2012)

MS Secretary of State  
P O Box 136  
Jackson, MS 39205-0136  
Phone: (601) 359-1401  
Fax: (601) 359-1499  
Email: Cheryn.baker@sos.ms.gov

### Newsletter Editor

**Kenneth D. Farmer**

YoungWilliams P.A.  
P O Box 23059  
Jackson, MS 39225-3059  
Phone: (601) 948-6100  
Fax: (601) 355-6136  
Email: kfarmer@youngwilliams.com