

## **Changes in the Model Business Corporation Act— Amendments to Chapter 7 and Related Provisions Relating to Shareholder Action Without a Meeting, Chapters 8 and 10 Relating to Shareholder Voting for the Election of Directors, and Chapter 13 Relating to Appraisal and Other Remedies for Fundamental Transactions\***

*By the Committee on Corporate Laws, ABA Section of Business Law\*\**

The Committee on Corporate Laws of the Section on Business Law (Committee) develops, and from time to time proposes changes in, the Model Business Corporation Act (Act). By publication after second reading in the August<sup>1</sup> and November 2005<sup>2</sup> and the February 2006<sup>3</sup> issues of *The Business Lawyer*, the Committee proposed a number of amendments to (i) chapter 7 (and related sections) relating to shareholder action without a meeting, (ii) chapters 8 and 10 relating to shareholder voting for the election of directors, and (iii) chapter 13 relating to appraisal and other remedies for fundamental transactions.

At its meeting on June 3, 2006, the Committee adopted the shareholder action without a meeting and director election amendments, effective as of that date, as proposed, but with further changes. In connection with the shareholder action without a meeting amendments, the Committee approved a change to section 13.22(b)(1) and its related Official Comment relating to the appraisal notice and form when shareholder action has been taken without a meeting. The Committee also approved an amendment to the Official Comment to section 13.25(a).

Recognizing the high level of public interest in the process of voting by shareholders for the election of directors, the Committee took the unusual step of providing three opportunities for public comment. The Committee first released

---

\* Editor's Note: This report is published in the form approved by the Committee on Corporate Laws without further editing by *The Business Lawyer*.

\*\* E. Norman Veasey, Chair.

1. Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Proposed Amendments Relating to Chapters 1, 7, and 14 with Conforming Amendments to Related Provisions of the Act*, 60 *BUS. LAW.* 1577 (2005).

2. Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Proposed Amendments to Chapters 8 and 10 relating to Voting by Shareholders for the Election of Directors*, 61 *BUS. LAW.* 399 (2005).

3. Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Proposed Amendments Relating to Appraisal and Other Remedies*, 61 *BUS. LAW.* 659 (2006).

for comments its Discussion Paper of June 22, 2005 and again requested public comment on its Preliminary Report of January 17, 2006. The full text of the Committee's Report, together with an Annex containing the proposed amendments to the Model Act, were publicly released on March 13, 2006 and later published in *The Business Lawyer* with an official comment period that ended May 30, 2006. As a result of this cautious and deliberate procedure, many thoughtful comments were received and considered by the Committee. As noted in the Preliminary Statement to *The Business Lawyer* publication, the Committee continued to have drafting concerns relating to how best to address contested director elections. After the close of the comment period on May 30, 2006 the Committee addressed that issue by approving a new subsection (b) to section 10.22, and the related Official Comment to address contested director elections.

Finally, the Committee approved the amendments relating to appraisal and other remedies for fundamental transactions, effective as of August 1, 2006. The Committee also approved an amendment to the appraisal "market out" provision in section 13.02 to reflect planned changes in the NASDAQ stock markets. That amendment also broadened the market out to include shares issued by an open end management investment company registered under the Investment Company Act of 1940 if such shares may be redeemed at net asset value at the option of the holder.

**(i) APPRAISAL NOTICE AND FORM**

*Amend section 13.22(b)(1) and the fifth paragraph of the related Official Comment as follows: (Marked to show changes)*

**§ 13.22. APPRAISAL NOTICE AND FORM**

\* \* \* \*

(b) The appraisal notice must be sent no earlier than the date the corporate action specified in section 13.02(a) became effective, and no later than 10 days after such date, and must:

- (1) supply a form that (i) specifies the first date of any announcement to shareholders made prior to the date the corporate action became effective of the principal terms of the proposed corporate action, (ii) if such announcement was made, requires the shareholder asserting appraisal rights to certify whether beneficial ownership of those shares for which appraisal rights are asserted was acquired before that date, and (iii) requires the shareholder asserting appraisal rights to certify that such shareholder did not vote for or consent to the transaction;

\* \* \* \*

**OFFICIAL COMMENT**

\* \* \* \*

Section 13.22(b)(1) requires the corporation to specify the date of the first announcement of the terms of the proposed corporate action if such announce-

ment was made prior to the date the corporate action became effective. The date of first announcement is the critical date for determining the rights of shareholder-transferees: persons who became shareholders prior to that date are entitled to full appraisal rights, while persons who became shareholders on or after that date are entitled only to the more limited rights provided by section 13.25. See the Official Comments to sections 13.23 and 13.25. The date the principal terms of the transaction were announced by the corporation to shareholders may be the day the terms were communicated directly to the shareholders, included in a public filing with the Securities and Exchange Commission, published in a newspaper of general circulation that can be expected to reach the financial community, or any earlier date on which such terms were first announced by any other person or entity to such persons or sources. Any announcement to news media or to shareholders that relates to the proposed transaction but does not contain the principal terms of the transaction to be authorized at the shareholders' meeting is not considered to be an announcement for the purposes of section 13.22. ~~If a corporation does not make a public announcement of the terms of a proposed corporate action, the requirement of section 13.22(b)(1) is not applicable.~~

\* \* \* \*

*Amend the Official Comment to section 13.25 as follows:*

#### OFFICIAL COMMENT

If a public announcement of the proposed corporate action is made, section 13.25(a) gives the corporation the option to treat differently shares acquired on or after the date of that announcement. The date of any public announcement is required to be specified by the corporation in its appraisal notice under section 13.22(b)(1). At the corporation's option, holders of shares acquired on or after this date, or shareholders who are required to but do not certify otherwise under section 13.23(a), are not entitled to immediate payment under section 13.24. Instead, shareholders described in subsection (a) may receive only an offer of payment which is conditioned on their agreement to accept it in full satisfaction of their claim. If the right of unconditional immediate payment were granted as to all after-acquired shares, speculators and others might be tempted to buy shares merely for the purpose of demanding appraisal. Since the function of appraisal rights is to protect investors against unforeseen changes, there is no need to give equally favorable treatment to purchasers who knew or should have known about the proposed changes.

**(ii) SHAREHOLDER VOTING IN THE ELECTION OF DIRECTORS**

*(Section 10.22(b) and Official Comment 2 marked to show changes)*

**§ 8.05. TERMS OF DIRECTORS GENERALLY**

\* \* \*

(b) The terms of all other directors expire at the next, or if their terms are staggered in accordance with section 8.06, at the applicable second or third, annual shareholders' meeting following their election, except to the extent (i) provided in section 10.22 if a bylaw electing to be governed by that section is in effect or (ii) a shorter term is specified in the articles of incorporation in the event of a director nominee failing to receive a specified vote for election.

\* \* \*

(e) Except to the extent otherwise provided in the articles of incorporation or under section 10.22 if a bylaw electing to be governed by that section is in effect, despite the expiration of a director's term, the director continues to serve until the director's successor is elected and qualifies or there is a decrease in the number of directors.

**OFFICIAL COMMENT**

Add the following sentence to the first paragraph of the Official Comment to section 8.05:

Section 8.05 also provides that a director term may expire before the next, or applicable second or third, annual shareholders' meeting if a bylaw invoking section 10.22 is in effect or the articles of incorporation provide for a shorter term in the event a director nominee fails to receive a specified vote for election.

Change the last paragraph of the Official Comment to section 8.05 to read as follows:

Section 8.05(e) provides for "holdover" directors so that directorships do not automatically become vacant at the expiration of their terms but the same persons continue in office until successors qualify for office. Thus the power of the board of directors to act continues uninterrupted even though an annual shareholders' meeting is not held or the shareholders are deadlocked or otherwise unable to elect directors at the meeting. Section 8.05 does provide for two possible exceptions to the general rule that directors hold over. First, it permits the articles of incorporation to modify or eliminate the holdover concept. Second, it recognizes that, if a bylaw is adopted invoking section 10.22, the effect will be that directors who are elected by a plurality vote but receive more votes against than for their election will not hold over following the abbreviated 90-day term of office specified in section 10.22.

### § 8.07. RESIGNATION OF DIRECTORS

- (a) A director may resign at any time by delivering a written resignation to the board of directors, or its chair, or to the secretary of the corporation.
- (b) A resignation is effective when the resignation is delivered unless the resignation specifies a later effective date or an effective date determined upon the happening of an event or events. A resignation that is conditioned upon failing to receive a specified vote for election as a director may provide that it is irrevocable.

#### OFFICIAL COMMENT

The resignation of a director is effective when the written notice is delivered unless the notice specifies a later effective date or an effective date determined upon the happening of an event or events, in which case the director continues to serve until that later date. Under section 8.10, a vacancy that will occur at a specific later date by reason of a resignation effective at a later date may be filled before the vacancy occurs. Since the individual giving the notice is still a member of the board, he or she may participate in all decisions until the specified date, including the choice of his or her successor under section 8.10. Section 8.10 does not permit vacancies that occur by virtue of a resignation conditioned upon a future event or events to be filled until such events occur.

The provisions in section 8.07(b) that a resignation may be made effective upon a date determined upon the happening of a future event or events, coupled with authority granted in the same section to make resignations conditioned at least in part upon failing to receive a specified vote for election irrevocable, are intended to clarify the enforceability of a director resignation conditioned upon “events” such as the director failing to achieve a specified vote for reelection, *e.g.*, more votes for than against, coupled with board acceptance of the resignation. These provisions thus permit corporations and individual directors to agree voluntarily and give effect, in a manner subsequently enforceable by the corporation, to voting standards for the election of directors that exceed the plurality default standard in section 7.28. The provisions of section 8.07(b) also make it clear that such arrangements do not contravene public policy. The express reference to the failure to receive a specified vote is not to be construed to address or negate the possible validity of other appropriate conditions for an irrevocable resignation.

### § 8.10. VACANCY ON BOARD

\* \* \*

- (b) If the vacant office was held by a director elected by a voting group of shareholders, only the holders of shares of that voting group are entitled to vote to fill the vacancy if it is filled by the shareholders, and only the directors elected by that voting group are entitled to fill the vacancy if it is filled by the directors.

\* \* \*

## OFFICIAL COMMENT

Change the third paragraph of the Official Comment to section 8.10 to read as follows:

Section 8.10(b) provides that if a voting group of shares is entitled to elect a director, only that voting group is entitled to fill a vacant office which was held by a director elected by that voting group, and only the directors elected by that voting group are entitled to fill the vacancy if it is filled by the directors. This section is part of the consistent treatment of directors elected by a voting group of shareholders. See sections 1.40, 7.25, 7.26, 7.28, 8.04 and 8.08(b).

## § 10.20. AMENDMENT BY BOARD OF DIRECTORS OR SHAREHOLDERS

\* \* \*

- (b) A corporation's board of directors may amend or repeal the corporation's bylaws, unless:
- (1) the articles of incorporation, ~~or~~ section 10.21 or, if applicable, section 10.22 reserve that power exclusively to the shareholders in whole or in part; or
  - (2) . . . .

## OFFICIAL COMMENT

Add the following sentences to the final paragraph of the Official Comment to Section 10.20:

Section 10.22 limits the power of directors to repeal a bylaw adopted by shareholders which opts in to the provisions of that section. See section 10.22 and the Official Comment thereto.

## § 10.22. BYLAW PROVISIONS RELATING TO THE ELECTION OF DIRECTORS

- (a) Unless the articles of incorporation (i) specifically prohibit the adoption of a bylaw pursuant to this section, (ii) alter the vote specified in section 7.28(a), or (iii) provide for cumulative voting, a public corporation may elect in its bylaws to be governed in the election of directors as follows:
- (1) each vote entitled to be cast may be voted for or against up to that number of candidates that is equal to the number of directors to be elected, or a shareholder may indicate an abstention, but without cumulating the votes;
  - (2) to be elected, a nominee must have received a plurality of the votes cast by holders of shares entitled to vote in the election at a meeting at which a quorum is present, provided that a nominee who is elected but receives more votes against than for election shall serve as a director for a term that shall terminate on the date that is the earlier of (i) 90

days from the date on which the voting results are determined pursuant to section 7.29(b)(5) or (ii) the date on which an individual is selected by the board of directors to fill the office held by such director, which selection shall be deemed to constitute the filling of a vacancy by the board to which section 8.10 applies. Subject to clause (3) of this section, a nominee who is elected but receives more votes against than for election shall not serve as a director beyond the 90-day period referenced above; and

(3) the board of directors may select any qualified individual to fill the office held by a director who received more votes against than for election.

(b) Subsection (a) does not apply to an election of directors by a voting group if (i) at the expiration of the time fixed under a provision requiring advance notification of director candidates, or (ii) absent such a provision, at a time fixed by the board of directors which is not more than 14 days before notice is given of the meeting at which the election is to occur, there are more candidates for election by the voting group than the number of directors to be elected, one or more of whom are properly proposed by shareholders. An individual shall not be considered a candidate for purposes of this subsection if the board of directors determines before the notice of meeting is given that such individual's candidacy does not create a bona fide election contest.

(c) A bylaw electing to be governed by this section may be repealed:

- (1) if originally adopted by the shareholders, only by the shareholders, unless the bylaw otherwise provides;
- (2) if adopted by the board of directors, by the board of directors or the shareholders.

## OFFICIAL COMMENT

Section 10.22 is effective only if a corporation elects in a bylaw adopted either by shareholders or by the board of directors to be governed by its terms. As provided in section 10.22(b), if such a bylaw is adopted by shareholders, it may be repealed only by shareholders unless the electing bylaw provides otherwise. If adopted by the board of directors, such a bylaw may be repealed by either the board of directors or the shareholders. The provisions of section 10.22 effectively modify the term and holdover provisions of section 8.05 pursuant to a limited exception recognized in that section. Accordingly, a bylaw provision that would seek to alter the term and holdover provision of section 8.05 that varied in any manner from section 10.22 would not be effective.

Only public corporations as defined in section 1.40(18A) may elect to be governed by section 10.22. Also, corporations whose articles of incorporation require cumulative voting (see section 7.28(c)), specifically prohibit the section 10.22 election, or alter the vote specified in section 7.28(a), are not eligible to elect to be governed by section 10.22. Since section 10.22 is a part of the Model Act, if

a corporation validly elects in a bylaw to be governed by its provisions, those provisions would supersede any other contrary provisions in the articles of incorporation or bylaws.

### 1. Section 10.22(a)

Section 10.22(a)(1) provides that each vote entitled to be cast in an election of directors may be voted for or against up to the number of candidates that is equal to the number of directors to be elected, or a shareholder may indicate an abstention. Application of this rule is straightforward if the nominees for director equal the number of directorships up for election. In that case, and by way of example, the holder of a single share could vote either for or against each director. In the unusual case that section 10.22(a) were applicable to a contested election notwithstanding the provisions of section 10.22(b) (i.e., in the absence of an advance notice bylaw, a contest arises as a result of candidates for director being proposed subsequent to the determination date under section 10.22(b)), the holder of a share would have to choose whether to indicate opposition to a slate by voting in favor of a candidate on an opposing slate or by voting against the candidates on the disfavored slate, or to abstain. Since it would be in the interests of all contestants to explain in their proxy materials that against votes would not affect the result in a contested election, the rational voter in a contested election could be expected to vote in favor of all candidates on the preferred slate to promote a simple plurality victory rather than voting against candidates on the disfavored slate. Nothing in section 10.22 would prevent the holder of more than one share from voting differently with respect to each share held.

Section 10.22(a) specifically contemplates that a corporate ballot for the election of directors would provide for “against” votes. Since “against” votes would have a potential effect with respect to corporations electing to be governed by section 10.22, existing rules of the Securities and Exchange Commission would mandate that a means for voting “against” also be provided in the form of proxy. See SEC Rule 14a-4(b)(2), 17 C.F.R. § 240.14a-4(b)(2) (2005), Instruction 2. While there is no prohibition in the Model Act against a corporation, outside of the context of section 10.22, offering to shareholders the opportunity to vote against candidates, unless section 10.22 is elected or the articles of incorporation are amended to make such a vote meaningful, an “against” vote is given no effect under the Model Act.

Section 10.22(a)(2) does not conflict with or alter the plurality voting default standard. A nominee who receives a plurality vote is still elected even if that nominee receives more votes against election than in favor of election. The term of that director is shortened, however, to a period ending no later than 90 days after the results of an election are determined by inspectors of election pursuant to section 7.29(b)(5), with no right to hold over, such that a vacancy would exist if no action is taken by the board prior to that date. As contemplated by section 8.10, that vacancy may be filled by shareholders or by the board of directors, unless the articles of incorporation provide otherwise. In the alternative, action

could be taken by amendment to, or in the manner provided in, the articles of incorporation or bylaws to reduce the size of the board. See section 8.03.

Within the 90-day period immediately following determination of the election results, section 10.22(a)(2) also grants to the board of directors the right to fill the office held by any director who received more votes against than for election. That action would be deemed to constitute the filling of a vacancy, with the result that, under section 8.05(d), the director filling the vacancy would be up for reelection at the next annual meeting, even if the term for that directorship would otherwise have been for more than one year, as in the case of a staggered board.

In the exercise of its power under section 10.22(a)(2), a board can select as a director any qualified person, which could include a director who received more against than for votes. Among other things, this power permits a board to respond to the use of section 10.22(a)(2) as a takeover device or to prevent harm to the corporation resulting from a failed election. As a practical matter, however, and given the directors' consideration of their duties, boards are likely to be hesitant to select such director to fill the vacancy in other contexts. There is also no limitation in section 10.22 or elsewhere in the Model Act on the power of either the board of directors or shareholders to fill a vacancy with the person who held such directorship before the vacancy arose.

## 2. Section 10.22(b)

Under section 10.22(b), when there are more candidates for election as directors by a voting group (as defined in section 1.40(26)) than seats to be filled, the resulting election contest would not be subject to the voting regime under section 10.22(a) but would be conducted by means of a plurality vote under section 7.28(a). Such plurality voting is appropriate in that circumstance because shareholders will have a choice.

Whether there are more candidates than the number of directors to be elected, and therefore whether the voting regime under section 10.22(a) is inapplicable, is determined, if the corporation has a provision in the articles of incorporation or the bylaws requiring advance notification of director candidates, when the time for such notice expires; otherwise the determination is made no later than 14 days before the notice of meeting is given to the shareholders. This assures that the voting regime that will apply will be known in advance of the giving of notice, and that the disclosure of the voting rules and form of proxy will be clear and reflect the applicable voting regime. The determination of how many candidates there are to fill the number of seats up for election can be made by the board of directors. In addition, section 10.22(b) gives the board the authority to determine that an individual shall not be considered a candidate for purposes of section 10.22(b) if the candidacy does not create a bona fide election contest. This determination must be made before notice of the meeting is given. The board might choose, for example, to exercise this authority to preserve the voting regime under section 10.22(a) when it is clear that an individual has designated himself or herself as a candidate without intending to solicit votes or for the purpose of

frustrating the availability of the section 10.22(a) voting regime. A board can be expected to exercise its authority under section 10.22(b) with care so as to give fair effect to the voting policies chosen by the corporation to govern the election of the corporation's directors.

The contested or uncontested nature of the election can change following the date for determining the voting regime that will apply. For example, an election that is contested at that date could become uncontested if a candidate withdraws, possibly as part of a settlement. Conversely, unless an advance notice bylaw has been adopted, an uncontested election could become contested before the vote is taken but after notice of the meeting has been given because in that situation there is nothing limiting the ability of shareholders to nominate candidates for directorships up until the time nominations are closed at the meeting. Section 10.22(b) does not authorize changing the voting regime in these circumstances. In some circumstances, a board, in the exercise of its general authority and if consistent with its duties, might decide to reset the determination date so that the appropriate voting regime applies by renouncing the meeting, either with or without delaying the meeting depending upon the available time, and by providing revised disclosure of the applicable voting regime and a revised form of proxy, if necessary.

### 3. Inclusion in Articles of Incorporation

As provided in section 2.02(b)(3), an election to have section 10.22 apply also may be included in the articles of incorporation. As with any amendment to the articles of incorporation, its adoption and amendment requires the approval of both the directors and the shareholders. See section 10.03.

#### **(iii) AMENDMENT TO MARKET-OUT PROVISION**

*(Section 13.02(b)(1) and the related Official Comment marked to show changes)*

### **§13.02. RIGHT TO APPRAISAL**

\* \* \* \* \*

(b) Notwithstanding subsection (a), the availability of appraisal rights under subsections (a)(1), (2), (3), (4), (6) and (8) shall be limited in accordance with the following provisions:

(1) Appraisal rights shall not be available for the holders of shares of any class or series of shares which is:

(i) a covered security under Section 18 (b)(1)(A) or (B) of the Securities Act of 1933, as amended; or

(ii) traded in an organized market and has at least 2,000 shareholders and a market value of at least \$ 20 million (exclusive of the value of such shares held by the corporation's subsidiaries, senior executives, directors and beneficial shareholders owning more than 10 percent of such shares); or

(iii) issued by an open end management investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and may be redeemed at the option of the holder at net asset value.

## OFFICIAL COMMENT

\* \* \* \* \*

### 2. MARKET OUT TO APPRAISAL RIGHTS

Chapter 13 provides a limited exception to appraisal rights for those situations where shareholders can either accept the appraisal-triggering corporate action or can sell their shares in a liquid and reliable market or an equivalent transaction. This provision, the so-called market out, is predicated on the theory that where an efficient market exists, the market price will be an adequate proxy for the fair value of the corporation's shares, thus making appraisal unnecessary. Furthermore, after the corporation announces an appraisal-triggering action which is a transaction such as a merger, the market operates at maximum efficiency with respect to the corporation's shares because interested parties and market professionals evaluate the proposal and competing proposals may be generated if the original proposal is deemed inadequate. Moreover, the market out reflects an evaluation that the uncertainty, costs and time commitment involved in any appraisal proceeding are not warranted where shareholders can sell their shares in an efficient, fair and liquid market.

For purposes of this chapter, the market out is provided for a class or series of shares if two criteria are met: the market in which the shares are traded must be "liquid" and the value of the shares established by the appraisal-triggering event must be "reliable." Except as provided in section 13.02(b)(1) (iii), liquidity is addressed in section 13.02(b)(1) and requires the class or series of stock to satisfy either one of two requirements: (1) The class or series must be a covered security under section 18 (a)(1)(A) or (B) of the Securities Act of 1933. This means that it must be listed on the New York Stock Exchange or the American Stock Exchange, or on the NASDAQ Global Select Market or the NASDAQ Global Market (successors to the NASDAQ National Market), or on certain other markets having comparable listing standards as determined by the Securities and Exchange Commission. (2) If not in these categories, the class or series must be traded in an organized market and have at least 2,000 record or beneficial shareholders (provided that using both concepts does not result in duplication) and have a market value of at least \$20 million, excluding the value of shares held by the corporation's subsidiaries, senior executives, directors and beneficial shareholders owning more than 10 percent of the class or series.

Shares issued by an open end management investment company registered under the Investment Company Act of 1940 that may be redeemed at the option of the holder at net asset value provide an equivalent quality of liquidity and reliability, and are also included in the market out.

— |

| —

— |

| —