

The 2016 Revision of the Model Business Corporation Act

Corporate Laws Committee of the Business Law Section of the American Bar Association

EXPOSURE DRAFT JUNE 2016

The sole purpose of this exposure draft is to elicit substantive comment. It has not been approved by the American Bar Association or its Business Law Section, and should not be cited or relied upon as authoritative.

I. INTRODUCTION

Sixty-six years ago the Committee on Corporate Laws of the ABA's Business Law Section (the Committee) published the Model Business Corporation Act (the Act or the Model Act). Now substantially adopted by a majority of the States, the Act has strongly influenced the law governing U.S. corporations. Like corporate law, however, the Act has not been static: the Committee approved a substantial revision of the Act in 1969, less than 20 years after its initial publication; and just 15 years later, in 1984, the Committee adopted what was then called the Revised Model Business Corporation Act, a top to bottom revision of the original Act.

Through periodic amendments, the Act has continued to evolve in significant ways since 1984, as further described below. Until recently, however, the Committee has not undertaken a comprehensive revision of the Act in a form that could be adopted by state legislatures as a means to capture all of the changes to the Act since 1984. Nor has there been any systematic attempt to revise the Act to eliminate inconsistent terminology and adjust provisions that have become outdated over the more than three decades since the 1984 Revision.

Accordingly, since 2010, under the leadership of Karl John Ege and A. Gilchrist Sparks III, as its chairs, the Committee, now formally known as the "Corporate Laws Committee," has undertaken a thorough review and revision of the Act and its Official Comment, resulting in the accompanying Exposure Draft. By publishing the Exposure Draft, the Committee invites comment on matters that have not previously been published for comment in *The Business Lawyer* and formally approved for inclusion in the Act. The description below of the Exposure Draft is intended to facilitate comments

by identifying those portions of the Exposure Draft that involve the more substantively significant proposed changes to the Act and its Official Comment. The accompanying Exposure Draft is marked to show changes from the version of the Act set forth in the 2013 Supplement to the 4th edition of the Model Business Corporation Act Annotated.¹

Comments should be limited to newly proposed changes, rather than changes that were previously proposed through publication after second reading in *The Business Lawyer*, as to which the opportunity to submit comments has already been given and were subsequently formally approved by the Committee.² Comments on the newly

¹ The marked changes thus include amendments to the Act and its Official Comment that have been published for comment after approval on second reading since 2013.

² Changes that have already been exposed for comment in *The Business Lawyer* are the following:

- Changes in the Model Business Corporation Act—Proposed Section 2.08, 71 Bus. Law. 543 (2016)
- Changes in the Model Business Corporation Act – Proposed Amendments to Chapter 16, 71 Bus. Law. 547 (2016)
- Changes in the Model Business Corporation Act to Section 8.70, 71 Bus. Law. 87 (2015/2016)
- Changes in the Model Business Corporation Act – Proposed Subchapter E of Chapter 1 Permitting Ratification of Defective Corporate Actions, 71 Bus. Law. 93 (2015/2016) Changes in the Model Business Corporation Act – Proposed Amendments to Section 11.04 and Section 13.02, 71 Bus. Law. 105 (2015/2016)
- Changes in the Model Business Corporation Act – Proposed Amendments to Sections 2.02 and 8.70 (and Related Changes to Sections 1.43, 8.31 and 8.60) Permitting Advance Action to Limit or Eliminate Duties Regarding Business Opportunity, 69 Bus. Law. 717 (2014)
- Changes in the Model Business Corporation Act – Proposed Advance of Expenses Amendments to Sections 8.53 and 8.54, 69 Bus. Law. 733 (2014)
- Changes in the Model Business Corporation Act – Proposed Amendments to Sections 7.22, 7.24 and 7.29, 69 Bus. Law. 93 (2013)
- Changes in the Model Business Corporation Act – Proposed Amendments to Section 8.02 Relating to Qualifications for Directors and Nominees for Directors, 68 Bus. Law. 781 (2013)
- Changes in the Model Business Corporation Act – Proposed Amendments to Section 7.23, Definitions in Section 1.40 and Related Sections, 68 Bus. Law. 137 (2012)

proposed changes may be submitted by no later than August 15, 2016, to the Committee's current Chair, Karl John Ege, Esquire, by mail to 1201 3d Avenue, Suite 4900, Seattle, Washington 98101, or by email to kege@perkinscoie.com.

II. NOTABLE RECENT CHANGES TO THE ACT

Changes to the Act that have been adopted since the 2013 publication of the Model Business Corporation Act Annotated include the following:

- Adoption of a new subchapter E of chapter 1 of the Act, permitting the ratification of defective corporate actions, including actions in connection with the issuance of shares.
- Amendments to sections 2.02 and 8.70 (and related changes to sections 1.43, 8.31 and 8.60) that permit corporations to include in their articles of incorporation a provision that limits or eliminates a director's or an officer's duty to present a business opportunity to the corporation.
- The addition of section 2.08, permitting the articles of incorporation or the bylaws to specify the forum or forums for litigation of internal corporate claims.
- Amendments to section 8.02 clarifying the scope and operation of qualifications for nomination and election as directors.
- Amendments to sections 8.53 and 8.54 that eliminate the requirement that a director or officer seeking advancement of expenses provide a written affirmation that he or she has met the applicable standards for indemnification under the Act, or, in the case of a director, that the proceeding involves conduct for which liability has been eliminated under the articles of incorporation.

- Amendments to section 11.04 and certain provisions in chapter 13, permitting the merger of corporations without a shareholder vote following a tender offer, if certain conditions are met.
- Amendments to section 16.20 and to certain other sections of chapter 16 that address, among other things, the obligations of corporations to make financial statements available to shareholders, the maintenance of corporate records, and the inspection rights of shareholders and directors of corporations.

III. HIGHLIGHTS OF THE PROPOSED CHANGES

Many of the proposed changes in the black letter provisions of the Exposure Draft are stylistic and non-substantive; others are intended to promote internal consistency with the Act's provisions. The Committee does not intend that such ministerial changes have any substantive effect, through negative implication or otherwise. For example:

- The Committee proposes to add the following provision to section 10.20:
 - (c) A shareholder of the corporation does not have a vested property right resulting from any provision in the bylaws

This addition aligns section 10.20, dealing with bylaws, with section 10.01 of the existing Act, which disavows the vested rights concept in relation to the articles of incorporation. There should be no implication from adoption of the proposed amendment to section 10.20 that the vested rights concept had any force in relation to bylaws before the amendment.

- The Committee proposes to delete language in the Official Comment to various sections (e.g., section 11.04) reciting that provisions enabling a board of directors to submit a matter for shareholder approval without recommending adoption “are

not intended to relieve the board of its duty to consider carefully the proposed transaction and the interests of shareholders.” Elimination of that language should not be interpreted to suggest that the board of directors no longer has such a duty. Rather, the language to be deleted is unnecessary and potentially confusing, as the Act provides that directors have duties with respect to all of their decisions, and there is no reason to refer explicitly to such duties in one context while omitting any such reference in connection with the numerous other provisions of the Act that contemplate decisions by the board of directors.

- The Committee proposes to delete language in sections 9.24 and 9.55 of the current Act (corresponding to sections 9.24 and 9.35 of the Exposure Draft) to the effect that upon a domestication or conversion a pending action against a corporation continues against the domesticated or converted entity as if the domestication or conversion had not occurred. That language has not appeared in the corresponding provisions of chapter 11 governing mergers, and is unnecessary in view of the provision that liabilities of constituent corporations become liabilities of the surviving corporation in a merger. The proposed deletion of that language is not intended to suggest that an action against a corporation does not continue against the domesticated or converted entity following the domestication or conversion.

Set forth below are what the Committee believes are the most significant further proposed changes to the provisions of the Act.

Revisions to the Black Letter

1. *Changes Related to the Uniform Business Organizations Code*

Many of the Committee's proposed amendments to the Act stem from the 2011 adoption of Article 1 of the Uniform Business Organizations Code (UBOC) by the Uniform Law Commission (ULC).³ That uniform legislation contemplates what is commonly described as a "hub and spoke" form of business entity legislation, in which a "hub" contains provisions generally applicable to all forms of business entities, and in which each form of entity is also governed by a distinct set of applicable substantive provisions (a "spoke"). The Committee has agreed with the ULC to prepare a version of the Act that could serve as the "spoke" governing business corporations for use by jurisdictions that adopt the UBOC.⁴ In preparing to create that "spoke," the Committee decided that the freestanding version of the Act would benefit from revisions that would also make it more compatible with the terminology and concepts used in the UBOC. This decision accounts for many of the proposed changes in chapter 9 (domestication and conversion), chapter 11 (merger and share exchange), and chapter 15 (foreign corporations) of the Act, as well as corresponding proposed changes in pertinent definitions in chapter 1. In particular, chapter 9 has been thoroughly revised, and the separate subchapters in the current Act for nonprofit conversion, foreign nonprofit domestication and conversion and entity conversion are proposed to be combined into the general conversion provisions. The most notable proposed change to chapter 15 is

³ That uniform act is available at http://www.uniformlaws.org/shared/docs/harmonization_of_business_entity_acts/HUB_draft%20final_received%20dec%2016%202012.pdf.

⁴ The Exposure Draft does not include the "spoke," which will be published for comment and adoption after final approval of the freestanding Act.

the elimination of the concept of qualification to do business, and the substitution of foreign corporation registration as a prerequisite to doing business within the state.

The Committee's work in revising chapters 9 and 11 highlighted two topics on which the existing Act appeared to take perhaps unnecessarily divergent approaches: namely, the treatment of group voting (sometimes known as "class voting"), and "interest holder liability" (referred to in the current Act as "owner liability"). The Committee reviewed those divergences and, where they seemed unjustified, resolved to revise the provisions to make them consistent. For example, the Committee is proposing revisions so that where transactions have a similar effect (whether structured as mergers, domestications, or conversions), the existence of a group voting right – and the ability to eliminate that right by a provision of the articles of incorporation – would be treated similarly.

The Committee also proposes to add the concept of "new interest holder liability" to section 11.04, and to revise its provisions so that the requirement of written consent of shareholders on whom interest holder liability is imposed is not triggered if the transaction alters, but does not increase, pre-existing interest holder liability. Substantively similar interest holder liability provisions are included in sections 9.21 and 10.03.

2. *Procedures for Approving Fundamental Changes*

The Act has long prescribed similar procedural steps for approval of mergers, share exchanges, amendments of the articles of incorporation, sales of assets not in the ordinary course of business, dissolution, domestication and conversion. Despite that substantive similarity, the statutory language of the current Act varies from transaction to

transaction. The Committee is proposing amendments to the provisions of sections 9.21, 9.32 (9.52 in the current Act), 10.03, 11.04, 12.02, and 14.02 that would adopt uniform language and thereby eliminate unnecessary variation and the possibility of negative inference.

3. *Liquidating Distributions*

The current Act does not clearly articulate the treatment of distributions to shareholders made in the course of liquidation after dissolution of the corporation. Accordingly, the Committee proposes several amendments that would clarify, among other things, the establishment of a record date for determining shareholders entitled to receive a distribution in liquidation after dissolution. Related changes appear in sections 1.40 (defining “record date”) and 14.09 (director duties).

4. *Elimination of Section 6.28*

The Official Comment to section 6.28 of the current Act notes that this section “may be technically unnecessary,” because “there is no basis for the fear that shares issued properly under section 6.21 can be made assessable because of the subsequent use of the proceeds.” The Official Comment also says, “This section has been rarely cited or referred to in court decisions even though it appears in a large number of state statutes.” The Committee therefore believes that this unnecessary provision should be eliminated, although there is no intention to reject the proposition for which it has stood – namely, that a corporation may apply proceeds of a share issuance toward the expenses of selling or underwriting the issuance.

5. *Quorum and Voting Requirements*

The Committee proposes to amend section 8.24 to clarify the operation of its provisions regarding quorum and voting requirements applicable to the board of directors. The proposed changes would eliminate the use of the terms “fixed board size” and “variable-range size board,” and would substitute what the Committee believes is a clearer formulation, in which the denominator for quorum and voting purposes would be the number of directors “specified in or fixed in accordance with the articles of incorporation or bylaws.”

For shareholder meetings, the proposed revision to section 7.25(a) would clarify that the articles of incorporation may not provide for a quorum lower than a quorum requirement specified in the Act (for example, the quorum requirement of section 8.63(d) applicable to approval of a director’s conflicting interest transaction by qualified shares, and the quorum requirement specified in section 10.03 for amendments to the articles of incorporation).

6. *Corporation Voting its Own Shares*

Section 7.21(b) of the current Act disenfranchises shares held by majority-owned subsidiaries (direct and indirect) of the corporation. The Committee is proposing amendments to section 7.21, however, that would more clearly prescribe such disenfranchisement for shares in which the corporation itself has the economic interest, including shares owned by or belonging to the corporation indirectly through entities (non-corporate as well as corporate) that are controlled by the corporation.

7. *Director Duties and Eliminating the Term “Public Corporation”*

As a result of amendments adopted in 2005, section 8.01 of the current Act prescribes “oversight duties” for directors of public corporations (as defined in current section 1.40). The Committee has concluded that such a sharp demarcation of duties as between “public corporations” and other corporations has become increasingly artificial, especially in light of the evolution of trading of shares of companies that are not yet SEC registrants in “private” secondary securities markets. Accordingly, the Committee is proposing to delete from the text of section 8.01 the current specification of particular oversight duties for directors of “public corporations,” and to place discussion of such duties in the Official Comment as an elaboration on the more general articulation in section 8.01(b) of the managerial and oversight responsibility of boards of directors. Consistent with these proposed changes, the Committee also proposes to delete the definition of “public corporation” from section 1.40.

Consistent with the deletion of the definition of “public corporation,” it is proposed to amend sections 7.32 and 10.22 to delete the use of that term. Thus, a shareholders’ agreement under section 7.32 would no longer automatically cease to be effective when the corporation becomes a “public corporation.” Of course, the Act’s requirement of unanimous shareholder approval will likely make shareholders’ agreements under section 7.32 unavailable to public corporations as a practical matter, and in any event such agreements can still be drafted to effect automatic termination upon occurrence of an event like an initial public offering. Similarly, section 10.22 would no longer limit use of the majority vote bylaw to public companies; the

Committee has concluded that there is no continuing justification for limiting the flexibility of non-public companies to adopt the provision authorized in section 10.22.

8. *Venue for Judicial Proceedings*

In specifying a judicial remedy with respect to the rights and obligations it creates, the current Act directs that litigation to obtain that remedy be commenced in the “appropriate court of the county where the corporation’s principal office (or, if none, its registered office) in this state is located.”⁵ Recognizing that many states have now developed distinct “business courts” that may be more appropriate venues for such litigation, the Committee is proposing to afford legislatures adopting the Act the ability to fix venue in the court believed to be best suited to handle litigation of the type in question. Accordingly, references in the current Act to the “appropriate court, etc.” would be changed simply to “[name or describe court],” thereby affording greater flexibility to legislatures adopting the Act to choose the appropriate venue.

9. *Effective Date*

The Committee’s review of the current Act revealed that the provisions defining when filings and transactions become effective are not internally consistent. The Committee proposes a revised approach to make those provisions more uniform, and to adopt a definition of “effective date” for filed documents in section 1.40 that applies throughout the Act. Section 1.23, which provides definitive rules for when a filing with the secretary of state becomes effective, has also been revised to improve its clarity.

⁵ *E.g.*, section 13.30(b).

Revisions to the Official Comment

The Committee proposes to extensively revise the Official Comment to the Act so that it functions solely as a guide to interpretation of the statutory black letter provisions.

Thus, the Committee proposes to:

- Eliminate language in the Official Comment that merely restates operative statutory language.
- Eliminate comparisons with prior versions of the Act or with state corporation statutes. (It is expected, however, that such comparative material will be included in the next edition of or supplement to the Model Business Corporation Act Annotated).
- Eliminate discussion of case law and law review articles. (Although again, it is expected that such material will be included in the next edition of or supplement to the Model Business Corporation Act Annotated).

Other Changes

The Committee's proposal also includes notes on adoption and revised transitional provisions in chapter 17 of the Act that are intended to facilitate legislative consideration in adopting the new version of the Act. The Committee intends and hopes that the forthcoming revision of the Act will encourage state legislatures –in states that have already adopted much or all of the Act and in other states as well – to consider adopting the revised Act in full and thereby bring their corporate statutes into line with the most recent developments in corporate law. The Committee therefore welcomes inquiries about how the newly revised Act might be tailored for adoption in a particular jurisdiction.