I. CORPORATIONS

A. MODEL BUSINESS CORPORATION ACT

(with selected Official Comments)

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SUBCHAPTER A. RECORDS

CHAPTER 1. GENERAL PROVISIONS

SUBCHAPTER A. SHORT TITLE AND RESERVATION OF POWER

§ 1.01 Short Title

This Act shall be known and may be cited as the ''[name of state] Business Corporation Act.''

§ 1.02 Reservation of Power to Amend or Repeal

The [name of state legislature] has power to amend or repeal all or part of this Act at any time and all domestic and foreign corporations subject to this Act are governed by the amendment or repeal.

SUBCHAPTER B. FILING DOCUMENTS

§ 1.20 Requirements for Documents; Extrinsic Facts

(a) A document must satisfy the requirements of this section, and of any other section that adds to or varies these requirements, to be entitled to filing by the secretary of state.

(b) This Act must require or permit filing the document in the office of the secretary of state.

(c) The document must contain the information required by this Act. It may contain other information as well.

(d) The document must be typewritten or printed or, if electronically transmitted, it must be in a format that can be retrieved or reproduced in typewritten or printed form.

(e) The document must be in the English language. A corporate name need not be in English if written in English letters or Arabic or Roman numerals, and the certificate of existence required of foreign corporations need not be in English if accompanied by a reasonably authenticated English translation.

(f) The document must be executed:

(1) by the chairman of the board of directors of a domestic or foreign corporation, by its president, or by another of its officers;

(2) if directors have not been selected or the corporation has not been formed, by an incorporator; or

(3) if the corporation is in the hands of a receiver, trustee, or other court-appointed fiduciary, by that fiduciary.

(g) The person executing the document shall sign it and state beneath or opposite his signature his name and the capacity in which he signs. The document may but need not contain a corporate seal, attestation, an acknowledgement, or verification.

(h) If the secretary of state has prescribed a mandatory form for the document under section 1.21, the document must be in or on the prescribed form.

(i) The document must be delivered to the office of the secretary of state for filing. Delivery may be made by electronic transmission if and to the extent permitted by the secretary of state. If it is filed in typewritten or printed form and not transmitted electronically, the secretary of state may require one exact or conformed copy to be delivered with the document (except as provided in sections 5.03 and 15.09).

(j) When the document is delivered to the office of the secretary of state for filing, the correct filing fee, and any franchise tax, license fee, or penalty required to be paid therewith by this Act or other law must be paid or provision for payment made in a manner permitted by the secretary of state.

(k) Whenever a provision of this Act permits any of the terms of a plan or a filed document to be dependent on facts objectively ascertainable outside the plan or filed document, the following provisions apply:

(1) The manner in which the facts will operate upon the terms of the plan or filed document shall be set forth in the plan or filed document.

(2) The facts may include, but are not limited to:

(i) any of the following that is available in a nationally recognized news or information medium either in print or electronically: statistical or market indices, market prices of any security or group of securities, interest rates, currency exchange rates, or similar economic or financial data;

(ii) a determination or action by any person or body, including the corporation or any other party to a plan or filed document; or

(iii) the terms of, or actions taken under, an agreement to which the corporation is a party, or any other agreement or document.

(3) As used in this subsection:

(i) ''filed document'' means a document filed with the secretary of state under any provision of this Act except chapter 15 or section 16.21; and

(ii) ''plan'' means a plan of domestication, nonprofit conversion, entity conversion, merger or share exchange.

(4) The following provisions of a plan or filed document may not be made dependent on facts outside the plan or filed document:

(i) The name and address of any person required in a filed document.

(ii) The registered office of any entity required in a filed document.

(iii) The registered agent of any entity required in a filed document.

(iv) The number of authorized shares and designation of each class or series of shares.

(v) The effective date of a filed document.

(vi) Any required statement in a filed document of the date on which the underlying transaction was approved or the manner in which that approval was given.

(5) If a provision of a filed document is made dependent on a fact ascertainable outside of the filed document, and that fact is not ascertainable by reference to a source described in subsection (k)(2)(i) or a document that is a matter of public record, or the affected shareholders have not received notice of the fact from the corporation, then the corporation shall file with the secretary of state articles of amendment setting forth the fact promptly after the time when the fact referred to is first ascertainable or thereafter changes. Articles of amendment under this subsection (k)(5) are deemed to be authorized by the authorization of the original filed document or plan to which they relate and may be filed by the corporation without further action by the board of directors or the shareholders.

§ 1.21 Forms

(a) The secretary of state may prescribe and furnish on request forms for: (1) an application for a certificate of existence, (2) a foreign corporation's application for a certificate of authority to transact business in this state, (3) a foreign corporation's application for a certificate of withdrawal, and (4) the annual report. If the secretary of state so requires, use of these forms is mandatory.

(b) The secretary of state may prescribe and furnish on request forms for other documents required or permitted to be filed by this Act but their use is not mandatory.

§ 1.22 Filing, Service and Copying Fees

(a) The secretary of state shall collect the following fees when the documents described in this subsection are delivered to him for filing:

	Document	Fee
(1)	Articles of incorporation	$________.
(2)	Application for use of indistinguishable name	$________.
(3)	Application for reserved name	$________.
(4)	Notice of transfer of reserved name	$________.
(5)	Application for registered name	$________.
(6)	Application for renewal of registered name	$________.
(7)	Corporation's statement of change of registered agent or registered office or both	$________.
(8)	Agent's statement of change of registered office for each affected corporation	$________.
	not to exceed a total of	$________.
(9)	Agent's statement of resignation	No fee.
(9A)	Articles of domestication	$________.
(9B)	Articles of charter surrender	$________.
(9C)	Articles of nonprofit conversion	$________.
(9D)	Articles of domestication and conversion	$________.
(9E)	Articles of entity conversion	$________.
(10)	Amendment of articles of incorporation	$________.
(11)	Restatement of articles of incorporation	$________.
	with amendment of articles	$________.
(12)	Articles of merger or share exchange	$________.
(13)	Articles of dissolution	$________.
(14)	Articles of revocation of dissolution	$________.
(15)	Certificate of administrative dissolution	No fee.
(16)	Application for reinstatement following administrative dissolution	$________.
(17)	Certificate of reinstatement	No fee.
(18)	Certificate of judicial dissolution	No fee.
(19)	Application for certificate of authority	$________.
(20)	Application for amended certificate of authority	$________.
(21)	Application for certificate of withdrawal	$________.

	Document	Fee
(21A)	Application for transfer of authority	$________.
(22)	Certificate of revocation of authority to transact business	No fee.
(23)	Annual report	$________.
(24)	Articles of correction	$________.
(25)	Application for certificate of existence or authorization	$________.
(26)	Any other document required or permitted to be filed by this Act.	$________.

(b) The secretary of state shall collect a fee of $_______ each time process is served on him under this Act. The party to a proceeding causing service of process is entitled to recover this fee as costs if he prevails in the proceeding.

(c) The secretary of state shall collect the following fees for copying and certifying the copy of any filed document relating to a domestic or foreign corporation:

(1) $_______ a page for copying; and

(2) $_______ for the certificate.

§ 1.23 Effective Time and Date of Document

(a) Except as provided in subsection (b) and section 1.24(c), a document accepted for filing is effective:

(1) at the date and time of filing , as evidenced by such means as the secretary of state may use for the purpose of recording the date and time of filing; or

(2) at the time specified in the document as its effective time on the date it is filed.

(b) A document may specify a delayed effective time and date, and if it does so the document becomes effective at the time and date specified. If a delayed effective date but no time is specified, the document is effective at the close of business on that date. A delayed effective date for a document may not be later than the 90th day after the date it is filed.

§ 1.24 Correcting Filed Document

(a) A domestic or foreign corporation may correct a document filed by the secretary of state if (1) the document contains an inaccuracy, or (2) the document was defectively executed, attested, sealed, verified or acknowledged, or (3) the electronic transmission was defective.

(b) A document is corrected:

(1) by preparing articles of correction that

(i) describe the document (including its filing date) or attach a copy of it to the articles,

(ii) specify the inaccuracy or defect to be corrected, and

(iii) correct the inaccuracy or defect; and

(2) by delivering the articles to the secretary of state for filing.

(c) Articles of correction are effective on the effective date of the document they correct except as to persons relying on the uncorrected document and adversely affected by the correction. As to those persons, articles of correction are effective when filed.

OFFICIAL COMMENT

Section 1.24 permits making corrections in filed documents without refiling the entire document or submitting formal articles of amendment. This correction procedure has two advantages: (1) filing articles of correction may be less expensive than refiling the document or filing articles of amendment, and (2) articles of correction do not alter the effective date of the underlying document being corrected. Indeed, under section 1.24(c), even the correction relates back to the original effective date of the document except as to persons relying on the original document and adversely affected by the correction. As to these persons, the effective date of articles of correction is the date the articles are filed.

A document may be corrected either because it contains an inaccuracy or because it was defectively executed (including defects in optional forms of execution that do not affect the eligibility of the original document for filing). In addition, the document may be corrected if the electronic transmission was defective. This is intended to cover the situation where an electronic filing is made but, due to a defect in transmission, the filed document is later discovered to be inconsistent with the document intended to be filed. If no filing is made because of a defect in transmission, articles of correction may not be used to make a retroactive filing. Therefore, a corporation making an electronic filing should take steps to confirm that the filing was received by the secretary of state.

A provision in a document setting an effective date (section 1.23) may be corrected under this section, but the corrected effective date must comply with section 1.23 measured from the date of the original filing of the document being corrected, i.e. it cannot be before the date of filing of the document or more than 90 days thereafter.

§ 1.25 Filing Duty of Secretary of State

(a) If a document delivered to the office of the secretary of state for filing satisfies the requirements of section 1.20, the secretary of state shall file it.

(b) The secretary of state files a document by recording it as filed on the date and time of receipt. After filing a document, except as provided in sections 5.03 and 15.10, the secretary of state shall deliver to the domestic or foreign corporation or its representative a copy of the document with an acknowledgement of the date and time of filing.

(c) If the secretary of state refuses to file a document, he shall return it to the domestic or foreign corporation or its representative within five days after the document was delivered, together with a brief, written explanation of the reason for his refusal.

(d) The secretary of state's duty to file documents under this section is ministerial. His filing or refusing to file a document does not:

(1) affect the validity or invalidity of the document in whole or part;

(2) relate to the correctness or incorrectness of information contained in the document;

(3) create a presumption that the document is valid or invalid or that information contained in the document is correct or incorrect.

§ 1.26 Appeal From Secretary of State's Refusal to File Document

(a) If the secretary of state refuses to file a document delivered to his office for filing, the domestic or foreign corporation may appeal the refusal within 30 days after the return of the document to the [name or describe] court [of the county where the corporations's principal office (or, if none in this state, its registered office) is or will be located] [of $________ county]. The appeal is commenced by petitioning the court to compel filing the document and by attaching to the petition the document and the secretary of state's explanation of his refusal to file.

(b) The court may summarily order the secretary of state to file the document or take other action the court considers appropriate.

(c) The court's final decision may be appealed as in other civil proceedings.

§ 1.27 Evidentiary Effect of Copy of Filed Document

A certificate from the secretary of state delivered with a copy of a document filed by the secretary of state, is conclusive evidence that the original document is on file with the secretary of state.

OFFICIAL COMMENT

The secretary of state may be requested to certify that a specific document has been filed with him upon payment of the fees specified in section 1.22(c). Section 1.27 provides that the certificate is conclusive evidence only that the document is on file. The limited effect of the certificate is consistent with the ministerial filing obligation imposed on the secretary of state under the Model Act. The certificate from the secretary of state, as well as the copy of the document, may be delivered by electronic transmission.

§ 1.28 Certificate of Existence

(a) Anyone may apply to the secretary of state to furnish a certificate of existence for a domestic corporation or a certificate of authorization for a foreign corporation.

(b) A certificate of existence or authorization sets forth:

(1) the domestic corporation's corporate name or the foreign corporation's corporate name used in this state;

(2) that (i) the domestic corporation is duly incorporated under the law of this state, the date of its incorporation, and the period of its duration if less than perpetual; or (ii) that the foreign corporation is authorized to transact business in this state;

(3) that all fees, taxes, and penalties owed to this state have been paid, if (i) payment is reflected in the records of the secretary of state and (ii) nonpayment affects the existence or authorization of the domestic or foreign corporation;

(4) that its most recent annual report required by section 16.21 has been delivered to the secretary of state;

(5) that articles of dissolution have not been filed; and

(6) other facts of record in the office of the secretary of state that may be requested by the applicant.

(c) Subject to any qualification stated in the certificate, a certificate of existence or authorization issued by the secretary of state may be relied upon as conclusive evidence that the domestic or foreign corporation is in existence or is authorized to transact business in this state.

§ 1.29 Penalty for Signing False Document

(a) A person commits an offense if he signs a document he knows is false in any material respect with intent that the document be delivered to the secretary of state for filing.

(b) An offense under this section is a [______] misdemeanor [punishable by a fine of not to exceed $______].

SUBCHAPTER C. SECRETARY OF STATE

§ 1.30 Powers

The secretary of state has the power reasonably necessary to perform the duties required of him by this Act.

SUBCHAPTER D. DEFINITIONS

§ 1.40 Act Definitions

In this Act:

(1) "Articles of incorporation" means the original articles of incorporation, all amendments thereof, and any other documents permitted or required to be filed by a domestic business corporation with the secretary of state under any provision of this Act except

section 16.21. If an amendment of the articles or any other document filed under this Act restates the articles in their entirety, thenceforth the articles shall not include any prior documents.

(2) ''Authorized shares'' means the shares of all classes a domestic or foreign corporation is authorized to issue.

(3) ''Conspicuous'' means so written that a reasonable person against whom the writing is to operate should have noticed it. For example, printing in italics or boldface or contrasting color, or typing in capitals or underlined, is conspicuous.

(4) ''Corporation,'' ''domestic corporation'' or ''domestic business corporation'' means a corporation for profit, which is not a foreign corporation, incorporated under or subject to the provisions of this Act.

(5) ''Deliver'' or ''delivery'' means any method of delivery used in conventional commercial practice, including delivery by hand, mail, commercial delivery, and electronic transmission.

(6) ''Distribution'' means a direct or indirect transfer of money or other property (except its own shares) or incurrence of indebtedness by a corporation to or for the benefit of its shareholders in respect of any of its shares. A distribution may be in the form of a declaration or payment of a dividend; a purchase, redemption, or other acquisition of shares; a distribution of indebtedness; or otherwise.

(6A) ''Domestic unincorporated entity'' means an unincorporated entity whose internal affairs are governed by the laws of this state.

(7) ''Effective date of notice'' is defined in section 1.41.

(7A) ''Electronic transmission'' or ''electronically transmitted'' means any process of communication not directly involving the physical transfer of paper that is suitable for the retention, retrieval, and reproduction of information by the recipient.

(7B) ''Eligible entity'' means a domestic or foreign unincorporated entity or a domestic or foreign nonprofit corporation.

(7C) ''Eligible interests'' means interests or memberships.

(8) ''Employee'' includes an officer but not a director. A director may accept duties that make him also an employee.

(9) ''Entity'' includes a domestic and foreign business corporation; domestic and foreign nonprofit corporation; estate; trust; domestic and foreign unincorporated entity; and state, United States, and foreign government.

(9A) The phrase ''facts objectively ascertainable'' outside of a filed document or plan is defined in section 1.20(k).

(9AA) ''Expenses'' means reasonable expenses of any kind that are incurred in connection with a matter.

(9B) ''Filing entity'' means an unincorporated entity that is of a type that is created by filing a public organic document.

(10) ''Foreign corporation'' means a corporation incorporated under a law other than the law of this state; which would be a business corporation if incorporated under the laws of this state.

(10A) ''Foreign nonprofit corporation'' means a corporation incorporated under a law other than the law of this state, which would be a nonprofit corporation if incorporated under the laws of this state.

(10B) ''Foreign unincorporated entity'' means an unincorporated entity whose internal affairs are governed by an organic law of a jurisdiction other than this state.

(11) ''Governmental subdivision'' includes authority, county, district, and municipality.

(12) ''Includes'' denotes a partial definition.

(13) ''Individual'' means a natural person.

(13A) ''Interest'' means either or both of the following rights under the organic law of an unincorporated entity:

(i) the right to receive distributions from the entity either in the ordinary course or upon liquidation; or

(ii) the right to receive notice or vote on issues involving its internal affairs, other than as an agent, assignee, proxy or person responsible for managing its business and affairs.

(13B) ''Interest holder'' means a person who holds of record an interest.

(14) ''Means'' denotes an exhaustive definition.

(14A) ''Membership'' means the rights of a member in a domestic or foreign nonprofit corporation.

(14B) ''Nonfiling entity'' means an unincorporated entity that is of a type that is not created by filing a public organic document.

(14C) ''Nonprofit corporation'' or ''domestic nonprofit corporation'' means a corporation incorporated under the laws of this state and subject to the provisions of the [Model Nonprofit Corporation Act].

(15) ''Notice'' is defined in section 1.41.

(15A) ''Organic document'' means a public organic document or a private organic document.

(15B) ''Organic law'' means the statute governing the internal affairs of a domestic or foreign business or nonprofit corporation or unincorporated entity.

(15C) ''Owner liability'' means personal liability for a debt, obligation or liability of a domestic or foreign business or nonprofit corporation or unincorporated entity that is imposed on a person:

(i) solely by reason of the person's status as a shareholder, member or interest holder; or

(ii) by the articles of incorporation, bylaws or an organic document under a provision of the organic law of an entity authorizing the articles of incorporation, bylaws or an organic document to make one or more specified shareholders, members or interest holders liable in their capacity as shareholders, members or interest holders for all or specified debts, obligations or liabilities of the entity.

(16) ''Person'' includes an individual and an entity.

(17) ''Principal office'' means the office (in or out of this state) so designated in the annual report where the principal executive offices of a domestic or foreign corporation are located.

(17A) ''Private organic document'' means any document (other than the public organic document, if any) that determines the internal governance of an unincorporated entity. Where a private organic document has been amended or restated, the term means the private organic document as last amended or restated.

(17B) ''Public organic document'' means the document, if any, that is filed of public record to create an unincorporated entity. Where a public organic document has been amended or restated, the term means the public organic document as last amended or restated.

(18) ''Proceeding'' includes civil suit and criminal, administrative, and investigatory action.

(18A) ''Public corporation'' means a corporation that has shares listed on a national securities exchange or regularly traded in a market maintained by one or more members of a national securities association.

(19) ''Record date'' means the date established under chapter 6 or 7 on which a corporation determines the identity of its shareholders and their shareholdings for purposes of this Act. The determinations shall be made as of the close of business on the record date unless another time for doing so is specified when the record date is fixed.

(20) ''Secretary'' means the corporate officer to whom the board of directors has delegated responsibility under section 8.40(c)

for custody of the minutes of the meetings of the board of directors and of the shareholders and for authenticating records of the corporation.

(21) ''Shareholder'' means the person in whose name shares are registered in the records of a corporation or the beneficial owner of shares to the extent of the rights granted by a nominee certificate on file with a corporation.

(22) ''Shares'' means the units into which the proprietary interests in a corporation are divided.

(22A) ''Sign'' or ''signature'' includes any manual, facsimile, conformed or electronic signature.

(23) ''State,'' when referring to a part of the United States, includes a state and commonwealth (and their agencies and governmental subdivisions) and a territory, and insular possession (and their agencies and governmental subdivisions) of the United States.

(24) ''Subscriber'' means a person who subscribes for shares in a corporation, whether before or after incorporation.

(24A) ''Unincorporated entity'' means an organization or artificial legal person that either has a separate legal existence or has the power to acquire an estate in real property in its own name and that is not any of the following: a domestic or foreign business or nonprofit corporation, an estate, a trust, a state, the United States, or a foreign government. The term includes a general partnership, limited liability company, limited partnership, business trust, joint stock association and unincorporated nonprofit association.

(25) ''United States'' includes a district, authority, bureau, commission, department, and any other agency of the United States.

(26) ''Voting group'' means all shares of one or more classes or series that under the articles of incorporation or this Act are entitled to vote and be counted together collectively on a matter at a meeting of shareholders. All shares entitled by the articles of incorporation or this Act to vote generally on the matter are for that purpose a single voting group.

(27) ''Voting power'' means the current power to vote in the election of directors.

OFFICIAL COMMENT

* * *

2. Corporation, Domestic Corporation, Domestic Business Corporation, Foreign Corporation and Foreign Business Corporation

''Corporation,'' ''domestic corporation,'' ''domestic business corporation,'' ''foreign corporation,'' and ''foreign business corporation'' are defined in sections

1.40(4) and (10). The word ‘‘corporation,’’ when used alone, refers only to domestic corporations. In a few instances, the phrase ‘‘domestic corporation’’ has been used in order to contrast it with a foreign corporation. The phrase ‘‘domestic business corporation’’ has been used on occasion to contrast it with a domestic nonprofit corporation.

* * *

4. Electronic Transmission

‘‘Electronic transmission’’ or ‘‘electronically transmitted’’ includes both communication systems which in the normal course produce paper, such as telegrams and facsimiles, as well as communication systems which transmit and permit the retention of data which is then subject to subsequent retrieval and reproduction in written form. Electronic transmission is intended to be broadly construed and include the evolving methods of electronic delivery, including electronic transmissions between computers via modem, as well as data stored and delivered on magnetic tapes or computer diskettes. The phrase is not intended to include voice mail and other similar systems which do not automatically provide for the retrieval of data in printed or typewritten form.

5. Entity

The term ‘‘entity,’’ defined in section 1.40(9), appears in the definition of ‘‘person’’ in section 1.40(16) and is included to cover all types of artificial persons. Estates and trusts and general partnerships are included even though they may not, in some jurisdictions, be considered artificial persons. ‘‘Trust,’’ by itself, means a non-business trust, such as a traditional testamentary or inter vivos trust.

The term ‘‘entity’’ is broader than the term ‘‘unincorporated entity’’ which is defined in section 1.40(24A). See also the definitions of ‘‘governmental subdivision’’ in section 1.40(11), ‘‘state’’ in section 1.40(23), and ‘‘United States’’ in section 1.40(25).

A form of co-ownership of property or sharing of returns from property that is not a partnership under the Uniform Partnership Act (1997) will not be an ‘‘unincorporated entity.’’ In that connection, section 202(c) of the Uniform Partnership Act (1997) provides, among other things, that:

In determining whether a partnership is formed, the following rules apply:

(1) Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not by itself establish a partnership, even if the co-owners share profits made by the use of the property.

(2) The sharing of gross returns does not by itself establish a partnership, even if the persons sharing them have a joint or common right or interest in property from which the returns are derived.

5.1 Expenses

The Act provides in a number of contexts that expenses relating to a proceeding incurred by a person shall or may be paid by another, through indemnification or by court order in specific contexts. See sections 7.46, 7.48, 8.50(3), 8.53(a), 13.31(b) and (c), 14.32(e), 16.04(c) and 16.05(c). In all cases, the expenses must be reasonable in the circumstances. The type or character of the expenses is not otherwise limited. Examples include such usual things as fees and disbursements of counsel, experts of all kinds, and jury and similar litigation consultants; travel, lodging, transcription, reproduction, photographic, video recording, communication, and delivery costs, whether included in the disbursements of counsel, experts, or consultants, or directly incurred; court costs; and premiums for posting required bonds.

Historically, before the inclusion in section 1.40 of the Act of the definition of ''expenses'', a number of the affected sections explicitly contained the phrase ''including counsel fees'', or similar words, after ''expenses''. The exclusion of other elements of expenses was not intended in these sections (see the definition of ''includes'' in subsection (12)). With the current universal definition, singling out this one example of expenses in the statutory text was deemed unnecessary and stylistically inconsistent. The current formulation, referring to expenses ''of any kind'' and eliminating the example of counsel fees, also more clearly avoids any possible incorrect negative inference that other elements of expenses, not specified, might be excluded if one example were specified.

5.2 Membership

''Membership'' is defined in section 1.40(14A) for purposes of this Act to refer only to the rights of a member in a nonprofit corporation. Although the owners of a limited liability company are generally referred to as ''members,'' for purposes of this Act they are referred to as ''interest holders'' and what they own in the limited liability company is referred to in this Act as an ''interest.''

5.3 Organic Documents, Public Organic Documents, and Private Organic Documents

The term ''organic documents'' in section 1.40(15A) includes both public organic documents and private organic documents. The term ''public organic document'' includes such documents as the certificate of limited partnership of a limited partnership, the articles of organization or certificate of formation of a limited liability company, the deed of trust of a business trust and comparable documents, however denominated, that are publicly filed to create other types of unincorporated entities. An election of limited liability partnership status is not of itself a public organic document because it does not create the underlying general or limited partnership filing the election, although the election may be made part of the public organic document of the partnership by its organic law. The term ''private organic document'' includes such documents as a partnership agreement of a general or limited partnership, an operating agreement of a limited liability company and comparable documents, however denominated, of other types of unincorporated entities.

5.4 Owner Liability

The term ''owner liability'' is used in the context of provisions in chapters 9 and 11 that preserve the personal liability of shareholders, members, and interest holders when the entity in which they hold shares, memberships or interests is the subject of a transaction under those chapters. The term includes only liabilities that are imposed pursuant to statute on shareholders, members or interest holders. Liabilities that a shareholder, member or interest holder incurs by contract are not included. Thus, for example, if a state's business corporation law were to make shareholders personally liable for unpaid wages, that liability would be an ''owner liability.'' If, on the other hand, a shareholder were to guarantee payment of an obligation of a corporation, that liability would not be an ''owner liability.'' The reason for excluding contractual liabilities from the definition of ''owner liability'' is because those liabilities are constitutionally protected from impairment and thus do not need to be separately protected in chapters 9 and 11.

5.5 Unincorporated Entity

The term ''unincorporated entity'' is a subset of the broader term ''entity.''

There is some question as to whether a partnership subject to the Uniform Partnership Act (1914) is an entity or merely an aggregation of its partners. That question has been resolved by section 201 of the Uniform Partnership Act (1997), which makes clear that a general partnership is an entity with its own separate legal existence. Section 8 of the Uniform Partnership Act (1914) gives partnerships subject to it the power to acquire estates in real property and thus such a partnership will be an ''unincorporated entity.'' As a result, all general partnerships will be ''unincorporated entities'' regardless of whether the state in which they are organized has adopted the new Uniform Partnership Act (1997).

The term ''unincorporated entity'' includes limited liability partnerships and limited liability limited partnerships because those entities are forms of general partnerships and limited partnerships, respectively, that have made the additional required election claiming that status.

Section 4 of the Uniform Unincorporated Nonprofit Association Act gives an unincorporated nonprofit association the power to acquire an estate in real property and thus an unincorporated nonprofit association organized in a state that has adopted that act will be an ''unincorporated entity.'' At common law, an unincorporated nonprofit association was not a legal entity and did not have the power to acquire real property. Most states that have not adopted the Uniform Act have nonetheless modified the common law rule, but states that have not adopted the Uniform Act should analyze whether they should modify the definition of ''unincorporated entity'' to add an express reference to unincorporated nonprofit associations.

''Business trust'' includes any trust carrying on a business, such as a Massachusetts trust, real estate investment trust, or other common law or statutory business trust. The term ''unincorporated entity'' expressly excludes estates and trusts (i.e., trusts that are not business trusts), whether or not they would be considered artificial persons under the governing jurisdiction's law, to make it clear that they are not eligible to participate in a conversion under subchapter E of chapter 9 or a merger or share exchange under chapter 11.

9. Sign

The definition of ''sign'' or ''signature'' includes manual, facsimile, conformed or electronic signatures. In this regard, it is intended that any manifestation of an intention to execute or authenticate a document will be accepted. Electronic signatures are expected to encompass any methodology approved by the secretary of state for purposes of verification of the authenticity of the document. This could include a typewritten conformed signature or other electronic entry in the form of a computer data compilation of any characters or series of characters comprising a name intended to evidence authorization and execution of a document.

* * *

12. Voting Power

Under section 1.40(27) the term ''voting power'' means the current power to vote in the election of directors. Application of this definition turns on whether the relevant shares carry the power to vote in the election of directors as of the time for voting on the relevant transaction. If shares carry the power to vote in the election of directors only under a certain contingency, as is often the case with preferred stock, the shares would not carry voting power within the meaning of section 1.40(27) unless the contingency has occurred, and only during the period when the voting rights are in effect. Shares that carry the power to vote for any directors as of the time to vote on the relevant transaction have the current power to vote in the election of directors within the meaning of section 1.40(27) even if the shares do not carry the power to vote for all directors.

§ 1.41 Notice

(a) Notice under this Act must be in writing unless oral notice is reasonable under the circumstances. Notice by electronic transmission is written notice.

(b) Notice may be communicated in person; by mail or other method of delivery; or by telephone, voice mail or other electronic means. If these forms of personal notice are impracticable, notice may be communicated by a newspaper of general circulation in the area where published, or by radio, television, or other form of public broadcast communication.

(c) Written notice by a domestic or foreign corporation to its shareholder, if in a comprehensible form, is effective (i) upon deposit in the United States mail, if mailed postpaid and correctly addressed to the shareholder's address shown in the corporation's current record of shareholders, or (ii) when electronically transmitted to the shareholder in a manner authorized by the shareholder.

(d) Written notice to a domestic or foreign corporation (authorized to transact business in this state) may be addressed to its registered agent at its registered office or to the secretary of the corporation at its principal office shown in its most recent annual report or, in the case of a foreign corporation that has not yet delivered an annual report, in its application for a certificate of authority.

(e) Except as provided in subsection (c), written notice, if in a comprehensible form, is effective at the earliest of the following:

(1) when received;

(2) five days after its deposit in the United States Mail, if mailed postpaid and correctly addressed;

(3) on the date shown on the return receipt, if sent by registered or certified mail, return receipt requested, and the receipt is signed by or on behalf of the addressee.

(f) Oral notice is effective when communicated if communicated in a comprehensible manner.

(g) If this Act prescribes notice requirements for particular circumstances, those requirements govern. If articles of incorporation or bylaws prescribe notice requirements, not inconsistent with this section or other provisions of this Act, those requirements govern.

§ 1.42 Number of Shareholders

(a) For purposes of this Act, the following identified as a shareholder in a corporation's current record of shareholders constitutes one shareholder:

(1) three or fewer co-owners;

(2) a corporation, partnership, trust, estate, or other entity;

(3) the trustees, guardians, custodians, or other fiduciaries of a single trust, estate, or account.

(b) For purposes of this Act, shareholdings registered in substantially similar names constitute one shareholder if it is reasonable to believe that the names represent the same person.

§ 1.44 Householding

(a) A corporation has delivered written notice or any other report or statement under this Act, the articles of incorporation or the bylaws to all shareholders who share a common address if:

(1) The corporation delivers one copy of the notice, report or statement to the common address;

(2) The corporation addresses the notice, report or statement to those shareholders either as a group or to each of those shareholders individually or to the shareholders in a form to which each of those shareholders has consented; and

(3) Each of those shareholders consents to delivery of a single copy of such notice, report or statement to the shareholders' common address.

Any such consent shall be revocable by any of such shareholders who deliver written notice of revocation to the corporation. If such written notice of revocation is delivered, the corporation shall begin providing individual notices, reports or other statements to the revoking shareholder no later than 30 days after delivery of the written notice of revocation.

(b) Any shareholder who fails to object by written notice to the corporation, within 60 days of written notice by the corporation of its intention to send single copies of notices, reports or statements to shareholders who share a common address as permitted by subsection (a), shall be deemed to have consented to receiving such single copy at the common address.

OFFICIAL COMMENT

The proxy rules under the Securities Exchange Act of 1934 permit publicly held corporations to meet their obligation to deliver proxy statements and annual reports to shareholders who share a common address by delivery of a single copy of such materials to the common address under certain conditions. See 17 C.F.R. § 240.14a–3(e). This practice is known as ''householding.'' This section permits a corporation comparable flexibility to household the written notice of shareholder meetings as well as any other written notices, reports or statements required to be delivered to shareholders under the Act, the corporation's articles of incorporation or the corporation's bylaws. Ability to household such notices, reports or statements would not, of course, eliminate the practical necessity of delivering to a common address sufficient copies of any accompanying document requiring individual shareholder signature or other action, such as a proxy card or consent.

In order to meet the conditions of subsection (a), the written notice, report or statement must be delivered to the common address. Address means a street address, a post office box number, an electronic mail address, a facsimile telephone number or another similar destination to which paper or electronic transmission may be sent. The written notice, report or statement must also be addressed to the shareholders who share that address either as a group (e.g., ''ABC Corporation Shareholders,'' ''Jane Doe and Household,'' or ''the Smith Family'') or to each of the shareholders individually (e.g., ''John Doe and Richard Jones''). Such shareholders must consent specifically to being addressed in any other way than as a group or individually Finally, each shareholder at the common address must have consented to household delivery either affirmatively or implicitly by failure to object to the notice by the corporation permitted in subsection (b). Affirmative consent may be by any reasonable means of written or oral communication to the corporation or its agent. Implicit consent may only be given by means of the notice permitted in subsection (b).

Whether consent is explicit or implicit, it is revocable at any time by a shareholder by written notice delivered to the corporation. If such written notice of revocation is delivered, the corporation shall provide individual notices, reports or other statements to the revoking shareholder beginning no later than 30 days after delivery of the written revocation to the corporation.

In order to be effective, the written notice of intention to household notices, reports or other statements permitted by subsection (b) must explain that affirmative or implied consent may be revoked and the method for revoking.

CHAPTER 2. INCORPORATION

§ 2.01 Incorporators

One or more persons may act as the incorporator or incorporators of a corporation by delivering articles of incorporation to the secretary of state for filing.

§ 2.02 Articles of Incorporation

(a) The articles of incorporation must set forth:

(1) a corporate name for the corporation that satisfies the requirements of section 4.01;

(2) the number of shares the corporation is authorized to issue;

(3) the street address of the corporation's initial registered office and the name of its initial registered agent at that office; and

(4) the name and address of each incorporator.

(b) The articles of incorporation may set forth:

(1) the names and addresses of the individuals who are to serve as the initial directors;

(2) provisions not inconsistent with law regarding:

(i) the purpose or purposes for which the corporation is organized;

(ii) managing the business and regulating the affairs of the corporation;

(iii) defining, limiting, and regulating the powers of the corporation, its board of directors, and shareholders;

(iv) a par value for authorized shares or classes of shares;

(v) the imposition of personal liability on shareholders for the debts of the corporation to a specified extent and upon specified conditions;

(3) any provision that under this Act is required or permitted to be set forth in the bylaws;

(4) a provision eliminating or limiting the liability of a director to the corporation or its shareholders for money damages for any action taken, or any failure to take any action, as a director, except liability for (A) the amount of a financial benefit received by a director to which he is not entitled; (B) an intentional infliction of harm on the corporation or the shareholders; (C) a violation of section 8.33; or (D) an intentional violation of criminal law; and

(5) a provision permitting or making obligatory indemnification of a director for liability (as defined in section 8.50(5)) to any person

for any action taken, or any failure to take any action, as a director except liability for (A) receipt of a financial benefit to which he is not entitled, (B) an intentional infliction of harm on the corporation or its shareholders, (C) a violation of section 8.33, or (D) an intentional violation of criminal law.

(c) The articles of incorporation need not set forth any of the corporate powers enumerated in this Act.

(d) Provisions of the articles of incorporation may be made dependent upon facts objectively ascertainable outside the articles of incorporation in accordance with section 1.20(k).

§ 2.03 Incorporation

(a) Unless a delayed effective date is specified, the corporate existence begins when the articles of incorporation are filed.

(b) The secretary of state's filing of the articles of incorporation is conclusive proof that the incorporators satisfied all conditions precedent to incorporation except in a proceeding by the state to cancel or revoke the incorporation or involuntarily dissolve the corporation.

§ 2.04 Liability for Preincorporation Transactions

All persons purporting to act as or on behalf of a corporation, knowing there was no incorporation under this Act, are jointly and severally liable for all liabilities created while so acting.

OFFICIAL COMMENT

Earlier versions of the Model Act, and the statutes of many states, have long provided that corporate existence begins only with the acceptance of articles of incorporation by the secretary of state. Many states also have statutes that provide expressly that those who prematurely act as or on behalf of a corporation are personally liable on all transactions entered into or liabilities incurred before incorporation. A review of recent case law indicates, however, that even in states with such statutes courts have continued to rely on common law concepts of de facto corporations, de jure corporations, and corporations by estoppel that provide uncertain protection against liability for preincorporation transactions. These cases caused a review of the underlying policies represented in earlier versions of the Model Act and the adoption of a slightly more flexible or relaxed standard.

Incorporation under modern statutes is so simple and inexpensive that a strong argument may be made that nothing short of filing articles of incorporation should create the privilege of limited liability. A number of situations have arisen, however, in which the protection of limited liability arguably should be recognized even though the simple incorporation process established by modern statutes has not been completed.

(1) The strongest factual pattern for immunizing participants from personal liability occurs in cases in which the participant honestly and

reasonably but erroneously believed the articles had been filed. In Cranson v. International Business Machines Corp., 234 Md. 477, 200 A.2d 33 (1964), for example, the defendant had been shown executed articles of incorporation some months earlier before he invested in the corporation and became an officer and director. He was also told by the corporation's attorney that the articles had been filed, but in fact they had not been filed because of a mix-up in the attorney's office. The defendant was held not liable on the "corporate" obligation.

(2) Another class of cases, which is less compelling but in which the participants sometimes have escaped personal liability, involves the defendant who mails in articles of incorporation and then enters into a transaction in the corporate name; the letter is either delayed or the secretary of state's office refuses to file the articles after receiving them or returns them for correction. E.g., Cantor v. Sunshine Greenery, Inc., 165 N.J.Super. 411, 398 A.2d 571 (1979). Many state filing agencies adopt the practice of treating the date of receipt as the date of issuance of the certificate even though delays and the review process may result in the certificate being backdated. The finding of nonliability in cases of this second type can be considered an extension of this principle by treating the date of original mailing or original filing as the date of incorporation.

(3) A third class of cases in which the participants sometimes have escaped personal liability involves situations where the third person has urged immediate execution of the contract in the corporate name even though he knows that the other party has not taken any steps toward incorporating. E.g., Quaker Hill v. Parr, 148 Colo. 45, 364 P.2d 1056 (1961).

(4) In another class of cases the defendant has represented that a corporation exists and entered into a contract in the corporate name when he knows that no corporation has been formed, either because no attempt has been made to file articles of incorporation or because he has already received rejected articles of incorporation from the filing agency. In these cases, the third person has dealt solely with the "corporation" and has not relied on the personal assets of the defendant. The imposition of personal liability in this class of cases, it has sometimes been argued, gives the plaintiff more than he originally bargained for. On the other hand, to recognize limited liability in this situation threatens to undermine the incorporation process, since one then may obtain limited liability by consistently conducting business in the corporate name. Most courts have imposed personal liability in this situation. E.g., Robertson v. Levy, 197 A.2d 443 (D.C.App.1964).

(5) A final class of cases involves inactive investors who provide funds to a promoter with the instruction, "Don't start doing business until you incorporate." After the promoter does start business without incorporating, attempts have been made, sometimes unsuccessfully, to hold the investors liable as partners. E.g., Frontier Refining Co. v. Kunkels, Inc., 407 P.2d 880 (Wyo.1965). One case held that the language of section 146 of the 1969 Model Act ["*persons who assume to act* as a corporation are liable for preincorporation transactions"] creates a distinction between active and inactive participants, makes only the former liable as partners, and therefore relieves the latter of personal liability. Nevertheless, "active" participation

was defined to include all investors who actively participate in the policy and operational decisions of the organization and is, therefore, a larger group than merely the persons who incurred the obligation in question on behalf of the "corporation." Timberline Equipment Co. v. Davenport, 267 Or. 64, 72–76, 514 P.2d 1109, 1113–14 (1973).

After a review of these situations, it seemed appropriate to impose liability only on persons who act as or on behalf of corporations "knowing" that no corporation exists. Analogous protection has long been accorded under the uniform limited partnership acts to limited partners who contribute capital to a partnership in the erroneous belief that a limited partnership certificate has been filed. Uniform Limited Partnership Act § 12 (1916); Revised Uniform Limited Partnership Act § 3.04 (1976). Persons protected under § 3.04 of the latter are persons who "erroneously but in good faith" believe that a limited partnership certificate has been filed. The language of section 2.04 has essentially the same meaning.

While no special provision is made in section 2.04, the section does not foreclose the possibility that persons who urge defendants to execute contracts in the corporate name knowing that no steps to incorporate have been taken may be estopped to impose personal liability on individual defendants. This estoppel may be based on the inequity perceived when persons, unwilling or reluctant to enter into a commitment under their own name, are persuaded to use the name of a nonexistent corporation, and then are sought to be held personally liable under section 2.04 by the party advocating that form of execution. By contrast, persons who knowingly participate in a business under a corporate name are jointly and severally liable on "corporate" obligations under section 2.04 and may not argue that plaintiffs are "estopped" from holding them personally liable because all transactions were conducted on a corporate basis.

§ 2.05 Organization of Corporation

(a) After incorporation:

(1) if initial directors are named in the articles of incorporation, the initial directors shall hold an organizational meeting, at the call of a majority of the directors, to complete the organization of the corporation by appointing officers, adopting bylaws, and carrying on any other business brought before the meeting;

(2) if initial directors are not named in the articles, the incorporator or incorporators shall hold an organizational meeting at the call of a majority of the incorporators:

(i) to elect directors and complete the organization of the corporation; or

(ii) to elect a board of directors who shall complete the organization of the corporation.

(b) Action required or permitted by this Act to be taken by incorporators at an organizational meeting may be taken without a meeting if the action taken is evidenced by one or more written consents describing the action taken and signed by each incorporator.

(c) An organizational meeting may be held in or out of this state.

§ 2.06 Bylaws

(a) The incorporators or board of directors of a corporation shall adopt initial bylaws for the corporation.

(b) The bylaws of a corporation may contain any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with law or the articles of incorporation.

§ 2.07 Emergency Bylaws

(a) Unless the articles of incorporation provide otherwise, the board of directors of a corporation may adopt bylaws to be effective only in an emergency defined in subsection (d). The emergency bylaws, which are subject to amendment or repeal by the shareholders, may make all provisions necessary for managing the corporation during the emergency, including:

(1) procedures for calling a meeting of the board of directors;

(2) quorum requirements for the meeting; and

(3) designation of additional or substitute directors.

(b) All provisions of the regular bylaws consistent with the emergency bylaws remain effective during the emergency. The emergency bylaws are not effective after the emergency ends.

(c) Corporate action taken in good faith in accordance with the emergency bylaws:

(1) binds the corporation; and

(2) may not be used to impose liability on a corporate director, officer, employee, or agent.

(d) An emergency exists for purposes of this section if a quorum of the corporation's directors cannot readily be assembled because of some catastrophic event.

CHAPTER 3. PURPOSES AND POWERS

§ 3.01 Purposes

(a) Every corporation incorporated under this Act has the purpose of engaging in any lawful business unless a more limited purpose is set forth in the articles of incorporation.

(b) A corporation engaging in a business that is subject to regulation under another statute of this state may incorporate under this Act only if permitted by, and subject to all limitations of, the other statute.

§ 3.02 General Powers

Unless its articles of incorporation provide otherwise, every corporation has perpetual duration and succession in its corporate name and has the same powers as an individual to do all things necessary or convenient to carry out its business and affairs, including without limitation power:

(1) to sue and be sued, complain and defend in its corporate name;

(2) to have a corporate seal, which may be altered at will, and to use it, or a facsimile of it, by impressing or affixing it or in any other manner reproducing it;

(3) to make and amend bylaws, not inconsistent with its articles of incorporation or with the laws of this state, for managing the business and regulating the affairs of the corporation;

(4) to purchase, receive, lease, or otherwise acquire, and own, hold, improve, use, and otherwise deal with, real or personal property, or any legal or equitable interest in property, wherever located;

(5) to sell, convey, mortgage, pledge, lease, exchange, and otherwise dispose of all or any part of its property;

(6) to purchase, receive, subscribe for, or otherwise acquire; own, hold, vote, use, sell, mortgage, lend, pledge, or otherwise dispose of; and deal in and with shares or other interests in, or obligations of, any other entity;

(7) to make contracts and guarantees, incur liabilities, borrow money, issue its notes, bonds, and other obligations, (which may be convertible into or include the option to purchase other securities of the corporation), and secure any of its obligations by mortgage or pledge of any of its property, franchises, or income;

(8) to lend money, invest and reinvest its funds, and receive and hold real and personal property as security for repayment;

(9) to be a promoter, partner, member, associate, or manager of any partnership, joint venture, trust, or other entity;

(10) to conduct its business, locate offices, and exercise the powers granted by this Act within or without this state;

(11) to elect directors and appoint officers, employees, and agents of the corporation, define their duties, fix their compensation, and lend them money and credit;

(12) to pay pensions and establish pension plans, pension trusts, profit sharing plans, share bonus plans, share option plans, and benefit or incentive plans for any or all of its current or former directors, officers, employees, and agents;

(13) to make donations for the public welfare or for charitable, scientific, or educational purposes;

(14) to transact any lawful business that will aid governmental policy;

(15) to make payments or donations, or do any other act, not inconsistent with law, that furthers the business and affairs of the corporation.

§ 3.03 Emergency Powers

(a) In anticipation of or during an emergency defined in subsection (d), the board of directors of a corporation may:

(1) modify lines of succession to accommodate the incapacity of any director, officer, employee, or agent; and

(2) relocate the principal office, designate alternative principal offices or regional offices, or authorize the officers to do so.

(b) During an emergency defined in subsection (d), unless emergency bylaws provide otherwise:

(1) notice of a meeting of the board of directors need be given only to those directors whom it is practicable to reach and may be given in any practicable manner, including by publication and radio; and

(2) one or more officers of the corporation present at a meeting of the board of directors may be deemed to be directors for the meeting, in order of rank and within the same rank in order of seniority, as necessary to achieve a quorum.

(c) Corporate action taken in good faith during an emergency under this section to further the ordinary business affairs of the corporation:

(1) binds the corporation; and

(2) may not be used to impose liability on a corporate director, officer, employee, or agent.

(d) An emergency exists for purposes of this section if a quorum of the corporation's directors cannot readily be assembled because of some catastrophic event.

§ 3.04 Ultra Vires

(a) Except as provided in subsection (b), the validity of corporate action may not be challenged on the ground that the corporation lacks or lacked power to act.

(b) A corporation's power to act may be challenged:

(1) in a proceeding by a shareholder against the corporation to enjoin the act;

(2) in a proceeding by the corporation, directly, derivatively, or through a receiver, trustee, or other legal representative, against an incumbent or former director, officer, employee, or agent of the corporation; or

(3) in a proceeding by the Attorney General under section 14.30.

(c) In a shareholder's proceeding under subsection (b)(1) to enjoin an unauthorized corporate act, the court may enjoin or set aside the act, if equitable and if all affected persons are parties to the proceeding, and may award damages for loss (other than anticipated profits) suffered by the corporation or another party because of enjoining the unauthorized act.

CHAPTER 4. NAME

§ 4.01 Corporate Name

(a) A corporate name:

(1) must contain the word "corporation," "incorporated," "company," or "limited," or the abbreviation "corp.," "inc.," "co.," or "ltd.", or words or abbreviations of like import in another language; and

(2) may not contain language stating or implying that the corporation is organized for a purpose other than that permitted by section 3.01 and its articles of incorporation.

(b) Except as authorized by subsections (c) and (d), a corporate name must be distinguishable upon the records of the secretary of state from:

(1) the corporate name of a corporation incorporated or authorized to transact business in this state;

(2) a corporate name reserved or registered under section 4.02 or 4.03;

(3) the fictitious name adopted by a foreign corporation authorized to transact business in this state because its real name is unavailable; and

(4) the corporate name of a not-for-profit corporation incorporated or authorized to transact business in this state.

(c) A corporation may apply to the secretary of state for authorization to use a name that is not distinguishable upon his records from one or more of the names described in subsection (b). The secretary of state shall authorize use of the name applied for if:

(1) the other corporation consents to the use in writing and submits an undertaking in form satisfactory to the secretary of state

to change its name to a name that is distinguishable upon the records of the secretary of state from the name of the applying corporation; or

(2) the applicant delivers to the secretary of state a certified copy of the final judgment of a court of competent jurisdiction establishing the applicant's right to use the name applied for in this state.

(d) A corporation may use the name (including the fictitious name) of another domestic or foreign corporation that is used in this state if the other corporation is incorporated or authorized to transact business in this state and the proposed user corporation:

(1) has merged with the other corporation;

(2) has been formed by reorganization of the other corporation; or

(3) has acquired all or substantially all of the assets, including the corporate name, of the other corporation.

(e) This Act does not control the use of fictitious names.

§ 4.02 Reserved Name

(a) A person may reserve the exclusive use of a corporate name, including a fictitious name for a foreign corporation whose corporate name is not available, by delivering an application to the secretary of state for filing. The application must set forth the name and address of the applicant and the name proposed to be reserved. If the secretary of state finds that the corporate name applied for is available, he shall reserve the name for the applicant's exclusive use for a nonrenewable 120–day period.

(b) The owner of a reserved corporate name may transfer the reservation to another person by delivering to the secretary of state a signed notice of the transfer that states the name and address of the transferee.

§ 4.03 Registered Name

(a) A foreign corporation may register its corporate name, or its corporate name with any addition required by section 15.06, if the name is distinguishable upon the records of the secretary of state from the corporate names that are not available under section 4.01(b).

(b) A foreign corporation registers its corporate name, or its corporate name with any addition required by section 15.06, by delivering to the secretary of state for filing an application:

(1) setting forth its corporate name, or its corporate name with any addition required by section 15.06, the state or country and date

of its incorporation, and a brief description of the nature of the business in which it is engaged; and

(2) accompanied by a certificate of existence (or a document of similar import) from the state or country of incorporation.

(c) The name is registered for the applicant's exclusive use upon the effective date of the application.

(d) A foreign corporation whose registration is effective may renew it for successive years by delivering to the secretary of state for filing a renewal application, which complies with the requirements of subsection (b), between October 1 and December 31 of the preceding year. The renewal application renews the registration for the following calendar year.

(e) A foreign corporation whose registration is effective may thereafter qualify as a foreign corporation under the registered name or consent in writing to the use of that name by a corporation thereafter incorporated under this Act or by another foreign corporation thereafter authorized to transact business in this state. The registration terminates when the domestic corporation is incorporated or the foreign corporation qualifies or consents to the qualification of another foreign corporation under the registered name.

CHAPTER 5. OFFICE AND AGENT

§ 5.01 Registered Office and Registered Agent

Each corporation must continuously maintain in this state:

(1) a registered office that may be the same as any of its places of business; and

(2) a registered agent, who may be:

(i) an individual who resides in this state and whose business office is identical with the registered office;

(ii) a domestic corporation or not-for-profit domestic corporation whose business office is identical with the registered office; or

(iii) a foreign corporation or not-for-profit foreign corporation authorized to transact business in this state whose business office is identical with the registered office.

§ 5.02 Change of Registered Office or Registered Agent

(a) A corporation may change its registered office or registered agent by delivering to the secretary of state for filing a statement of change that sets forth:

(1) the name of the corporation,

(2) the street address of its current registered office;

(3) if the current registered office is to be changed, the street address of the new registered office;

(4) the name of its current registered agent;

(5) if the current registered agent is to be changed, the name of the new registered agent and the new agent's written consent (either on the statement or attached to it) to the appointment; and

(6) that after the change or changes are made, the street addresses of its registered office and the business office of its registered agent will be identical.

(b) If a registered agent changes the street address of his business office, he may change the street address of the registered office of any corporation for which he is the registered agent by notifying the corporation in writing of the change and signing (either manually or in facsimile) and delivering to the secretary of state for filing a statement that complies with the requirements of subsection (a) and recites that the corporation has been notified of the change.

§ 5.03 Resignation of Registered Agent

(a) A registered agent may resign his agency appointment by signing and delivering to the secretary of state for filing the signed original and two exact or conformed copies of a statement of resignation. The statement may include a statement that the registered office is also discontinued.

(b) After filing the statement the secretary of state shall mail one copy to the registered office (if not discontinued) and the other copy to the corporation at its principal office.

(c) The agency appointment is terminated, and the registered office discontinued if so provided, on the 31st day after the date on which the statement was filed.

§ 5.04 Service on Corporation

(a) A corporation's registered agent is the corporation's agent for service of process, notice, or demand required or permitted by law to be served on the corporation.

(b) If a corporation has no registered agent, or the agent cannot with reasonable diligence be served, the corporation may be served by registered or certified mail, return receipt requested, addressed to the secretary of the corporation at its principal office. Service is perfected under this subsection at the earliest of:

(1) the date the corporation receives the mail;

(2) the date shown on the return receipt, if signed on behalf of the corporation; or

(3) five days after its deposit in the United States Mail, as evidenced by the postmark, if mailed postpaid and correctly addressed.

(c) This section does not prescribe the only means, or necessarily the required means, of serving a corporation.

CHAPTER 6. SHARES AND DISTRIBUTIONS

SUBCHAPTER A. SHARES

§ 6.01 Authorized Shares

(a) The articles of incorporation must set forth any classes of shares and series of shares within a class, and the number of shares of each class and series, that the corporation is authorized to issue. If more than one class or series of shares is authorized, the articles of incorporation must prescribe a distinguishing designation for each class or series and must describe, prior to the issuance of shares of a class or series, the terms, including the preferences, rights, and limitations, of that class or series. Except to the extent varied as permitted by this section, all shares of a class or series must have terms, including preferences, rights and limitations, that are identical with those of other shares of the same class or series.

(b) The articles of incorporation must authorize:

(1) one or more classes or series of shares that together have unlimited voting rights, and

(2) one or more classes or series of shares (which may be the same class or classes as those with voting rights) that together are entitled to receive the net assets of the corporation upon dissolution.

(c) The articles of incorporation may authorize one or more classes of shares that:

(1) have special, conditional, or limited voting rights, or no right to vote, except to the extent otherwise provided by this Act;

(2) are redeemable or convertible as specified in the articles of incorporation:

(i) at the option of the corporation, the shareholder, or another person or upon the occurrence of a specified event;

(ii) for cash, indebtedness, securities, or other property; and

(iii) at prices and in amounts specified, or determined in accordance with a formula;

(3) entitle the holders to distributions calculated in any manner, including dividends that may be cumulative, noncumulative, or partially cumulative; or

(4) have preference over any other class or series of shares with respect to distributions, including distributions upon the dissolution of the corporation.

(d) Terms of shares may be made dependent upon facts objectively ascertainable outside the articles of incorporation in accordance with section 1.20(k).

(e) Any of the terms of shares may vary among holders of the same class or series so long as such variations are expressly set forth in the articles of incorporation.

(f) The description of the preferences, rights and limitations of classes or series of shares in subsection (c) is not exhaustive.

§ 6.02 Terms of Class or Series Determined by Board of Directors

(a) If the articles of incorporation so provide, the board of directors is authorized, without shareholder approval, to:

(1) classify any unissued shares into one or more classes or into one or more series within a class,

(2) reclassify any unissued shares of any class into one or more classes or into one or more series within one or more classes, or

(3) reclassify any unissued shares of any series of any class into one or more classes or into one or more series within a class.

(b) If the board of directors acts pursuant to subsection (a), it must determine the terms, including the preferences, rights and limitations, to the same extent permitted under section 6.01, of:

(1) any class of shares before the issuance of any shares of that class, or

(2) any series within a class before the issuance of any shares of that series.

(c) Before issuing any shares of a class or series created under this section, the corporation must deliver to the secretary of state for filing articles of amendment setting forth the terms determined under subsection (a).

§ 6.03 Issued and Outstanding Shares

(a) A corporation may issue the number of shares of each class or series authorized by the articles of incorporation. Shares that are issued are outstanding shares until they are reacquired, redeemed, converted, or cancelled.

(b) The reacquisition, redemption, or conversion of outstanding shares is subject to the limitations of subsection (c) of this section and to section 6.40.

(c) At all times that shares of the corporation are outstanding, one or more shares that together have unlimited voting rights and one or more shares that together are entitled to receive the net assets of the corporation upon dissolution must be outstanding.

§ 6.04 Fractional Shares

(a) A corporation may:

(1) issue fractions of a share or pay in money the value of fractions of a share;

(2) arrange for disposition of fractional shares by the shareholders;

(3) issue scrip in registered or bearer form entitling the holder to receive a full share upon surrendering enough scrip to equal a full share.

(b) Each certificate representing scrip must be conspicuously labeled ''scrip'' and must contain the information required by section 6.25(b).

(c) The holder of a fractional share is entitled to exercise the rights of a shareholder, including the right to vote, to receive dividends, and to participate in the assets of the corporation upon liquidation. The holder of scrip is not entitled to any of these rights unless the scrip provides for them.

(d) The board of directors may authorize the issuance of scrip subject to any condition considered desirable, including:

(1) that the scrip will become void if not exchanged for full shares before a specified date; and

(2) that the shares for which the scrip is exchangeable may be sold and the proceeds paid to the scripholders.

SUBCHAPTER B. ISSUANCE OF SHARES

§ 6.20 Subscription for Shares Before Incorporation

(a) A subscription for shares entered into before incorporation is irrevocable for six months unless the subscription agreement provides a longer or shorter period or all the subscribers agree to revocation.

(b) The board of directors may determine the payment terms of subscriptions for shares that were entered into before incorporation, unless the subscription agreement specifies them. A call for payment by the board of directors must be uniform so far as practicable as to all shares of the same class or series, unless the subscription agreement specifies otherwise.

(c) Shares issued pursuant to subscriptions entered into before incorporation are fully paid and nonassessable when the corporation receives the consideration specified in the subscription agreement.

(d) If a subscriber defaults in payment of money or property under a subscription agreement entered into before incorporation, the corporation may collect the amount owed as any other debt. Alternatively, unless the subscription agreement provides otherwise, the corporation may rescind the agreement and may sell the shares if the debt remains unpaid more than 20 days after the corporation sends written demand for payment to the subscriber.

(e) A subscription agreement entered into after incorporation is a contract between the subscriber and the corporation subject to section 6.21.

§ 6.21 Issuance of Shares

(a) The powers granted in this section to the board of directors may be reserved to the shareholders by the articles of incorporation.

(b) The board of directors may authorize shares to be issued for consideration consisting of any tangible or intangible property or benefit to the corporation, including cash, promissory notes, services performed, contracts for services to be performed, or other securities of the corporation.

(c) Before the corporation issues shares, the board of directors must determine that the consideration received or to be received for shares to be issued is adequate. That determination by the board of directors is conclusive insofar as the adequacy of consideration for the issuance of shares relates to whether the shares are validly issued, fully paid, and nonassessable.

(d) When the corporation receives the consideration for which the board of directors authorized the issuance of shares, the shares issued therefor are fully paid and nonassessable.

(e) The corporation may place in escrow shares issued for a contract for future services or benefits or a promissory note, or make other arrangements to restrict the transfer of the shares, and may credit distributions in respect of the shares against their purchase price, until the services are performed, the note is paid, or the benefits received. If the services are not performed, the note is not paid, or the benefits are not received, the shares escrowed or restricted and the distributions credited may be cancelled in whole or part.

(f)(1) An issuance of shares or other securities convertible into or rights exercisable for shares, in a transaction or a series of integrated transactions, requires approval of the shareholders, at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the matter exists, if:

(i) the shares, other securities, or rights are issued for consideration other than cash or cash equivalents, and

(ii) the voting power of shares that are issued and issuable as a result of the transaction or series of integrated transactions will comprise more than 20 percent of the voting power of the shares of the corporation that were outstanding immediately before the transaction.

(2) In this subsection:

(i) For purposes of determining the voting power of shares issued and issuable as a result of a transaction or series of integrated transactions, the voting power of shares shall be the greater of (A) the voting power of the shares to be issued, or (B) the voting power of the shares that would be outstanding after giving effect to the conversion of convertible shares and other securities and the exercise of rights to be issued.

(ii) A series of transactions is integrated if consummation of one transaction is made contingent on consummation of one or more of the other transactions.

OFFICIAL COMMENT

The financial provisions of the Model Act reflect a modernization of the concepts underlying the capital structure and limitations on distributions of corporations. This process of modernization began with amendments in 1980 to the 1969 Model Act that eliminated the concepts of ''par value'' and ''stated capital,'' and further modernization occurred in connection with the development of the revised Act in 1984. Practitioners and legal scholars have long recognized that the statutory structure embodying ''par value'' and ''legal capital'' concepts is not only complex and confusing but also fails to serve the original purpose of protecting creditors and senior security holders from payments to junior security holders. Indeed, to the extent security holders are led to believe that it provides this protection, these provisions may be affirmatively misleading. The Model Act has therefore eliminated these concepts entirely and substituted a simpler and more flexible structure that provides more realistic protection to these interests. Major aspects of this new structure are:

(1) the provisions relating to the issuance of shares set forth in this and the following sections;

(2) the provisions limiting distributions by corporations set forth in section 6.40 and discussed in the Official Comment to that section; and

(3) the elimination of the concept of treasury shares described in the Official Comment to section 6.31.

Section 6.21 incorporates not only the elimination of the concepts of par value and stated capital from the Model Act in 1980 but also eliminates the earlier rule declaring certain kinds of property ineligible as consideration for shares. The caption of the section, ''Issuance of Shares by the Board of Directors,'' reflects the change in emphasis from imposing restrictions on the issuance of shares to establishing general principles for their issuance. The section replaces two sections captioned, respectively, ''Consideration for Shares'' (section 18) and ''Payment for Shares'' (section 19) in the 1969 Model Act.

1. Consideration

Since shares need not have a par value, under section 6.21 there is no minimum price at which specific shares must be issued and therefore there can be no ''watered stock'' liability for issuing shares below an arbitrarily fixed price. The price at which shares are issued is primarily a matter of concern to other shareholders whose interests may be diluted if shares are issued at unreasonably low prices or for overvalued property. This problem of equality of treatment essentially involves honest and fair judgments by directors and cannot be effectively addressed by an arbitrary doctrine establishing a minimum price for shares such as ''par value'' provided under older statutes.

Section 6.21(b) specifically validates contracts for future services (including promoters' services), promissory notes, or ''any tangible or intangible property or benefit to the corporation,'' as consideration for the present issue of shares. The term ''benefit'' should be broadly construed to include, for example, a reduction of a liability, a release of a claim, or benefits obtained by a corporation by contribution of its shares to a charitable organization or as a prize in a promotion. In the realities of commercial life, there is sometimes a need for the issuance of shares for contract rights or such intangible property or benefits. And, as a matter of business economics, contracts for future services, promissory notes, and intangible property or benefits often have value that is as real as the value of tangible property or past services, the only types of property that many older statutes permit as consideration for shares. Thus, only business judgment should determine what kind of property should be obtained for shares, and a determination by the directors meeting the requirements of section 8.30 to accept a specific kind of valuable property for shares should be accepted and not circumscribed by artificial or arbitrary rules.

2. Board Determination of Adequacy

The issuance of some shares for cash and other shares for promissory notes, contracts for past or future services, or for tangible or intangible property or benefits, like the issuance of shares for an inadequate consideration, opens the possibility of dilution of the interests of other shareholders. For example, persons acquiring shares for cash may be unfairly treated if optimistic values are placed on past or future services or intangible benefits being provided by other persons. The problem is particularly acute if the persons providing services, promissory notes, or property or benefits of debatable value are themselves connected with the promoters of the corporation or with its directors. Protection of shareholders against abuse of the power granted to the board of directors to determine that shares should be issued for intangible property or benefits is provided in part by the requirement that the board must act in accordance with the requirements of section 8.30, and, if applicable, section 8.31, in determining that the consideration received for shares is adequate, and in part by the requirement of section 16.21 that the corporation must inform all shareholders annually of all shares issued during the previous year for promissory notes or promises of future services.

Accounting principles are not specified in the Model Act, and the board of directors is not required by the statute to determine the ''value'' of noncash consideration received by the corporation (as was the case in earlier versions of the Model Act). In many instances, property or benefit received by the corporation will be of uncertain value; if the board of directors determines that the issuance of shares for the property or benefit is an appropriate transaction that protects the shareholders from dilution, that is sufficient under section 6.21. The board of directors does not have to make an explicit ''adequacy'' determination by formal resolution; that determination may be inferred from a determination to authorize the issuance of shares for a specified consideration.

Section 6.21 also does not require that the board of directors determine the value of the consideration to be entered on the books of the corporation, though the board of directors may do so if it wishes. Of course, a specific value must be placed on the consideration received for the shares for bookkeeping purposes, but bookkeeping details are not the statutory responsibility of the board of directors. The statute also does not require the board of directors to determine the corresponding entry on the right-hand side of the balance sheet under owner's equity to be designated as ''stated capital'' or be allocated among ''stated capital'' and other surplus accounts. The corporation, however, may determine that the shareholders' equity accounts should be divided into these traditional categories if it wishes.

The second sentence of section 6.21(c) describes the effect of the determination by the board of directors that consideration is adequate for the issuance of shares. That determination, without more, is conclusive to the extent that adequacy is relevant to the question whether the shares are validly issued, fully paid, and nonassessable. Section 6.21(d) provides that shares are fully paid and nonassessable when the corporation receives the consideration for which the board of directors authorized their issuance. Whether shares are validly issued may depend on compliance with corporate procedural requirements, such as issuance within the amount authorized in the articles of incorporation or holding a directors' meeting upon proper notice and with a quorum present. The Model Act does not address the remedies that may be available for issuances that are subject to challenge. This somewhat more elaborate clause replaces the provision in earlier versions of the Model Act and many state statutes that the determination by the board of directors of consideration for the issuance of shares was ''conclusive in the absence of fraud in the transaction.''

Shares issued pursuant to preincorporation subscriptions are governed by section 6.20 and not this section.

The revised Model Act does not address the question whether validly issued shares may thereafter be cancelled on the grounds of fraud or bad faith if the shares are in the hands of the original shareholder or other persons who were aware of the circumstances under which they were issued when they acquired the shares. It also leaves to the Uniform Commercial Code other questions relating to the rights of persons other than the person acquiring the shares from the corporation. See the Official Comment to section 6.22.

Section 6.21(e) permits the board of directors to determine that shares issued for promissory notes or for contracts for future services or benefits be placed in escrow or their transfer otherwise restricted until the services are performed, the benefits received, or the notes are paid. The section also defines the rights of the corporation with respect to these shares. If the shares are issued without being restricted as provided in this subsection, they are validly issued insofar as the adequacy of consideration is concerned. See section 6.22 and its Official Comment.

Section 6.21(a) provides that the powers granted to the board of directors by this section may be reserved to the shareholders by the articles of incorporation. No negative inference should be drawn from section 6.21(a) with respect to the efficacy of similar provisions under other sections of the Model Act.

3. Shareholder Approval Requirement for Certain Issuances

Section 6.21(f) provides that an issuance of shares or other securities convertible into or rights exercisable for shares, in a transaction or a series of integrated transactions, for consideration other than cash or cash equivalents, requires shareholder approval if either the voting power of the shares to be issued, or the voting power of the shares into which those shares and other securities are convertible and for which any rights to be issued are exercisable, will comprise more than 20 percent of the voting power outstanding immediately before the issuance. Section 6.21(f) is generally patterned on New York Stock Exchange Listed Company Manual Rule 312.03, American Stock Exchange Company Guide Rule 712(b), and NASDAQ Stock Market Rule 4310(c)(25)(H)(i). The calculation of the 20 percent compares the maximum number of votes entitled to be cast by the shares to be issued or that could be outstanding after giving effect to the conversion of convertible securities and the exercise of rights being issued, with the actual number of votes entitled to be cast by outstanding shares before the transaction. The test tends to be conservative: The calculation of one part of the equation, voting power outstanding immediately before the transaction, is based on actual voting power of the shares then outstanding, without giving effect to the possible conversion of existing convertible shares and securities and the exercise of existing rights. In contrast, the calculation of the other part of the equation voting power that is or may be outstanding as a result of the issuance takes into account the possible future conversion of shares and securities and the exercise of rights to be issued as part of the transaction.

In making the 20 percent determination under this subsection, shares that are issuable in a business combination of any kind, including a merger, share exchange, acquisition of assets, or otherwise, on a contingent basis are counted as shares or securities to be issued as a result of the transaction. On the other hand, shares that are issuable under antidilution clauses, such as those designed to take account of future share splits or share dividends, are not counted as shares or securities to be issued as a result of the transaction, because they are issuable only as a result of a later corporate action authorizing the split or dividend. If a transaction involves an earnout provision, under which the total amount of shares or securities to be issued will depend on future earnings or other performance measures, the maximum amount of shares or securities that can be issued under the earnout shall be included in the determination.

If the number of shares to be issued or issuable is not fixed, but is subject to a formula, the application of the test in section 6.21(f)(2)(i) requires a calculation of the maximum amount that could be issued under the formula, whether stated as a range or otherwise, in the governing agreement. Even if ultimate issuance of the maximum amount is unlikely, a vote will be required if the maximum amount would result in an issuance of more than 20 percent of the voting power of shares outstanding immediately before the transaction.

Shares that have or would have only contingent voting rights when issued or issuable are not shares that carry voting power for purposes of the calculation under section 6.21(f).

The vote required to approve issuances that fall within section 6.21(f) is the basic voting rule under the Act, set forth in section 7.25, that more shares must be voted in favor of the issuance than are voted against. This is the same voting rule that applies under chapter 10 for amendments of the articles of incorporation, under chapter 11 for mergers and share exchanges, under chapter 12 for a disposition of assets that requires shareholder approval, and under chapter 14 for voluntary dissolution. The quorum rule under section 6.21(f) is also the same as the quorum rule under chapters 10, 11, 12, and 14: there must be present at the meeting at least a majority of the votes entitled to be cast on the matter.

Section 6.21(f) does not apply to an issuance for cash or cash equivalents, whether or not in connection with a public offering. ''Cash equivalents,'' within the meaning of section 6.21(f), are short-term investments that are both readily convertible to known amounts of cash and present insignificant risk of changes in interest rates. Generally, only investments with original maturities of three months or less or investments that are highly liquid and can be cashed in at any time on short notice could qualify under these definitions. Examples of cash equivalents are types of Treasury Bills, investment grade commercial paper, and moneymarket funds. Shares that are issued partly for cash or cash equivalents and partly for other consideration are ''issued for consideration other than cash or cash equivalents'' within the meaning of section 6.21(f).

The term ''rights'' in section 6.21(f) includes warrants, options, and rights of exchange, whether at the option of the holder, the corporation, or another person. The term ''voting power'' is defined in section 1.40(27) as the current power to vote in the election of directors. See also the Comment to that subsection. Transactions are integrated within the meaning of section 6.21(f) where consummation of one transaction is made contingent on consummation of one or more of the other transactions. If this test is not satisfied, transactions are not integrated for purposes of section 6.21(f) merely because they are proximate in time or because the kind of consideration for which the corporation issues shares is similar in each transaction.

Section 6.21(f) only applies to issuances for consideration. Accordingly, like the Stock Exchange and NASDAQ rules on which section 6.21(f) is based, section 6.21(f) does not require shareholder approval for share dividends (which includes ''splits'') or for shareholder rights plans. See section 6.23 and the official Comment thereto.

Illustrations of the application of section 6.21(f) follow:

1. C corporation, which has 2 million shares of Class A voting common stock outstanding (carrying one vote per share), proposes to issue 600,000 shares of authorized but unissued shares of Class B non-voting common stock in exchange for a business owned by D Corporation. The proposed issuance does not require shareholder approval under section 6.21(f), because the Class B shares do not carry voting power.

2. The facts being otherwise as stated in Illustration 1, C proposes to issue 600,000 additional shares of its Class A voting common stock. The proposed issuance requires shareholder approval under section 6.21(f), because the voting power carried by the shares to be issued will comprise more than 20 percent of the voting power of C's shares outstanding immediately before the issuance.

3. The facts being otherwise as stated in Illustration 1, C proposes to issue 400,000 shares of authorized but unissued voting preferred, each share of which carries one vote and is convertible into 1.5 shares of Class A voting common. The proposed issuance requires shareholder approval under section 6.21(f). Although the voting power of the preferred shares to be issued will not comprise more than 20 percent of the voting power of C's shares outstanding immediately before the issuance, the voting power of the shares issuable upon conversion of the preferred will carry more than 20 percent of such voting power.

4. The facts being otherwise as stated in Illustration 1, C proposes to issue 200,000 shares of its Class A voting common stock, and 100,000 shares of authorized but unissued nonvoting preferred stock, each share of which is convertible into 2.5 shares of C's Class A voting common stock. The proposed issuance requires shareholder approval under section 6.21(f), because the voting power of the Class A shares to be issued, after giving effect to the common stock that is issuable upon conversion of the preferred, would comprise more than 20 percent of the voting power of C's outstanding shares immediately before the issuance.

5. The facts being otherwise as stated in Illustration 4, each share of the preferred stock is convertible into 1.2 shares of the Class A voting common stock. The proposed issuance does not require shareholder approval under section 6.21(f), because neither the voting power of the shares to be issued at the outset (200,000) nor the voting power of the shares that would be outstanding after giving effect to the common issuable upon conversion of the preferred (a total of 320,000) constitutes more than 20 percent of the voting power of C's outstanding shares immediately before the issuance.

6. The facts being otherwise as stated in Illustration 1, C proposes to acquire businesses from Corporations G, H, and I, for 200,000, 300,000, and 400,000 shares of Class A voting common stock, respectively, within a short period of time. None of the transactions is conditioned on the negotiation or completion of the other transactions. The proposed issuance of voting shares does not require shareholder approval, because the three transactions are not integrated within the meaning of section 6.21(f), and none of the transactions individually involves the issuance of more than 20 percent of the voting power of C's outstanding shares immediately before each issuance.

§ 6.22 Liability of Shareholders

(a) A purchaser from a corporation of its own shares is not liable to the corporation or its creditors with respect to the shares except to pay the consideration for which the shares were authorized to be issued (section 6.21) or specified in the subscription agreement (section 6.20).

(b) Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct.

OFFICIAL COMMENT

With the elimination of the concepts of par value and watered stock in 1980, the sole obligation of a purchaser of shares from the corporation, as set forth in section 6.22(a), is to pay the consideration established by the board of directors (or the consideration specified in the subscription, in the case of preincorporation subscriptions). The consideration for the shares may consist of promissory notes, contracts for future services, or tangible or intangible property or benefits, and, if the board of directors so decide, the delivery of the notes, contracts, or accrual of the benefits constitute full payment for the shares. See the Official Comment to section 6.21. Upon the transfer to the corporation of the consideration so determined or specified, the shareholder has no further responsibility to the corporation or its creditors ''with respect to the shares,'' though the shareholder may have continuing obligations under a contract or promissory note entered into in connection with the acquisition of shares.

Section 6.22(a) deals only with the responsibility for payment by the purchaser of shares from the corporation. The revised Model Act leaves to the Uniform Commercial Code questions with respect to the rights of subsequent purchasers of shares and the power of the corporation to cancel shares if the consideration is not paid when due. See sections 8–202 and 8–301 of the Uniform Commercial Code.

Section 6.22(b) sets forth the basic rule of nonliability of shareholders for corporate acts or debts that underlies modern corporation law. Unless such liability is provided for in the articles of incorporation (see section 2.02(b)(2)(v)), shareholders are not liable for corporate obligations, though the last clause recognizes that such liability may be assumed voluntarily or by other conduct.

§ 6.23 Share Dividends

(a) Unless the articles of incorporation provide otherwise, shares may be issued pro rata and without consideration to the corporation's shareholders or to the shareholders of one or more classes or series. An issuance of shares under this subsection is a share dividend.

(b) Shares of one class or series may not be issued as a share dividend in respect of shares of another class or series unless (1) the articles of incorporation so authorize, (2) a majority of the votes entitled to be cast by the class or series to be issued approve the issue, or (3) there are no outstanding shares of the class or series to be issued.

(c) If the board of directors does not fix the record date for determining shareholders entitled to a share dividend, it is the date the board of directors authorizes the share dividend.

§ 6.24 Share Options

(a) A corporation may issue rights, options, or warrants for the purchase of shares or other securities of the corporation. The board of directors shall determine (i) the terms upon which the rights, options, or warrants are issued and (ii) the terms, including the consideration for which the shares or other securities are to be issued. The authorization by the board of directors for the corporation to issue such rights, options, or warrants constitutes authorization of the issuance of the shares or other securities for which the rights, options or warrants are exercisable.

(b) The terms and conditions of such rights, options or warrants, including those outstanding on the effective date of this section, may include, without limitation, restrictions or conditions that:

(1) preclude or limit the exercise, transfer or receipt of such rights, options or warrants by any person or persons owning or offering to acquire a specified number or percentage of the outstanding shares or other securities of the corporation or by any transferee or transferees of any such person or persons, or

(2) invalidate or void such rights, options or warrants held by any such person or persons or any such transferee or transferees.

OFFICIAL COMMENT

A specific provision authorizing the creation of rights, options and warrants appears in many state business corporation statutes. Even though corporations doubtless have the inherent power to issue these instruments, specific authorization is desirable because of the economic importance of rights, options and warrants, and because it is desirable to confirm the broad discretion of the board of directors in determining the consideration to be received by the corporation for their issuance. The creation of incentive compensation plans for directors, officers, agents, and employees is basically a matter of business judgment. This is equally true for incentive plans that involve the issuance of rights, options or warrants and for those that involve the payment of cash. In appropriate cases incentive plans may provide for exercise prices that are below the current market prices of the underlying shares or other securities.

Section 6.24(a) does not require shareholder approval of rights, options or warrants. Of course, prior shareholder approval may be sought as a discretionary matter, or required in order to comply with the rules of national securities markets (see N.Y.S.E. Listed Company Manual section 309.00), or to acquire the federal income tax benefits conditioned upon shareholder approval of such plans (see section 422(b)(1) of the Internal Revenue Code of 1986, as amended).

Under section 6.24(a), the board of directors may designate the interests issued as options, warrants, rights, or by some other name. These interests may be evidenced by certificates, contracts, letter agreements, or in other forms that are appropriate under the circumstances. Rights, options, or warrants may be issued together with or independently of the corporation's issuance and sale of its shares or other securities.

Some publicly held corporations have delegated administration of programs involving incentive compensation in the form of share rights or options to compensation committees composed of nonmanagement directors, subject to the general oversight of the board of directors.

Section 6.24(b) is intended to clarify that the issuance of rights, options, or warrants as part of a shareholder rights plan is permitted. A number of courts have addressed whether shareholder rights plans are permitted under statutes similar to prior sections 6.01, 6.02, and 6.24. These courts have not agreed on whether provisions similar in language in sections 6.01, 6.02, and 6.24 permit such plans to distinguish between holders of the same class of shares based on the identity of the holder of the shares. However, in each of the states in which a court has interpreted a statute of that state as prohibiting such shareholder rights plans, the legislature has subsequently adopted legislation validating such plans. Section 6.24(b) clarifies that such plans are permitted.

The permissible scope of shareholder rights plans may, however, be limited by the courts. For example, courts have been sensitive to plans containing provisions which the courts perceive as infringing upon the power of the board of directors.

§ 6.25 Form and Content of Certificates

(a) Shares may but need not be represented by certificates. Unless this Act or another statute expressly provides otherwise, the rights and obligations of shareholders are identical whether or not their shares are represented by certificates.

(b) At a minimum each share certificate must state on its face:

(1) the name of the issuing corporation and that it is organized under the law of this state;

(2) the name of the person to whom issued; and

(3) the number and class of shares and the designation of the series, if any, the certificate represents.

(c) If the issuing corporation is authorized to issue different classes of shares or different series within a class, the designations, relative rights, preferences, and limitations applicable to each class and the variations in rights, preferences, and limitations determined for each series (and the authority of the board of directors to determine variations for future series) must be summarized on the front or back of each certificate. Alternatively, each certificate may state conspicuously on its front or back that the corporation will furnish the shareholder this information on request in writing and without charge.

(d) Each share certificate (1) must be signed (either manually or in facsimile) by two officers designated in the bylaws or by the board of directors and (2) may bear the corporate seal or its facsimile.

(e) If the person who signed (either manually or in facsimile) a share certificate no longer holds office when the certificate is issued, the certificate is nevertheless valid.

§ 6.26 Shares Without Certificates

(a) Unless the articles of incorporation or bylaws provide otherwise, the board of directors of a corporation may authorize the issue of some or all of the shares of any or all of its classes or series without certificates. The authorization does not affect shares already represented by certificates until they are surrendered to the corporation.

(b) Within a reasonable time after the issue or transfer of shares without certificates, the corporation shall send the shareholder a written statement of the information required on certificates by section 6.25(b) and (c), and, if applicable, section 6.27.

§ 6.27 Restriction on Transfer of Shares and Other Securities

(a) The articles of incorporation, bylaws, an agreement among shareholders, or an agreement between shareholders and the corporation may impose restrictions on the transfer or registration of transfer of shares of the corporation. A restriction does not affect shares issued before the restriction was adopted unless the holders of the shares are parties to the restriction agreement or voted in favor of the restriction.

(b) A restriction on the transfer or registration of transfer of shares is valid and enforceable against the holder or a transferee of the holder if the restriction is authorized by this section and its existence is noted conspicuously on the front or back of the certificate or is contained in the information statement required by section 6.26(b). Unless so noted, a restriction is not enforceable against a person without knowledge of the restriction.

(c) A restriction on the transfer or registration of transfer of shares is authorized:

(1) to maintain the corporation's status when it is dependent on the number or identity of its shareholders;

(2) to preserve exemptions under federal or state securities law;

(3) for any other reasonable purpose.

(d) A restriction on the transfer or registration of transfer of shares may:

(1) obligate the shareholder first to offer the corporation or other persons (separately, consecutively, or simultaneously) an opportunity to acquire the restricted shares;

(2) obligate the corporation or other persons (separately, consecutively, or simultaneously) to acquire the restricted shares;

(3) require the corporation, the holders of any class of its shares, or another person to approve the transfer of the restricted shares, if the requirement is not manifestly unreasonable;

(4) prohibit the transfer of the restricted shares to designated persons or classes of persons, if the prohibition is not manifestly unreasonable.

(e) For purposes of this section, ''shares'' includes a security convertible into or carrying a right to subscribe for or acquire shares.

§ 6.28 Expense of Issue

A corporation may pay the expenses of selling or underwriting its shares, and of organizing or reorganizing the corporation, from the consideration received for shares.

SUBCHAPTER C. SUBSEQUENT ACQUISITION OF SHARES BY SHAREHOLDERS AND CORPORATION

§ 6.30 Shareholders' Preemptive Rights

(a) The shareholders of a corporation do not have a preemptive right to acquire the corporation's unissued shares except to the extent the articles of incorporation so provide.

(b) A statement included in the articles of incorporation that "the corporation elects to have preemptive rights" (or words of similar import) means that the following principles apply except to the extent the articles of incorporation expressly provide otherwise:

(1) The shareholders of the corporation have a preemptive right, granted on uniform terms and conditions prescribed by the board of directors to provide a fair and reasonable opportunity to exercise the right, to acquire proportional amounts of the corporation's unissued shares upon the decision of the board of directors to issue them.

(2) A shareholder may waive his preemptive right. A waiver evidenced by a writing is irrevocable even though it is not supported by consideration.

(3) There is no preemptive right with respect to:

(i) shares issued as compensation to directors, officers, agents, or employees of the corporation, its subsidiaries or affiliates;

(ii) shares issued to satisfy conversion or option rights created to provide compensation to directors, officers, agents, or employees of the corporation, its subsidiaries or affiliates;

(iii) shares authorized in articles of incorporation that are issued within six months from the effective date of incorporation;

(iv) shares sold otherwise than for money.

(4) Holders of shares of any class without general voting rights but with preferential rights to distributions or assets have no preemptive rights with respect to shares of any class.

(5) Holders of shares of any class with general voting rights but without preferential rights to distributions or assets have no preemptive rights with respect to shares of any class with preferential rights to distributions or assets unless the shares with preferen-

tial rights are convertible into or carry a right to subscribe for or acquire shares without preferential rights.

(6) Shares subject to preemptive rights that are not acquired by shareholders may be issued to any person for a period of one year after being offered to shareholders at a consideration set by the board of directors that is not lower than the consideration set for the exercise of preemptive rights. An offer at a lower consideration or after the expiration of one year is subject to the shareholders' preemptive rights.

(c) For purposes of this section, ''shares'' includes a security convertible into or carrying a right to subscribe for or acquire shares.

§ 6.31 Corporation's Acquisition of Its Own Shares

(a) A corporation may acquire its own shares, and shares so acquired constitute authorized but unissued shares.

(b) If the articles of incorporation prohibit the reissue of the acquired shares, the number of authorized shares is reduced by the number of shares acquired.

OFFICIAL COMMENT

Section 6.31 applies only to shares that a corporation acquires for its own account. Shares that a corporation acquires in a fiduciary capacity for the account of others are not considered to be acquired by the corporation for purposes of this section.

Shares that are reacquired by the corporation become authorized but unissued shares under section 6.31(a) unless the articles prohibit reissue, in which event the shares are canceled and the number of authorized shares is reduced as required by section 6.31(b).

If the number of authorized shares of a class is reduced as a result of the operation of section 6.31(b), the board should amend the articles of incorporation under section 10.05(6) to reflect that reduction. If there are no remaining authorized shares in a class as a result of the operation of section 6.31, the board should amend the articles of incorporation under section 10.05(7) to delete the class from the classes of shares authorized by articles of incorporation.

SUBCHAPTER D. DISTRIBUTIONS

§ 6.40 Distributions to Shareholders

(a) A board of directors may authorize and the corporation may make distributions to its shareholders subject to restriction by the articles of incorporation and the limitation in subsection (c).

(b) If the board of directors does not fix the record date for determining shareholders entitled to a distribution (other than one involving a purchase, redemption, or other acquisition of the corporation's shares), it is the date the board of directors authorizes the distribution.

(c) No distribution may be made if, after giving it effect:

(1) the corporation would not be able to pay its debts as they become due in the usual course of business; or

(2) the corporation's total assets would be less than the sum of its total liabilities plus (unless the articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

(d) The board of directors may base a determination that a distribution is not prohibited under subsection (c) either on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances or on a fair valuation or other method that is reasonable in the circumstances.

(e) Except as provided in subsection (g), the effect of a distribution under subsection (c) is measured:

(1) in the case of distribution by purchase, redemption, or other acquisition of the corporation's shares, as of the earlier of (i) the date money or other property is transferred or debt incurred by the corporation or (ii) the date the shareholder ceases to be a shareholder with respect to the acquired shares;

(2) in the case of any other distribution of indebtedness, as of the date the indebtedness is distributed; and

(3) in all other cases, as of (i) the date the distribution is authorized if the payment occurs within 120 days after the date of authorization or (ii) the date the payment is made if it occurs more than 120 days after the date of authorization.

(f) A corporation's indebtedness to a shareholder incurred by reason of a distribution made in accordance with this section is at parity with the corporation's indebtedness to its general, unsecured creditors except to the extent subordinated by agreement.

(g) Indebtedness of a corporation, including indebtedness issued as a distribution, is not considered a liability for purposes of determinations under subsection (c) if its terms provide that payment of principal and interest are made only if and to the extent that payment of a distribution to shareholders could then be made under this section. If the indebtedness is issued as a distribution, each payment of principal or interest is treated as a distribution, the effect of which is measured on the date the payment is actually made.

(h) This section shall not apply to distributions in liquidation under chapter 14.

OFFICIAL COMMENT

The reformulation of the statutory standards governing distributions is another important change made by the 1980 revisions to the financial provisions of the Model Act. It has long been recognized that the traditional ''par value'' and ''stated capital'' statutes do not provide significant protection against distributions of capital to shareholders. While most of these statutes contained elaborate provisions establishing ''stated capital,'' ''capital surplus,'' and ''earned surplus'' (and often other types of surplus as well), the net effect of most statutes was to permit the distribution to shareholders of most or all of the corporation's net assets—its capital along with its earnings—if the shareholders wished this to be done. However, statutes also generally imposed an equity insolvency test on distributions that prohibited distributions of assets if the corporation was insolvent or if the distribution had the effect of making the corporation insolvent or unable to meet its obligations as they were projected to arise.

The financial provisions of the revised Model Act, which are based on the 1980 amendments, sweep away all the distinctions among the various types of surplus but retain restrictions on distributions built around both the traditional equity insolvency and balance sheet tests of earlier statutes.

1. The Scope of Section 6.40

Section 1.40 defines ''distribution'' to include virtually all transfers of money, indebtedness of the corporation or other property to a shareholder in respect of the corporation's shares. It thus includes cash or property dividends, payments by a corporation to purchase its own shares, distributions of promissory notes or indebtedness, and distributions in partial or complete liquidation or voluntary or involuntary dissolution. Section 1.40 excludes from the definition of ''distribution'' transactions by the corporation in which only its own shares are distributed to its shareholders. These transactions are called ''share dividends'' in the revised Model Business Corporation Act. See section 6.23.

Section 6.40 imposes a single, uniform test on all distributions. Many of the old ''par value'' and ''stated capital'' statutes provided tests that varied with the type of distribution under consideration or did not cover certain types of distributions at all.

2. Equity Insolvency Test

As noted above, older statutes prohibited payment of dividends if the corporation was, or as a result of the payment would be, insolvent in the equity sense. This test is retained, appearing in section 6.40(c)(1).

In most cases involving a corporation operating as a going concern in the normal course, information generally available will make it quite apparent that no particular inquiry concerning the equity insolvency test is needed. While neither a balance sheet nor an income statement can be conclusive as to this test, the existence of significant shareholders' equity and normal operating conditions are of themselves a strong indication that no issue should arise under that test. Indeed, in the case of a corporation having regularly audited financial statements, the absence of any qualification in the most recent auditor's opinion as to the corporation's status as a "going concern," coupled with a lack of subsequent adverse events, would normally be decisive.

It is only when circumstances indicate that the corporation is encountering difficulties or is in an uncertain position concerning its liquidity and operations that the board of directors or, more commonly, the officers or others upon whom they may place reliance under section 8.30(b), may need to address the issue. Because of the overall judgment required in evaluating the equity insolvency test, no one or more "bright line" tests can be employed. However, in determining whether the equity insolvency test has been met, certain judgments or assumptions as to the future course of the corporation's business are customarily justified, absent clear evidence to the contrary. These include the likelihood that (a) based on existing and contemplated demand for the corporation's products or services, it will be able to generate funds over a period of time sufficient to satisfy its existing and reasonably anticipated obligations as they mature, and (b) indebtedness which matures in the near-term will be refinanced where, on the basis of the corporation's financial condition and future prospects and the general availability of credit to businesses similarly situated, it is reasonable to assume that such refinancing may be accomplished. To the extent that the corporation may be subject to asserted or unasserted contingent liabilities, reasonable judgments as to the likelihood, amount, and time of any recovery against the corporation, after giving consideration to the extent to which the corporation is insured or otherwise protected against loss, may be utilized. There may be occasions when it would be useful to consider a cash flow analysis, based on a business forecast and budget, covering a sufficient period of time to permit a conclusion that known obligations of the corporation can reasonably be expected to be satisfied over the period of time that they will mature.

In exercising their judgment, the directors are entitled to rely, under section 8.30(b) as noted above, on information, opinions, reports, and statements prepared by others. Ordinarily, they should not be expected to become involved in the details of the various analyses or market or economic projections that may be relevant. Judgments must of necessity be made on the basis of information in the hands of the directors when a distribution is authorized. They should not, of course, be held responsible as a matter of hindsight for unforeseen developments. This is particularly true with respect to assumptions as to the ability of the corporation's business to repay long-term obligations which do not mature for several years, since the primary focus of the directors' decision to make a distribution should normally be on the corporation's prospects and obligations in the shorter term, unless special factors concerning the corporation's prospects require the taking of a longer term perspective.

3. Relationship to the Federal Bankruptcy Act and Other Fraudulent Conveyance Statutes

The revised Model Business Corporation Act establishes the validity of distributions from the corporate law standpoint under section 6.40 and determines the potential liability of directors for improper distributions under sections 8.30 and 8.33. The federal Bankruptcy Act and state fraudulent conveyance statutes, on the other hand, are designed to enable the trustee or other representative to recapture for the benefit of creditors funds distributed to others in some circumstances. In light of these diverse purposes, it was not thought necessary to make the tests of section 6.40 identical with the tests for insolvency under these various statutes.

4. Balance Sheet Test

Section 6.40(c)(2) requires that, after giving effect to any distribution, the corporation's assets equal or exceed its liabilities plus (with some exceptions) the dissolution preferences of senior equity securities. Section 6.40(d) authorizes asset and liability determinations to be made for this purpose on the basis of either (1) financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances or (2) a fair valuation or other method that is reasonable in the circumstances. The determination of a corporation's assets and liabilities and the choice of the permissible basis on which to do so are left to the judgment of its board of directors. In making a judgment under section 6.40(d), the board may rely under section 8.30(b) upon opinions, reports, or statements, including financial statements and other financial data prepared or presented by public accountants or others.

Section 6.40 does not utilize particular accounting terminology of a technical nature or specify particular accounting concepts. In making determinations under this section, the board of directors may make judgments about accounting matters, giving full effect to its right to rely upon professional or expert opinion.

In a corporation with subsidiaries, the board of directors may rely on unconsolidated statements prepared on the basis of the equity method of accounting (see American Institute of Certified Public Accountants, *APB Opinion No. 18* (1971)) as to the corporation's investee corporations, including corporate joint ventures and subsidiaries, although other evidence would be relevant in the total determination.

a. Generally accepted accounting principles

The board of directors should in all circumstances be entitled to rely upon reasonably current financial statements prepared on the basis of generally accepted accounting principles in determining whether or not the balance sheet test of section 6.40(c)(2) has been met, unless the board is then aware that it would be unreasonable to rely on the financial statements because of newly-discovered or subsequently arising facts or circumstances. But section 6.40 does not mandate the use of generally accepted accounting principles; it only requires the use of accounting practices and principles that are reasonable in the circumstances. While publicly-owned corporations subject to registration under the Securities Exchange Act of 1934 must, and many other corporations in fact do, utilize financial statements prepared on the basis of generally accepted accounting principles, a great number of smaller or closely-held corporations do not. Some of these corporations maintain records solely on a tax accounting basis and their financial statements are of necessity prepared on that basis. Others prepare financial statements that substantially reflect generally accepted accounting principles but may depart from them in some respects (e.g., footnote disclosure). These facts of corporate life indicate that a statutory standard of reasonableness, rather than stipulating generally accepted accounting principles as the normative standard, is appropriate in order to achieve a reasonable degree of flexibility and to accommodate the needs of the many different types of business corporations which might be subject to these provisions, including in particular closely-held corporations. Accordingly, the revised Model Business

Corporation Act contemplates that generally acceptable accounting principles are always ''reasonable in the circumstances'' and that other accounting principles may be perfectly acceptable, under a general standard of reasonableness, even if they do not involve the ''fair value'' or ''current value'' concepts that are also contemplated by section 6.40(d).

b. Other principles

Section 6.40(d) specifically permits determinations to be made under section 6.40(c)(2) on the basis of a fair valuation or other method that is reasonable in the circumstances. Thus the statute authorizes departures from historical cost accounting and sanctions the use of appraisal and current value methods to determine the amount available for distributions. No particular method of valuation is prescribed in the statute, since different methods may have validity depending upon the circumstances, including the type of enterprise and the purpose for which the determination is made. For example, it is inappropriate to apply a ''quick-sale liquidation'' method to value an enterprise, particularly with respect to the payment of normal dividends. On the other hand, a ''quick-sale liquidation valuation'' method might be appropriate in certain circumstances for an enterprise in the course of reducing its asset or business base by a material degree. In most cases, a fair valuation method or a going-concern basis would be appropriate if it is believed that the enterprise will continue as a going concern.

Ordinarily a corporation should not selectively revalue assets. It should consider the value of all of its material assets, whether or not reflected in the financial statements (e.g., a valuable executory contract). Likewise, all of a corporation's material obligations should be considered and revalued to the extent appropriate and possible. In any event, section 6.40(d) calls for the application under section 6.40(c)(2) of a method of determining the aggregate amount of assets and liabilities that is reasonable in the circumstances.

Section 6.40(d) also refers to some ''other method that is reasonable in the circumstances.'' This phrase is intended to comprehend within section 6.40(c)(2) the wide variety of possibilities that might not be considered to fall under a ''fair valuation'' but might be reasonable in the circumstances of a particular case.

5. Preferential Dissolution Rights and the Balance Sheet Test

Section 6.40(c)(2) provides that a distribution may not be made unless the total assets of the corporation exceed its liabilities plus the amount that would be needed to satisfy any shareholders' superior preferential rights upon dissolution if the corporation were to be dissolved at the time of the distribution. This requirement in effect treats preferential dissolution rights of shares for distribution purposes as if they were liabilities for the sole purpose of determining the amount available for distributions, and carries forward analogous treatment of shares having preferential dissolution rights from earlier versions of the Model Act. In making the calculation of the amount that must be added to the liabilities of the corporation to reflect the preferential dissolution rights, the assumption should be made that the preferential dissolution rights are to be established pursuant to the articles of incorporation, as of the date of the distribution or proposed distribution. The amount so determined must include arrearages in preferential dividends if the articles of incorporation require that they be paid upon the dissolution of the corporation. In the case of shares having both a preferential right upon dissolution and other nonpreferential rights, only the preferential right should be taken into account. The treatment of preferential dissolution rights of classes of shares set forth in section 6.40(c)(2) is applicable only to the balance sheet test and is not applicable to the equity insolvency test of section 6.40(c)(1). The treatment of preferential rights mandated by this section may always be eliminated by an appropriate provision in the articles of incorporation.

6. Time of Measurement

Section 6.40(e)(3) provides that the time for measuring the effect of a distribution for compliance with the equity insolvency and balance sheet tests for all distributions not involving the reacquisition of shares or the distribution of indebtedness is the date of authorization, if the payment occurs within 120 days following the authorization; if the payment occurs more than 120 days after the authorization, however, the date of payment must be used. If the corporation elects to make a distribution in the form of its own indebtedness under section 6.40(e)(2), the validity of that distribution must be measured as of the time of distribution unless the indebtedness qualifies under section 6.40(g).

Section 6.40(e)(1) provides a different rule for the time of measurement when the distribution involves a reacquisition of shares. See below, Application to Reacquisition of Shares—Time of measurement.

7. Record Date

Section 6.40(b) fixes the record date (if the board of directors does not otherwise fix it) for distributions other than those involving a reacquisition of shares as the date the board of directors authorizes the distribution. No record date is necessary for a reacquisition of shares from one or more specific shareholders. The board of directors has discretion to set a record date for a reacquisition if it is to be pro rata and to be offered to all shareholders as of a specified date.

8. Application to Repurchases or Redemption of Shares

The application of the equity insolvency and balance sheet tests to distributions that involve the purchase, redemption, or other acquisition of shares creates unique problems; section 6.40 provides specific rules for the resolution of these problems as described below.

a. Time of measurement

Section 6.40(e)(1) provides that the time for measuring the effect of a distribution under section 6.40(c), if shares of the corporation are reacquired, is the earlier of (i) the payment date, or (ii) the date the shareholder ceased to be a shareholder with respect to the shares, except as provided in section 6.40(g).

b. When tests are applied to redemption-related debt

In an acquisition of its shares, a corporation may transfer property or incur debt to the former holder of the shares. The case law on the status of this debt is conflicting. However, share repurchase agreements involving payment for shares over a period of time are of special importance in closely held corporate enterprises. Section 6.40(e) provides a clear rule for this situation: the legality of the distribution must be measured at the time of the issuance or incurrence of the debt, not at a later date when the debt is actually paid except as otherwise provided in section 6.40(g). Of course, this does not preclude a later challenge of a payment on account of redemption-related debt by a bankruptcy trustee on the ground that it constitutes a preferential payment to a creditor.

c. Priority of debt distributed directly or incurred in connection with a reacquisition of shares

Section 6.40(f) provides that indebtedness created to acquire the corporation's shares or issued as a distribution is on a parity with the indebtedness of the corporation to its general, unsecured creditors, except to the extent subordinated by agreement. General creditors are better off in these situations than they would have been if cash or other property had been paid out for the shares or distributed (which is proper under the statute), and no worse off than if cash had been paid or distributed and then lent back to the corporation, making the shareholders (or former shareholders) creditors. The parity created by section 6.40(f) is logically consistent with the rule established by section 6.40(e) that these transactions should be judged at the time of the issuance of the debt.

d. Treatment of certain indebtedness

Section 6.40(g) provides that indebtedness need not be taken into account as a liability in determining whether the tests of section 6.40(c) have been met if the terms of the indebtedness provide that payments of principal or interest can be made only if and to the extent that payment of a distribution could then be made under section 6.40. This has the effect of making the holder of the indebtedness junior to all other creditors but senior to the holders of all classes of shares, not only during the time the corporation is operating but also upon dissolution and liquidation. It should be noted that the creation of such indebtedness, and the related limitations on payments of principal and interest, may create tax problems or raise other legal questions.

Although section 6.40(g) is applicable to all indebtedness meeting its tests, regardless of the circumstances of its issuance, it is anticipated that it will be applicable most frequently to permit the reacquisition of shares of the corporation at a time when the deferred purchase price exceeds the net worth of the corporation. This type of reacquisition will often be necessary in the case of businesses in early stages of development or service businesses whose value derives principally from existing or prospective net income or cash flow rather than from net asset value. In such situations, it is anticipated that net worth will grow over time from operations so that when payments in respect of the indebtedness are to be made the two insolvency tests will be satisfied. In the meantime, the fact that the indebtedness is outstanding will not prevent distributions that could be made under subsection (c) if the indebtedness were not counted in making the determination.

9. Distribution in Liquidation

Subsection (h) provides that distributions in liquidation under chapter 14 are not subject to the distribution limitations of section 6.40. Chapter 14 provides specifically for payment of creditor claims and distributions to shareholders in liquidation upon dissolution of the corporation. See section 14.09.

CHAPTER 7. SHAREHOLDERS

SUBCHAPTER A. MEETINGS

§ 7.01 Annual Meeting

(a) Unless directors are elected by written consent in lieu of an annual meeting as permitted by section 7.04, a corporation shall hold a meeting of shareholders annually at a time stated in or fixed in accordance with the bylaws; provided, however, that if a corporation's articles of incorporation authorize shareholders to cumulate their votes when electing directors pursuant to section 7.28, directors may not be elected by less than unanimous written consent.

(b) Annual shareholders' meetings may be held in or out of this state at the place stated in or fixed in accordance with the bylaws. If no place is stated in or fixed in accordance with the bylaws, annual meetings shall be held at the corporation's principal office.

(c) The failure to hold an annual meeting at the time stated in or fixed in accordance with a corporation's bylaws does not affect the validity of any corporate action.

§ 7.02 Special Meeting

(a) A corporation shall hold a special meeting of shareholders:

(1) on call of its board of directors or the person or persons authorized to do so by the articles of incorporation or bylaws; or

(2) if the holders of at least 10 percent of all the votes entitled to be cast on any issue proposed to be considered at the proposed special meeting sign, date, and deliver to the corporation one or more written demands for the meeting describing the purpose or purposes for which it is to be held, provided that the articles of incorporation may fix a lower percentage or a higher percentage not exceeding 25 percent of all the votes entitled to be cast on any issue proposed to be considered. Unless otherwise provided in the articles of incorporation, a written demand for a special meeting may be revoked by a writing to that effect received by the corporation prior to the receipt by the corporation of demands sufficient in number to require the holding of a special meeting.

(b) If not otherwise fixed under sections 7.03 or 7.07, the record date for determining shareholders entitled to demand a special meeting is the date the first shareholder signs the demand.

(c) Special shareholders' meetings may be held in or out of this state at the place stated in or fixed in accordance with the bylaws. If no place is stated or fixed in accordance with the bylaws, special meetings shall be held at the corporation's principal office.

(d) Only business within the purpose or purposes described in the meeting notice required by section 7.05(c) may be conducted at a special shareholders' meeting.

§ 7.03 Court–Ordered Meeting

(a) The [name or describe] court of the county where a corporation's principal office (or, if none in this state, its registered office) is located may summarily order a meeting to be held:

(1) on application of any shareholder of the corporation entitled to participate in an annual meeting if an annual meeting was not held or action by written consent in lieu thereof did not become effective within the earlier of 6 months after the end of the corporation's fiscal year or 15 months after its last annual meeting; or

(2) on application of a shareholder who signed a demand for a special meeting valid under section 7.02 if:

(i) notice of the special meeting was not given within 30 days after the date the demand was delivered to the corporation's secretary; or

(ii) the special meeting was not held in accordance with the notice.

(b) The court may fix the time and place of the meeting, determine the shares entitled to participate in the meeting, specify a record date for determining shareholders entitled to notice of and to vote at the meeting, prescribe the form and content of the meeting notice, fix the quorum required for specific matters to be considered at the meeting (or direct that the votes represented at the meeting constitute a quorum for action on those matters), and enter other orders necessary to accomplish the purpose or purposes of the meeting.

§ 7.04 Action Without Meeting

(a) Action required or permitted by this Act to be taken at a shareholders' meeting may be taken without a meeting if the action is taken by all the shareholders entitled to vote on the action. The action must be evidenced by one or more written consents bearing the date of signature and describing the action taken, signed by all the shareholders entitled to vote on the action, and delivered to the corporation for inclusion in the minutes or filing with the corporate records.

(b) The articles of incorporation may provide that any action required or permitted by this Act to be taken at a shareholders' meeting may be taken without a meeting, and without prior notice, if consents in writing setting forth the action so taken are signed by the holders of outstanding shares having not less than the minimum number of votes that would be required to authorize or take the action at a meeting at which all shares entitled to vote on the action were present and voted.

The written consent shall bear the date of signature of the shareholder who signs the consent and be delivered to the corporation for inclusion in the minutes or filing with the corporate records.

(c) If not otherwise fixed under section 7.07 and if prior board action is not required respecting the action to be taken without a meeting, the record date for determining the shareholders entitled to take action without a meeting shall be the first date on which a signed written consent is delivered to the corporation. If not otherwise fixed under section 7.07 and if prior board action is required respecting the action to be taken without a meeting, the record date shall be the close of business on the day the resolution of the board taking such prior action is adopted. No written consent shall be effective to take the corporate action referred to therein unless, within 60 days of the earliest date on which a consent delivered to the corporation as required by this section was signed, written consents signed by the holders of shares having sufficient votes to take the action have been delivered to the corporation. A written consent may be revoked by a writing to that effect delivered to the corporation before unrevoked written consents sufficient in number to take the corporate action are delivered to the corporation.

(d) A consent signed pursuant to the provisions of this section has the effect of a vote taken at a meeting and may be described as such in any document. Unless the articles of incorporation, bylaws or a resolution of the board of directors provides for a reasonable delay to permit tabulation of written consents, the action taken by written consent shall be effective when written consents signed by the holders of shares having sufficient votes to take the action are delivered to the corporation.

(e) If this Act requires that notice of a proposed action be given to nonvoting shareholders and the action is to be taken by written consent of the voting shareholders, the corporation must give its nonvoting shareholders written notice of the action not more than 10 days after (i) written consents sufficient to take the action have been delivered to the corporation, or (ii) such later date that tabulation of consents is completed pursuant to an authorization under subsection (d). The notice must reasonably describe the action taken and contain or be accompanied by the same material that, under any provision of this Act, would have been required to be sent to nonvoting shareholders in a notice of a meeting at which the proposed action would have been submitted to the shareholders for action.

(f) If action is taken by less than unanimous written consent of the voting shareholders, the corporation must give its nonconsenting voting shareholders written notice of the action not more than 10 days after (i) written consents sufficient to take the action have been delivered to the corporation, or (ii) such later date that tabulation of consents is completed pursuant to an authorization under subsection (d). The notice must reasonably describe the action taken and contain or be accompanied by the same material that, under any provision of the Act, would have been required to be sent to voting shareholders in an notice of a meeting at which the action would have been submitted to the shareholders for action.

(g) The notice requirements in subsections (e) and (f) shall not delay the effectiveness of actions taken by written consent, and a failure to comply with such notice requirements shall not invalidate actions taken by written consent, provided that this subsection shall not be deemed to limit judicial power to fashion any appropriate remedy in favor of a shareholder adversely affected by a failure to give such notice within the required time period.

(h) An electronic transmission may be used to consent to an action, if the electronic transmission contains or is accompanied by information from which the corporation can determine the date on which the electronic transmission was signed and that the electronic transmission was authorized by the shareholder, the shareholder's agent or the shareholder's attorney-in-fact.

(i) Delivery of a written consent to the corporation under this section is delivery to the corporation's registered agent at its registered office or to the secretary of the corporation at its principal office.

§ 7.05 Notice of Meeting

(a) A corporation shall notify shareholders of the date, time, and place of each annual and special shareholders' meeting no fewer than 10 nor more than 60 days before the meeting date. Unless this Act or the articles of incorporation require otherwise, the corporation is required to give notice only to shareholders entitled to vote at the meeting.

(b) Unless this Act or the articles of incorporation require otherwise, notice of an annual meeting need not include a description of the purpose or purposes for which the meeting is called.

(c) Notice of a special meeting must include a description of the purpose or purposes for which the meeting is called.

(d) If not otherwise fixed under section 7.03 or 7.07, the record date for determining shareholders entitled to notice of and to vote at an annual or special shareholders' meeting is the day before the first notice is delivered to shareholders.

(e) Unless the bylaws require otherwise, if an annual or special shareholders' meeting is adjourned to a different date, time, or place, notice need not be given of the new date, time, or place if the new date, time, or place is announced at the meeting before adjournment. If a new record date for the adjourned meeting is or must be fixed under section 7.07, however, notice of the adjourned meeting must be given under this section to persons who are shareholders as of the new record date.

§ 7.06 Waiver of Notice

(a) A shareholder may waive any notice required by this Act, the articles of incorporation, or bylaws before or after the date and time stated in the notice. The waiver must be in writing, be signed by the shareholder entitled to the notice, and be delivered to the corporation for inclusion in the minutes or filing with the corporate records.

(b) A shareholder's attendance at a meeting:

(1) waives objection to lack of notice or defective notice of the meeting, unless the shareholder at the beginning of the meeting objects to holding the meeting or transacting business at the meeting;

(2) waives objection to consideration of a particular matter at the meeting that is not within the purpose or purposes described in the meeting notice, unless the shareholder objects to considering the matter when it is presented.

§ 7.07 Record Date

(a) The bylaws may fix or provide the manner of fixing the record date for one or more voting groups in order to determine the shareholders entitled to notice of a shareholders' meeting, to demand a special meeting, to vote, or to take any other action. If the bylaws do not fix or provide for fixing a record date, the board of directors of the corporation may fix a future date as the record date.

(b) A record date fixed under this section may not be more than 70 days before the meeting or action requiring a determination of shareholders.

(c) A determination of shareholders entitled to notice of or to vote at a shareholders' meeting is effective for any adjournment of the meeting unless the board of directors fixes a new record date, which it must do if the meeting is adjourned to a date more than 120 days after the date fixed for the original meeting.

(d) If a court orders a meeting adjourned to a date more than 120 days after the date fixed for the original meeting, it may provide that the original record date continues in effect or it may fix a new record date.

§ 7.08 Conduct of the Meeting

(a) At each meeting of shareholders, a chair shall preside. The chair shall be appointed as provided in the bylaws or, in the absence of such provision, by the board.

(b) The chair, unless the articles of incorporation or bylaws provide otherwise, shall determine the order of business and shall have the authority to establish rules for the conduct of the meeting.

(c) Any rules adopted for, and the conduct of, the meeting shall be fair to shareholders.

(d) The chair of the meeting shall announce at the meeting when the polls close for each matter voted upon. If no announcement is made, the polls shall be deemed to have closed upon the final adjournment of the meeting. After the polls close, no ballots, proxies or votes nor any revocations or changes thereto may be accepted.

OFFICIAL COMMENT

Section 7.08 provides that, at any meeting of the shareholders, there shall be a chair who shall preside over the meeting. The chair is appointed in accordance with the bylaws. Generally, the chair of the board of directors presides over the meeting. However, the bylaws could provide that the chief executive officer, if different than the chair of the board, preside over the meeting and they should provide a means of designating an alternate if that individual is for any reason unable to preside.

Section 7.08(b) gives the chair, unless the articles of incorporation or bylaws provide otherwise, the authority to determine in what order items of business should be discussed and decided. Inherent in the chair's power to establish rules for the conduct of the meeting is the authority to require that the order of business be observed and that any discussion or comments from shareholders or their proxies be confined to the business item under discussion. However, it is also expected that the chair will not misuse the power to determine the order of business and to establish rules for the conduct of the meeting so as to unfairly foreclose the right of shareholders subject to the Act, the articles of incorporation and the bylaws to raise items which are properly a subject for shareholder discussion or action at some point in the meeting prior to adjournment.

The Act provides that only business within the purpose or purposes described in the meeting notice may be conducted at a special shareholders' meeting. See sections 7.02(d) and 7.05(c). In addition, a corporation's articles of incorporation or, more typically, its bylaws, may contain advance notice provisions requiring that shareholder nominations for election to the board of directors or resolutions intended to be voted on at the annual meeting must be made in writing and received by the corporation a prescribed number of days in advance of the meeting. Such advance notice bylaws are permitted provided (1) there is reasonable opportunity for shareholders to comply with them in a timely fashion, and (2) the requirements of the bylaws are reasonable in relationship to corporate needs.

Among the considerations to be taken into account in determining reasonableness are (a) how and with what frequency shareholders are advised of the specific bylaw provisions, and (b) whether the time frame within which director nominations or shareholder resolutions must be submitted is consistent with the corporation's need, if any, (i) to prepare and publish a proxy statement, (ii) to verify that the director nominee meets any established qualifications for director and is willing to serve, (iii) to determine that a proposed resolution is a proper subject for shareholder action under the Act or other state law, or (iv) to give interested parties adequate opportunity to communicate a recommendation or response with respect to such matters, or to solicit proxies. Whether or not an advance notice provision has been adopted, if a public company receives advance notice of a matter to be raised for a vote at an annual meeting, management may exercise its discretionary proxy authority only in compliance with SEC Rule 14a–4(c)(1) adopted under the Securities Exchange Act of 1934.

Section 7.08(b) also provides that the chair shall have the authority to establish rules for the conduct of the meeting. Complicated parliamentary rules (such as Robert's Rules of Order) ordinarily are not appropriate for shareholder meetings. The rules may cover such subjects as the proper means for obtaining the floor, who shall have the right to address the meeting, the manner in which shareholders will be recognized to speak, time limits per speaker, the number of times a shareholder may address the meeting, and the person to whom questions should be addressed. The substance of the rules should be communicated to shareholders prior to or at the beginning of the meeting. The chair is entitled to wide latitude in conducting the meeting and, unless inconsistent with a previously prescribed rule, may set requirements, observe practices, and follow customs that facilitate a fair and orderly meeting. Since, absent a modifying bylaw provision, the chair has exclusive authority with respect to the rules for and the conduct of the meeting, rulings by the chair may not be overruled by shareholders. On the other hand, any rule for or conduct of the meeting which does not satisfy the fairness mandate of section 7.08(c) would be subject to a judicial remedy.

Section 7.08(d) requires that an announcement be made at the meeting of shareholders specifying when the polls will close for each matter voted upon. It also provides that, once the polls close, no ballots, proxies, or votes and no changes thereto may be accepted. This statutory provision eliminates an area of uncertainty which had developed in the relatively sparse case law dealing with the effect of closing the polls, some of which suggested that, notwithstanding the closing of the polls, votes could be changed up until the time that the inspectors of election announced the results. Young v. Jebbett, 211 N.Y.S. 61 (N.Y. App. Div. 1925); State ex rel. David v. Dailey, 168 P.2d 330 (Wash. 1945). Any abusive use of the poll-closing power would be subject to judicial review under subsection (c) as well as under that line of cases requiring that meetings of shareholders be conducted fairly and proscribing inequitable manipulations of the shareholder voting machinery. See, e.g., Duffy v. Loft, Inc., 151 A. 223 (Del. Ch. 1930); Schnell v. Chris-Craft Ind., Inc., 285 A.2d 437 (Del. 1971).

SUBCHAPTER B. VOTING

§ 7.20 Shareholders' List for Meeting

(a) After fixing a record date for a meeting, a corporation shall prepare an alphabetical list of the names of all its shareholders who are entitled to notice of a shareholders' meeting. The list must be arranged by voting group (and within each voting group by class or series of shares) and show the address of and number of shares held by each shareholder.

(b) The shareholders' list must be available for inspection by any shareholder, beginning two business days after notice of the meeting is given for which the list was prepared and continuing through the meeting, at the corporation's principal office or at a place identified in the meeting notice in the city where the meeting will be held. A shareholder, his agent, or attorney is entitled on written demand to inspect and, subject to the requirements of section 16.02(c), to copy the list, during regular business hours and at his expense, during the period it is available for inspection.

(c) The corporation shall make the shareholders' list available at the meeting, and any shareholder, his agent, or attorney is entitled to inspect the list at any time during the meeting or any adjournment.

(d) If the corporation refuses to allow a shareholder, his agent, or attorney to inspect the shareholders' list before or at the meeting (or copy the list as permitted by subsection (b)), the [name or describe] court of the county where a corporation's principal office (or, if none in this state, its registered office) is located, on application of the shareholder, may summarily order the inspection or copying at the corporation's expense and may postpone the meeting for which the list was prepared until the inspection or copying is complete.

(e) Refusal or failure to prepare or make available the shareholders' list does not affect the validity of action taken at the meeting.

§ 7.21 Voting Entitlement of Shares

(a) Except as provided in subsections (b) and (c) or unless the articles of incorporation provide otherwise, each outstanding share, regardless of class, is entitled to one vote on each matter voted on at a shareholders' meeting. Only shares are entitled to vote.

(b) Absent special circumstances, the shares of a corporation are not entitled to vote if they are owned, directly or indirectly, by a second corporation, domestic or foreign, and the first corporation owns, directly or indirectly, a majority of the shares entitled to vote for directors of the second corporation.

(c) Subsection (b) does not limit the power of a corporation to vote any shares, including its own shares, held by it in a fiduciary capacity.

(d) Redeemable shares are not entitled to vote after notice of redemption is mailed to the holders and a sum sufficient to redeem the shares has been deposited with a bank, trust company, or other financial institution under an irrevocable obligation to pay the holders the redemption price on surrender of the shares.

§ 7.22 Proxies

(a) A shareholder may vote his shares in person or by proxy.

(b) A shareholder or his agent or attorney-in-fact may appoint a proxy to vote or otherwise act for the shareholder by signing an appointment form, or by an electronic transmission. An electronic transmission must contain or be accompanied by information from which one can determine that the shareholder, the shareholder's agent, or the shareholder's attorney-in-fact authorized the transmission.

(c) An appointment of a proxy is effective when a signed appointment form or an electronic transmission of the appointment is received by the inspector of election or the officer or agent of the corporation authorized to tabulate votes. An appointment is valid for 11 months unless a longer period is expressly provided in the appointment form.

(d) An appointment of a proxy is revocable unless the appointment form or electronic transmission states that it is irrevocable and the appointment is coupled with an interest. Appointments coupled with an interest include the appointment of:

(1) A pledgee;

(2) A person who purchased or agreed to purchase the shares;

(3) A creditor of the corporation who extended it credit under terms requiring the appointment;

(4) An employee of the corporation whose employment contract requires the appointment; or

(5) A party to a voting agreement created under section 7.31.

(e) The death or incapacity of the shareholder appointing a proxy does not affect the right of the corporation to accept the proxy's authority unless notice of the death or incapacity is received by the secretary or other officer or agent authorized to tabulate votes before the proxy exercises his authority under the appointment.

(f) An appointment made irrevocable under subsection (d) is revoked when the interest with which it is coupled is extinguished.

(g) A transferee for value of shares subject to an irrevocable appointment may revoke the appointment if he did not know of its existence when he acquired the shares and the existence of the irrevocable appointment was not noted conspicuously on the certificate representing the shares or on the information statement for shares without certificates.

(h) Subject to section 7.24 and to any express limitation on the proxy's authority stated in the appointment form or electronic transmission, a corporation is entitled to accept the proxy's vote or other action as that of the shareholder making the appointment.

§ 7.23 Shares Held by Nominees

(a) A corporation may establish a procedure by which the beneficial owner of shares that are registered in the name of a nominee is recognized by the corporation as the shareholder. The extent of this recognition may be determined in the procedure.

(b) The procedure may set forth:

(1) the types of nominees to which it applies;

(2) the rights or privileges that the corporation recognizes in a beneficial owner;

(3) the manner in which the procedure is selected by the nominee;

(4) the information that must be provided when the procedure is selected;

(5) the period for which selection of the procedure is effective; and

(6) other aspects of the rights and duties created.

§ 7.24 Corporation's Acceptance of Votes

(a) If the name signed on a vote, consent, waiver, or proxy appointment corresponds to the name of a shareholder, the corporation if acting in good faith is entitled to accept the vote, consent, waiver, or proxy appointment and give it effect as the act of the shareholder.

(b) If the name signed on a vote, consent, waiver, or proxy appointment does not correspond to the name of its shareholder, the corporation if acting in good faith is nevertheless entitled to accept the vote, consent, waiver, or proxy appointment and give it effect as the act of the shareholder if:

(1) the shareholder is an entity and the name signed purports to be that of an officer or agent of the entity;

(2) the name signed purports to be that of an administrator, executor, guardian, or conservator representing the shareholder and, if the corporation requests, evidence of fiduciary status acceptable to the corporation has been presented with respect to the vote, consent, waiver, or proxy appointment;

(3) the name signed purports to be that of a receiver or trustee in bankruptcy of the shareholder and, if the corporation requests, evidence of this status acceptable to the corporation has been presented with respect to the vote, consent, waiver, or proxy appointment;

(4) the name signed purports to be that of a pledgee, beneficial owner, or attorney-in-fact of the shareholder and, if the corporation requests, evidence acceptable to the corporation of the signatory's authority to sign for the shareholder has been presented with respect to the vote, consent, waiver, or proxy appointment;

(5) two or more persons are the shareholder as cotenants or fiduciaries and the name signed purports to be the name of at least one of the co-owners and the person signing appears to be acting on behalf of all the co-owners.

(c) The corporation is entitled to reject a vote, consent, waiver, or proxy appointment if the secretary or other officer or agent authorized to tabulate votes, acting in good faith, has reasonable basis for doubt about the validity of the signature on it or about the signatory's authority to sign for the shareholder.

* * *

(d) The corporation and its officer or agent who accepts or rejects a vote, consent, waiver, or proxy appointment in good faith and in accordance with the standards of this section or section 7.22(b) are not liable in damages to the shareholder for the consequences of the acceptance or rejection.

(e) Corporate action based on the acceptance or rejection of a vote, consent, waiver, or proxy appointment under this section is valid unless a court of competent jurisdiction determines otherwise.

§ 7.25 Quorum and Voting Requirements for Voting Groups

(a) Shares entitled to vote as a separate voting group may take action on a matter at a meeting only if a quorum of those shares exists with respect to that matter. Unless the articles of incorporation provides otherwise, a majority of the votes entitled to be cast on the matter by the voting group constitutes a quorum of that voting group for action on that matter.

(b) Once a share is represented for any purpose at a meeting, it is deemed present for quorum purposes for the remainder of the meeting and for any adjournment of that meeting unless a new record date is or must be set for that adjourned meeting.

(c) If a quorum exists, action on a matter (other than the election of directors) by a voting group is approved if the votes cast within the voting group favoring the action exceed the votes cast opposing the action, unless the articles of incorporation require a greater number of affirmative votes.

(d) An amendment of articles of incorporation adding, changing, or deleting a quorum or voting requirement for a voting group greater than specified in subsection (a) or (c) is governed by section 7.27.

(e) The election of directors is governed by section 7.28.

§ 7.26 Action by Single and Multiple Voting Groups

(a) If the articles of incorporation or this act provide for voting by a single voting group on a matter, action on that matter is taken when voted upon by that voting group as provided in section 7.25.

(b) If the articles of incorporation or this Act provide for voting by two or more voting groups on a matter, action on that matter is taken only when voted upon by each of those voting groups counted separately as provided in section 7.25. Action may be taken by one voting group on a matter even though no action is taken by another voting group entitled to vote on the matter.

§ 7.27 Greater Quorum or Voting Requirements

(a) The articles of incorporation may provide for a greater quorum or voting requirement for shareholders (or voting groups of shareholders) than is provided for by this Act.

(b) An amendment to the articles of incorporation that adds, changes, or deletes a greater quorum or voting requirement must meet the same quorum requirement and be adopted by the same vote and voting groups required to take action under the quorum and voting requirements then in effect or proposed to be adopted, whichever is greater.

§ 7.28 Voting for Directors; Cumulative Voting

(a) Unless otherwise provided in the articles of incorporation, directors are elected by a plurality of the votes cast by the shares entitled to vote in the election at a meeting at which a quorum is present.

(b) Shareholders do not have a right to cumulate their votes for directors unless the articles of incorporation so provide.

(c) A statement included in the articles of incorporation that ''[all] [a designated voting group of] shareholders are entitled to cumulate their votes for directors'' (or words of similar import) means that the shareholders designated are entitled to multiply the number of votes they are entitled to cast by the number of directors for whom they are entitled to vote and cast the product for a single candidate or distribute the product among two or more candidates.

(d) Shares otherwise entitled to vote cumulatively may not be voted cumulatively at a particular meeting unless:

(1) the meeting notice or proxy statement accompanying the notice states conspicuously that cumulative voting is authorized; or

(2) a shareholder who has the right to cumulate his votes gives notice to the corporation not less than 48 hours before the time set for the meeting of the shareholder's intent to cumulate his votes during the meeting, and if one shareholder gives this notice all other shareholders in the same voting group participating in the election are entitled to cumulate their votes without giving further notice.

§ 7.29 Inspectors of Election

(a) A public corporation shall, and any other corporation may, appoint one or more inspectors to act at a meeting of shareholders and make a written report of the inspectors' determinations. Each inspector shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of the inspector's ability.

(b) The inspectors shall

(1) ascertain the number of shares outstanding and the voting power of each;

(2) determine the shares represented at a meeting;

(3) determine the validity of proxies and ballots;

(4) count all votes; and

(5) determine the result.

(c) An inspector may be an officer or employee of the corporation.

OFFICIAL COMMENT

Section 7.29(a) requires that a public corporation must, and any other corporation may, appoint one or more inspectors of election to act at each meeting of shareholders and make a written report of the determinations made pursuant to section 7.29(b). It is contemplated that the selection of inspectors would be made by responsible officers or by the directors, as authorized either generally or specifically in the corporation's bylaws. Alternate inspectors could also be designated to replace any inspector who fails to act. The requirement of a written report is to facilitate judicial review of determinations made by inspectors.

Section 7.29(b) specifies the duties of inspectors of election. If no challenge of a determination by the inspectors within the authority given them under this section is timely made, such determination shall be conclusive. In the event of a challenge of any determination by the inspectors in a court of competent jurisdiction, the court should give such weight to determinations of fact by the inspectors as it shall deem appropriate, taking into account the relationship of the inspectors, if any, to the management of the company and other persons interested in the outcome of the vote, the evidence available to the inspectors, whether their determinations appear to be reasonable, and such other circumstances as the court shall regard as relevant. The court should review de novo all determinations of law made implicitly or explicitly by the inspectors.

Normally, in making the determinations contemplated by section 7.29(b), the only facts before the inspectors should be appointment forms and electronic transmissions (or written evidence thereof), envelopes submitted with appointment forms, ballots and the regular books and records of the corporation, including lists of holders obtained from depositories. However, inspectors may consider other reliable information for the limited purpose of reconciling appointment forms, electronic transmissions, and ballots submitted by or on behalf of banks, brokers, their nominees, and similar persons which represent more votes than the holder of a proxy is authorized by the record owner to cast or more votes than the shareholder holds of record. If the inspectors do consider such other information, it should be specifically referred to in their written report, including the person or persons from whom they obtained the information, when the information was obtained, the means by which the information was obtained, and the basis for the inspectors' belief that such information is accurate and reliable.

Section 7.29(c) provides that an inspector may be an officer or employee of the corporation. However, in the case of publicly-held corporations, good corporate practice suggests that such inspectors should be independent persons who are neither employees nor officers if there is a contested matter or a shareholder proposal to be considered. Not only will the issue of independent inspectors enhance investor perception as to the fairness of the voting process, but also the report of independent inspectors can be expected to be given greater evidentiary weight by any court reviewing a contested vote.

SUBCHAPTER C. VOTING TRUSTS AND AGREEMENTS

§ 7.30 Voting Trusts

(a) One or more shareholders may create a voting trust, conferring on a trustee the right to vote or otherwise act for them, by signing an agreement setting out the provisions of the trust (which may include anything consistent with its purpose) and transferring their shares to the trustee. When a voting trust agreement is signed, the trustee shall prepare a list of the names and addresses of all owners of beneficial interests in the trust, together with the number and class of shares each transferred to the trust, and deliver copies of the list and agreement to the corporation's principal office.

(b) A voting trust becomes effective on the date the first shares subject to the trust are registered in the trustee's name. A voting trust is valid for not more than 10 years after its effective date unless extended under subsection (c).

(c) All or some of the parties to a voting trust may extend it for additional terms of not more than 10 years each by signing written consent to the extension. An extension is valid for 10 years from the date the first shareholder signs the extension agreement. The voting trustee must deliver copies of the extension agreement and list of beneficial owners to the corporation's principal office. An extension agreement binds only those parties signing it.

§ 7.31 Voting Agreements

(a) Two or more shareholders may provide for the manner in which they will vote their shares by signing an agreement for that purpose. A voting agreement created under this section is not subject to the provisions of section 7.30.

(b) A voting agreement created under this section is specifically enforceable.

§ 7.32 Shareholder Agreements

(a) An agreement among the shareholders of a corporation that complies with this section is effective among the shareholders and the corporation even though it is inconsistent with one or more other provisions of this Act in that it:

(1) eliminates the board of directors or restricts the discretion or powers of the board of directors;

(2) governs the authorization or making of distributions whether or not in proportion to ownership of shares, subject to the limitations in section 6.40;

(3) establishes who shall be directors or officers of the corporation, or their terms of office or manner of selection or removal;

(4) governs, in general or in regard to specific matters, the exercise or division of voting power by or between the shareholders and directors or by or among any of them, including use of weighted voting rights or director proxies;

(5) establishes the terms and conditions of any agreement for the transfer or use of property or the provision of services between the corporation and any shareholder, director, officer or employee of the corporation or among any of them;

(6) transfers to one or more shareholders or other persons all or part of the authority to exercise the corporate powers or to manage the business and affairs of the corporation, including the resolution of any issue about which there exists a deadlock among directors or shareholders;

(7) requires dissolution of the corporation at the request of one or more of the shareholders or upon the occurrence of a specified event or contingency; or

(8) otherwise governs the exercise of the corporate powers or the management of the business and affairs of the corporation or the relationship among the shareholders, the directors and the corporation, or among any of them, and is not contrary to public policy.

(b) An agreement authorized by this section shall be:

(1) set forth (A) in the articles of incorporation or bylaws and approved by all persons who are shareholders at the time of the agreement or (B) in a written agreement that is signed by all persons who are shareholders at the time of the agreement and is made known to the corporation;

(2) subject to amendment only by all persons who are shareholders at the time of the amendment, unless the agreement provides otherwise; and

(3) valid for 10 years, unless the agreement provides otherwise.

(c) The existence of an agreement authorized by this section shall be noted conspicuously on the front or back of each certificate for outstanding shares or on the information statement required by section 6.26(b).

If at the time of the agreement the corporation has shares outstanding represented by certificates, the corporation shall recall the outstanding certificates and issue substitute certificates that comply with this subsection. The failure to note the existence of the agreement on the certificate or information statement shall not affect the validity of the agreement or any action taken pursuant to it. Any purchaser of shares who, at the time of purchase, did not have knowledge of the existence of the agreement shall be entitled to rescission of the purchase. A purchaser shall be deemed to have knowledge of the existence of the agreement if its existence is noted on the certificate or information statement for the shares in compliance with this subsection and, if the shares are not represented by a certificate, the information statement is delivered to the purchaser at or prior to the time of purchase of the shares. An action to enforce the right of rescission authorized by this subsection must be commenced within the earlier of 90 days after discovery of the existence of the agreement or two years after the time of purchase of the shares.

(d) An agreement authorized by this section shall cease to be effective when the corporation becomes a public corporation. If the agreement ceases to be effective for any reason, the board of directors may, if the agreement is contained or referred to in the corporation's articles of incorporation or bylaws, adopt an amendment to the articles of incorporation or bylaws, without shareholder action, to delete the agreement and any references to it.

(e) An agreement authorized by this section that limits the discretion or powers of the board of directors shall relieve the directors of, and impose upon the person or persons in whom such discretion or powers are vested, liability for acts or omissions imposed by law on directors to the extent that the discretion or powers of the directors are limited by the agreement.

(f) The existence or performance of an agreement authorized by this section shall not be a ground for imposing personal liability on any shareholder for the acts or debts of the corporation even if the agreement or its performance treats the corporation as if it were a partnership or results in failure to observe the corporate formalities otherwise applicable to the matters governed by the agreement.

(g) Incorporators or subscribers for shares may act as shareholders with respect to an agreement authorized by this section if no shares have been issued when the agreement is made.

OFFICIAL COMMENT

Shareholders of closely-held corporations, ranging from family businesses to joint ventures owned by large public corporations, frequently enter into agreements that govern the operation of the enterprise. In the past, various types of shareholder agreements were invalidated by courts for a variety of reasons, including so-called ''sterilization'' of the board of directors and failure to follow the statutory norms of the applicable corporation act. See, e.g., Long Park, Inc. v. Trenton–New Brunswick Theatres Co., 297 N.Y. 174, 77 N.E.2d 633 (1948). The more modern decisions reflect a greater willingness to uphold shareholder agreements, See, e.g., Galler v. Galler, 32 Ill.2d 16, 203 N.E.2d 577 (1964). In addition, many state corporation acts now contain provisions validating shareholder agreements. Heretofore, however, the Model Act has never expressly validated shareholder agreements.

Rather than relying on further uncertain and sporadic development of the law in the courts, section 7.32 rejects the older line of cases. It adds an important element of predictability currently absent from the Model Act and affords participants in closely-held corporations greater contractual freedom to tailor the rules of their enterprise.

Section 7.32 is not intended to establish or legitimize an alternative form of corporation. Instead, it is intended to add, within the context of the traditional corporate structure, legal certainty to shareholder agreements that embody various aspects of the business arrangement established by the shareholders to meet their business and personal needs. The subject matter of these arrangements includes governance of the entity, allocation of the economic return from the business, and other aspects of the relationships among shareholders, directors, and the corporation which are part of the business arrangement. Section 7.32 also recognizes that many of the corporate norms contained in the Model Act, as well as the corporation statutes of most states, were designed with an eye towards public companies, where management and share ownership are quite distinct. Cf. 1 O'Neal & Thompson, O'Neal's Close Corporations, section 5.06 (3d ed.). These functions are often conjoined in the close corporation. Thus, section 7.32 validates for nonpublic corporations various types of agreements among shareholders even when the agreements are inconsistent with the statutory norms contained in the Act.

Importantly, section 7.32 only addresses the parties to the shareholder agreement, their transferees, and the corporation, and does not have any binding legal effect on the state, creditors, or other third persons.

Section 7.32 supplements the other provisions of the Model Act. If an agreement is not in conflict with another section of the Model Act, no resort need be made to section 7.32, with its requirement of unanimity. For example, special provisions can be included in the articles of incorporation or bylaws with less than unanimous shareholder agreement so long as such provisions are not in conflict with other provisions of the Act. Similarly, section 7.32 would not have to be relied upon to validate typical buy-sell agreements among two or more shareholders or the covenants and other terms of a stock purchase agreement entered into in connection with the issuance of shares by a corporation.

The types of provisions validated by section 7.32 are many and varied. Section 7.32(a) defines the range of permissible subject matter for shareholder agreements largely by illustration, enumerating seven types of agreements that are expressly validated to the extent they would not be valid absent section 7.32. The enumeration of these types of agreements is not exclusive; nor should it give rise to a negative inference that an agreement of a type that is or might be embraced by one of the categories of section 7.32(a) is, ipso facto, a type of agreement that is not valid unless it complies with section 7.32. Section 7.32(a) also contains a ''catch all'' which adds a measure of flexibility to the seven enumerated categories.

Omitted from the enumeration in section 7.32(a) is a provision found in the Close Corporation Supplement and in the statutes of many of the states, broadly validating any arrangement the effect of which is to treat the corporation as a partnership. This type of provision was considered to be too elastic and indefinite, as well as unnecessary in light of the more detailed enumeration of permissible subject areas contained in section 7.32(a). Note, however, that under section 7.32(f) the fact that an agreement authorized by section 7.32(a) or its performance treats the corporation as a partnership is not a ground for imposing personal liability on the parties if the agreement is otherwise authorized by subsection (a).

1. Section 7.32(a)

Subsection (a) is the heart of section 7.32. It states that certain types of agreements are effective among the shareholders and the corporation even if inconsistent with another provision of the Model Act. Thus, an agreement authorized by section 7.32 is, by virtue of that section, ''not inconsistent with law'' within the meaning of sections 2.02(b)(2) and 2.06(b) of the Act. In contrast, a shareholder agreement that is not inconsistent with any provisions of the Model Act is not subject to the requirements of section 7.32.

The range of agreements validated by section 7.32(a) is expansive though not unlimited. The most difficult problem encountered in crafting a shareholder agreement validation provision is to determine the reach of the provision. Some states have tried to articulate the limits of a shareholder agreement validation provision in terms of negative grounds, stating that no shareholder agreement shall be invalid on certain specified grounds. See, e.g., Del. Code Ann. tit. 8, sections 350, 354 (1983); N.C. Gen. Stat. section 55–73(b) (1982). The deficiency in this type of statute is the uncertainty introduced by the ever present possibility of articulating another ground on which to challenge the validity of the agreement. Other states have provided that shareholder agreements may waive or alter all provisions in the corporation act except certain enumerated provisions that cannot be varied. See, e.g., Cal. Corp. Code section 300(b)–(c) (West 1989 and Supp.1990). The difficulty with this approach is that any enumeration of the provisions that can never be varied will almost inevitably be subjective, arbitrary, and incomplete.

The approach chosen in section 7.32 is more pragmatic. It defines the types of agreements that can be validated largely by illustration. The seven specific categories that are listed are designed to cover the most frequently used arrangements. The outer boundary is provided by section 7.32(a)(8), which provides an additional ''catch all'' for any provisions that, in a manner inconsistent with any other provision of the Model Act, otherwise govern the exercise of the corporate powers, the management of the business and affairs of the corporation, or the relationship between and among the shareholders, the directors, and the corporation or any of them. Section 7.32(a) validates virtually all types of shareholder agreements that, in practice, normally concern shareholders and their advisors.

Given the breadth of section 7.32(a), any provision that may be contained in the articles of incorporation with a majority vote under sections 2.02(b)(2)(ii) and (iii), as well as under section 2.02(b)(4), may also be effective if contained in a shareholder agreement that complies with section 7.32.

The provisions of a shareholder agreement authorized by section 7.32(a) will often, in operation, conflict with the literal language of more than one section of the Act, and courts should in such cases construe all related sections of the Act flexibly and in a manner consistent with the underlying intent of the shareholder agreement. Thus, for example, in the case of an agreement that provides for weighted voting by directors, every reference in the Act to a majority or other proportion of directors should be construed to refer to a majority or other proportion of the votes of the directors.

While the outer limits of the catch-all provision of subsection 7.32(a)(8) are left uncertain, there are provisions of the Model Act that cannot be overridden by resort to the catch-all. Subsection (a)(8), introduced by the term ''otherwise,'' is intended to be read in context with the preceding seven subsections and to be subject to a *ejusdem generis* rule of construction. Thus, in defining the outer limits, courts should consider whether the variation from the Model Act under consideration is similar to the variations permitted by the first seven subsections. Subsection (a)(8) is also subject to a public policy limitation, intended to give courts express authority to restrict the scope of the catch-all where there are substantial issues of public policy at stake. For example, a shareholder agreement that provides that the directors of the corporation have no duties of care or loyalty to the corporation or the shareholders would not be within the purview of section 7.32(a)(8), because it is not sufficiently similar to the types of arrangements suggested by the first seven subsections of section 7.32(a) and because such a provision could be viewed as contrary to a public policy of substantial importance. Similarly, a provision that exculpates directors from liability more broadly than permitted by section 2.02(b)(4) likely would not be validated under section 7.32, because, as the Official Comment to section 2.02(b)(4) states, there are serious public policy reasons which support the few limitations that remain on the right to exculpate directors from liability. Further development of the outer limits is left, however, for the courts.

As noted above, shareholder agreements otherwise validated by section 7.32 are not legally binding on the state, on creditors, or on other third parties. For example, an agreement that dispenses with the need to make corporate filings required by the Act would be ineffective. Similarly, an agreement among shareholders that provides that only the president has authority to enter into contracts for the corporation would not, without more, be binding against third parties, and ordinary principles of agency, including the concept of apparent authority, would continue to apply.

2. Section 7.32(b)

Section 7.32 minimizes the formal requirements for a shareholder agreement so as not to restrict unduly the shareholders' ability to take advantage of the flexibility the section provides. Thus, unlike comparable provisions in special close corporation legislation, it is not necessary to ''opt in'' to a special class of close corporations in order to obtain the benefits of section 7.32. An agreement can be validated under section 7.32 whether it is set forth in the articles of incorporation, the bylaws or in a separate agreement, and whether or not section 7.32 is specifically referenced in the agreement. The principal requirements are simply that the agreement be in writing and be approved or agreed to by all persons who are then shareholders. Where the corporation has a single shareholder, the requirement of an ''agreement among the shareholders'' is satisfied by the unilateral action of the shareholder in establishing the terms of the agreement, evidenced by provisions in the articles or by-laws, or in a writing signed by the sole shareholder. Although a writing signed by all the shareholders is not required where the agreement is contained in articles of incorporation or bylaws unanimously approved, it may be desirable to have all the shareholders actually sign the instrument in order to establish unequivocally their agreement. Similarly, while transferees are bound by a valid shareholder agreement, it may be desirable to obtain the affirmative written assent of the transferee at the time of the transfer. Subsection (b) also establishes and permits amendments by less than unanimous agreement if the shareholder agreement so provides.

Section 7.32(b) requires unanimous shareholder approval regardless of entitlement to vote. Unanimity is required because an agreement authorized by section 7.32 can effect material organic changes in the corporation's operation and structure, and in the rights and obligations of shareholders.

The requirement that the shareholder agreement be made known to the corporation is the predicate for the requirement in subsection (c) that share certificates or information statements be legended to note the existence of the agreement. No specific form of notification is required and the agreement need not be filed with the corporation. In the case of shareholder agreements in the articles or bylaws, the corporation will necessarily have notice. In the case of shareholder agreements outside the articles or bylaws, the requirement of signatures by all of the shareholders will in virtually all cases be sufficient to constitute notification to the corporation, as one or more signatories will normally also be a director or an officer.

3. Section 7.32(c)

Section 7.32(c) addresses the effect of a shareholder agreement on subsequent purchasers or transferees of shares. Typically, corporations with shareholder agreements also have restrictions on the transferability of the shares as authorized by section 6.27 of the Model Act, thus lessening the practical effects of the problem in the context of voluntary transferees. Transferees of shares without knowledge of the agreement or those acquiring shares upon the death of an original participant in a close corporation may, however, be heavily impacted. Weighing the burdens on transferees against the burdens on the remaining shareholders in the enterprise, section 7.32(c) affirms the continued validity of the shareholder agreement on all transferees, whether by purchase, gift, operation of law, or otherwise. Unlike restrictions on transfer, it may be impossible to enforce a shareholder agreement against less than all of the shareholders. Thus, under section 7.32, one who inherits shares subject to a shareholder agreement must continue to abide by the agreement. If that is not the desired result, care must be exercised at the initiation of the shareholder agreement to ensure a different outcome, such as providing for a buy-back upon death.

Where shares are transferred to a purchaser without knowledge of a shareholder agreement, the validity of the agreement is similarly unaffected, but the purchaser is afforded a rescission remedy against the seller. The term ''purchaser'' imports consideration. Under subsection (c) the time at which notice to a purchaser is relevant for purposes of determining entitlement to rescission is the time when a purchaser acquires the shares rather than when a commitment is made to acquire the shares. If the purchaser learns of the agreement after he is committed to purchase but before he acquires the shares, he should not be permitted to proceed with the purchase and still obtain the benefits of the remedies in section 7.32(c). Moreover, under contract principles and the securities laws a failure to disclose the existence of a shareholder agreement would in most cases constitute the omission of a material fact and may excuse performance of the commitment to purchase. The term purchaser includes a person acquiring shares upon initial issue or by transfer, and also includes a pledgee, for whom the time of purchase is the time the shares are pledged.

Section 7.32 addresses the underlying rights that accrue to shares and shareholders and the validity of shareholder action which redefines those rights, as contrasted with questions regarding entitlement to ownership of the security, competing ownership claims, and disclosure issues. Consistent with this dichotomy, the rights and remedies available to purchasers under section 7.32(c) are independent of those provided by contract law, article 8 of the Uniform Commercial Code, the securities laws, and other law outside the Model Act. With respect to the related subject of restrictions on transferability of shares, note that section 7.32 does not directly address or validate such restrictions, which are governed instead by section 6.27 of the Act. However, if such restrictions are adopted as a part of a shareholder agreement that complies with the requirements of section 7.32, a court should construe broadly the concept of reasonableness under section 6.27 in determining the validity of such restrictions.

Section 7.32(c) contains an affirmative requirement that the share certificate or information statement for the shares be legended to note the existence of a shareholder agreement. No specified form of legend is required, and a simple statement that ''[t]he shares represented by this certificate are subject to a shareholder agreement'' is sufficient. At that point a purchaser must obtain a copy of the shareholder agreement from his transferor or proceed at his peril. In the event a corporation fails to legend share certificates or information statements, a court may, in an appropriate case, imply a cause of action against the corporation in favor of an injured purchaser without knowledge of a shareholder agreement. The circumstances under which such a remedy would be implied, the proper measure of damages, and other attributes of and limitations on such an implied remedy are left to development in the courts.

If the purchaser has no actual knowledge of a shareholder agreement, and is not charged with knowledge by virtue of a legend on the certificate or information statement, he has a rescission remedy against his transferor (which would be the corporation in the case of a new issue of shares). While the statutory rescission remedy provided in subsection (c) is nonexclusive, it is intended to be a purchaser's primary remedy.

If the shares are certificated and duly-legended, a purchaser is charged with notice of the shareholder agreement even if the purchaser never saw the certificate. Thus, a purchaser is exposed to risk if he does not ask to see the certificate at or prior to the purchase of the shares. In the case of uncertificated shares, however, the purchaser is not charged with notice of the shareholder agreement unless a duly-legended information statement is delivered to the purchaser at or prior to the time of purchase. This different rule for uncertificated shares is intended to provide an additional safeguard to protect innocent purchasers, and is necessary because section 6.26(b) of the Act and section 8–408 of the U.C.C. permit delivery of information statements after a transfer of shares.

4. Section 7.32(d)

Section 7.32(d) contains a self-executing termination provision for a shareholder agreement when the shares of the corporation become publicly traded, and the corporation thereby becomes a public corporation as defined in section 1.40(18A). The statutory norms in the Model Act become more necessary and appropriate as the number of shareholders increases, as there is greater opportunity to acquire or dispose of an investment in the corporation, and as there is less opportunity for negotiation over the terms under which the enterprise will be conducted. Given that section 7.32 requires unanimity, however, in most cases a practical limit on the availability of a shareholder agreement will be reached before a public market develops. Subsection (d), coupled with a parallel change in section 8.01, rejects the use of an absolute number of shareholders in determining when the shelter of section 7.32 is lost.

5. Miscellaneous Provisions

Sections 7.32(c) through (g) contain a number of technical provisions. Subsection (e) provides a shift of liability from the directors to any person or persons in whom the discretion or powers otherwise exercised by the board of directors are vested. A shareholder agreement which provides for such a shift of responsibility, with the concomitant shift of liability provided by subsection (e), could also provide for exculpation from that liability to the extent otherwise authorized by the Act. The transfer of liability provided by subsection (e) covers liabilities imposed on directors "by law," which is intended to include liabilities arising under the Act, the common law, and statutory law outside the Act. Nevertheless, there could be cases where subsection (e) is ineffective and where a director is exposed to liability *qua* director, even though under a shareholder agreement he may have given up some or all of the powers normally exercised by directors.

Subsection (f), based on the Close Corporation Supplement and the Texas statute, narrows the grounds for imposing personal liability on shareholders for the liabilities of a corporation for acts or omissions authorized by a shareholder agreement validated by section 7.32. Subsection (g) addresses shareholder agreements for corporations that are in the process of being organized and do not yet have shareholders.

The Model Act does not, of course, address the tax status of a corporation formed under the Act. When an unorthodox arrangement is established pursuant to a shareholder agreement authorized by section 7.32, the corporation could in some circumstances be deemed a partnership for tax purposes, an issue to which counsel should be attuned, but which is not addressed in the Model Act. See Treas. Reg. section 301.7701–1 (as amended in 1977); Rev. Rul. 88–76, 1988–2 C.B. 360 (company organized pursuant to a Wyoming statute for "limited liability companies" classified for federal tax purposes as a partnership).

SUBCHAPTER D. DERIVATIVE PROCEEDINGS

INTRODUCTORY COMMENT

Subchapter D deals with the requirements applicable to shareholder derivative suits. A great deal of controversy has surrounded the derivative suit, and widely different perceptions as to the value and efficacy of this litigation continue to exist. On the one hand, the derivative suit has historically been the principal method of challenging allegedly illegal action by management. On the other hand, it has long been recognized that the derivative suit may be instituted more with a view to obtaining a settlement resulting in fees to the plaintiff's attorney than to righting a wrong to the corporation (the so-called ''strike suit'').

Subchapter D replaces section 7.40 of the Revised Model Business Corporation Act which at the time of its adoption was stated to reflect a reappraisal of the various procedural devices designed to control abuses of the derivative suit ''in light of major developments in corporate governance, the public demand for corporate accountability, and the corporate response in the form of greater independence and sense of responsibility in boards of directors.''

Subchapter D reflects a further reappraisal of the requirements for a derivative suit particularly in the light of the large number of judicial decisions dealing with (a) whether demand upon the board of directors is required and (b) the power of independent directors to dismiss a derivative suit. The first of these issues was dealt with indirectly in former section 7.40 by requiring that the complaint state whether demand was made and, if not, why not; the second issue was not covered at all.

Section 7.42 of subchapter D requires a demand on the corporation in all cases. The demand must be made at least 90 days before commencement of suit unless irreparable injury to the corporation would result. It is believed that this provision will eliminate the often excessive time and expense for both litigants and the court in litigating the question whether demand is required but at the same time will not unduly restrict the legitimate derivative suit.

Section 7.44 expressly requires the dismissal of a derivative suit if independent directors have determined that the maintenance of the suit is not in the best interests of the corporation. This section confirms the basic principle that a derivative suit is an action on behalf of the corporation and therefore should be controlled by those directors who can exercise an independent business judgment with respect to its continuance. At the same time, the court is required to assess the independence and good faith of the directors and the reasonableness of their inquiry and, if a majority of the board is not independent, the burden is placed on the corporation to prove each of these elements.

Section 7.44 also provides a procedure for the determination to be made by a panel appointed by the court.

§ 7.40 Subchapter Definitions

In this subchapter:

(1) ''Derivative proceeding'' means a civil suit in the right of a domestic corporation or, to the extent provided in section 7.47, in the right of a foreign corporation.

(2) "Shareholder" includes a beneficial owner whose shares are held in a voting trust or held by a nominee on the beneficial owner's behalf.

OFFICIAL COMMENT

The definition of "derivative proceeding" makes it clear that the subchapter applies to foreign corporations only to the extent provided in section 7.47. Section 7.47 provides that the law of the jurisdiction of incorporation governs except for sections 7.43 (stay of proceedings), 7.45 (discontinuance or settlement) and 7.46 (payment of expenses). See the Official Comment to section 7.47.

The definition of "shareholder," which applies only to subchapter D, includes all beneficial owners and therefore goes beyond the definition in section 1.40(22) which includes only record holders and beneficial owners who are certified by a nominee pursuant to the procedure specified in section 7.23. Similar definitions are found in section 13.01 (appraisal rights) and section 16.02(f) (inspection of records by a shareholder). In the context of subchapter D, beneficial owner means a person having a direct economic interest in the shares. The definition is not intended to adopt the broad definition of beneficial ownership in SEC Rule 13d–2 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.13d–2, which includes persons with the right to vote or dispose of the shares even though they have no economic interest in them.

§ 7.41 Standing

A shareholder may not commence or maintain a derivative proceeding unless the shareholder:

(1) was a shareholder of the corporation at the time of the act or omission complained of or became a shareholder through transfer by operation of law from one who was a shareholder at that time; and

(2) fairly and adequately represents the interests of the corporation in enforcing the right of the corporation.

OFFICIAL COMMENT

The Model Act and the statutes of many states have long imposed a "contemporaneous ownership" rule, i.e., the plaintiff must have been an owner of shares at the time of the transaction in question. This rule has been criticized as being unduly narrow and technical and unnecessary to prevent the transfer or purchase of lawsuits. A few states, particularly California, Cal. Corp. Code section 800(B) (West 1977 & Supp.1989), have relaxed this rule in order to grant standing to some subsequent purchasers of shares in limited circumstances.

The decision to retain the contemporaneous ownership rule in section 7.41(1) was based primarily on the view that it was simple, clear, and easy to apply. In contrast, the California approach might encourage the acquisition of shares in order to bring a lawsuit, resulting in litigation on peripheral issues such as the extent of the plaintiff's knowledge of the transaction in question when the plaintiff acquired the shares. Further, there has been no persuasive showing that the contemporaneous ownership rule has prevented the litigation of substantial suits, at least with respect to publicly held corporations where there are many persons who might qualify as plaintiffs to bring suit even if subsequent purchasers are disqualified.

Section 7.41 requires the plaintiff to be a shareholder and therefore does not permit creditors or holders of options, warrants or conversion rights to commence a derivative proceeding.

Section 7.41(2) follows the requirement of Federal Rule of Civil Procedure 23.1 with the exception that the plaintiff must fairly and adequately represent the interests of *the corporation* rather than *shareholders similarly situated* as provided in the rule. The clarity of the rule's language in this regard has been questioned by the courts. See Nolen v. Shaw–Walker Company, 449 F.2d 506, 508 n.4 (6th Cir. 1972). Furthermore, it is believed that the reference to the corporation in section 7.41(2) more properly reflects the nature of the derivative suit.

The introductory language of section 7.41 refers both to the commencement and maintenance of the proceeding to make it clear that the proceeding should be dismissed if, after commencement, the plaintiff ceases to be a shareholder or a fair and adequate representative. The latter would occur, for example, if the plaintiff were using the proceeding for personal advantage. If a plaintiff no longer has standing, courts have in a number of instances provided an opportunity for one or more other shareholders to intervene.

§ 7.42 Demand

No shareholder may commence a derivative proceeding until:

(1) a written demand has been made upon the corporation to take suitable action; and

(2) 90 days have expired from the date the demand was made unless the shareholder has earlier been notified that the demand has been rejected by the corporation or unless irreparable injury to the corporation would result by waiting for the expiration of the 90-day period.

OFFICIAL COMMENT

Section 7.42 requires a written demand on the corporation in all cases. The demand must be made at least 90 days before commencement of suit unless irreparable injury to the corporation would result. This approach has been adopted for two reasons. First, even though no director may be independent, the demand will give the board of directors the opportunity to reexamine the act complained of in the light of a potential lawsuit and take corrective action. Secondly, the provision eliminates the time and expense of the litigants and the court involved in litigating the question whether demand is required. It is believed that requiring a demand in all cases does not impose an onerous burden since a relatively short waiting period of 90 days is provided and this period may be shortened if irreparable injury to the corporation would result by waiting for the expiration of the 90 day period. Moreover, the cases in which demand is excused are relatively rare. Many plaintiffs' counsel as a matter of practice make a demand in all cases rather than litigate the issue whether demand is excused.

1. Form of Demand

Section 7.42 specifies only that the demand shall be in writing. The demand should, however, set forth the facts concerning share ownership and be sufficiently specific to apprise the corporation of the action sought to be taken and the grounds for that action so that the demand can be evaluated. See Allison v. General Motors Corp., 604 F. Supp. 1106, 1117 (D. Del. 1985). Detailed pleading is not required since the corporation can contact the shareholder for clarification if there are any questions. In keeping with the spirit of this section, the specificity of the demand should not become a new source of dilatory motions.

2. Upon Whom Demand Should Be Made

Section 7.42 states that demand shall be made upon the corporation. Reference is not made specifically to the board of directors as in previous section 7.40(b) since there may be instances, such as a decision to sue a third party for an injury to the corporation, in which the taking of, or refusal to take, action would fall within the authority of an officer of the corporation. Nevertheless, it is expected that in most cases the board of directors will be the appropriate body to review the demand.

To ensure that the demand reaches the appropriate person for review, it should be addressed to the board of directors, chief executive officer or corporate secretary of the corporation at its principal office.

3. The 90-Day Period

Section 7.42(2) provides that the derivative proceeding may not be commenced until 90 days after demand has been made. Ninety days has been chosen as a reasonable minimum time within which the board of directors can meet, direct the necessary inquiry into the charges, receive the results of the inquiry and make its decision. In many instances a longer period may be required. See, e.g., Mozes v. Welch, 638 F.Supp. 215 (D. Conn. 1986) (eight month delay in responding to demand not unreasonable). However, a fixed time period eliminates further litigation over what is or is not a reasonable time. The corporation may request counsel for the shareholder to delay filing suit until the inquiry is completed or, if suit is commenced, the corporation can apply to the court for a stay under section 7.43.

Two exceptions are provided to the 90 day waiting period. The first exception is the situation where the shareholder has been notified of the rejection of the demand prior to the end of the 90 days. The second exception is where irreparable injury to the corporation would otherwise result if the commencement of the proceeding is delayed for the 90 day period. The standard to be applied is intended to be the same as that governing the entry of a preliminary injunction. Compare Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch. 1974) with Gelco Corp. v. Coniston Partners, 811 F.2d 414 (8th Cir. 1987). Other factors may also be considered such as the possible expiration of the statute of limitations although this would depend on the period of time during which the shareholder was aware of the grounds for the proceeding.

It should be noted that the shareholder bringing suit does not necessarily have to be the person making the demand. Only one demand need be made in order for the corporation to consider whether to take corrective action.

4. Response by the Corporation

There is no obligation on the part of the corporation to respond to the demand. However, if the corporation, after receiving the demand, decides to institute litigation or, after a derivative proceeding has commenced, decides to assume control of the litigation, the shareholder's right to commence or control the proceeding ends unless it can be shown that the corporation will not adequately pursue the matter. As stated in Lewis v. Graves, 701 F.2d 245, 247–48 (2d Cir. 1983):

> The [demand] rule is intended ''to give the derivative corporation itself the opportunity to take over a suit which was brought on its behalf in the first place, and thus to allow the directors the chance to occupy their normal status as conductors of the corporation's affairs.'' Permitting corporations to assume control over shareholder derivative suits also has numerous practical advantages. Corporate management may be in a better position to pursue alternative remedies, resolving grievances without burdensome and expensive litigation. Deference to directors' judgments may also result in the termination of meritless actions brought solely for their settlement or harassment value. Moreover, where litigation is appropriate, the derivative corporation will often be in a better position to bring or assume the suit because of superior financial resources and knowledge of the challenged transactions. [Citations omitted.]

§ 7.43 Stay of Proceedings

If the corporation commences an inquiry into the allegations made in the demand or complaint, the court may stay any derivative proceeding for such period as the court deems appropriate.

OFFICIAL COMMENT

Section 7.43 provides that if the corporation undertakes an inquiry, the court may in its discretion stay the proceeding for such period as the court deems appropriate. This might occur where the complaint is filed 90 days after demand but the inquiry into the matters raised by the demand has not been completed or where a demand has not been investigated but the corporation commences the inquiry after the complaint has been filed. In either case, it is expected that the court will monitor the course of the inquiry to ensure that it is proceeding expeditiously and in good faith.

§ 7.44 Dismissal

(a) A derivative proceeding shall be dismissed by the court on motion by the corporation if one of the groups specified in subsection (b) or (e) has determined in good faith after conducting a reasonable inquiry upon which its conclusions are based that the maintenance of the derivative proceeding is not in the best interests of the corporation.

(b) Unless a panel is appointed pursuant to subsection (e), the determination in subsection (a) shall be made by:

(1) a majority vote of independent directors present at a meeting of the board of directors if the independent directors constitute a quorum; or

(2) a majority vote of a committee consisting of two or more independent directors appointed by majority vote of independent directors present at a meeting of the board of directors, whether or not such independent directors constituted a quorum.

(c) None of the following shall by itself cause a director to be considered not independent for purposes of this section:

(1) the nomination or election of the director by persons who are defendants in the derivative proceeding or against whom action is demanded;

(2) the naming of the director as a defendant in the derivative proceeding or as a person against whom action is demanded; or

(3) the approval by the director of the act being challenged in the derivative proceeding or demand if the act resulted in no personal benefit to the director.

(d) If a derivative proceeding is commenced after a determination has been made rejecting a demand by a shareholder, the complaint shall allege with particularity facts establishing either (1) that a majority of the board of directors did not consist of independent directors at the time the determination was made or (2) that the requirements of subsection (a) have not been met.

(e) If a majority of the board of directors does not consist of independent directors at the time the determination is made, the corporation shall have the burden of proving that the requirements of subsection (a) have been met. If a majority of the board of directors consists of independent directors at the time the determination is made, the plaintiff shall have the burden of proving that the requirements of subsection (a) have not been met.

(f) The court may appoint a panel of one or more independent persons upon motion by the corporation to make a determination whether the maintenance of the derivative proceeding is in the best interests of the corporation. In such case, the plaintiff shall have the burden of proving that the requirements of subsection (a) have not been met.

OFFICIAL COMMENT

At one time the Model Act did not expressly provide what happens when a board of directors properly rejects a demand to bring an action. In such event, judicial decisions indicate that the rejection should be honored and any ensuing derivative action should be dismissed. See Aronson v. Lewis, 473 A.2d 805, 813

(Del.1984). The Model Act was also silent on the effect of a determination by a special litigation committee of qualified directors that a previously commenced derivative action be dismissed. Section 7.44(a) specifically provides that the proceeding shall be dismissed if there is a proper determination that the maintenance of the proceeding is not in the best interests of the corporation. That determination can be made prior to commencement of the derivative action in response to a demand or after commencement upon examination of the allegations of the complaint.

The procedures set forth in section 7.44 are not intended to be exclusive. As noted in the comment to section 7.42, there may be instances where a decision to commence an action falls within the authority of an officer of the corporation depending upon the amount of the claim and the identity of the potential defendants.

1. The Persons Making the Determination

Section 7.44(b) prescribes the persons by whom the determination in subsection (a) may be made. Subsection (b) provides that the determination may be made (1) at a board meeting by a majority vote of qualified directors if the qualified directors constitute a quorum, or (2) by a majority vote of a committee consisting of two or more qualified directors appointed at a board meeting by a vote of the qualified directors in attendance, regardless of whether they constitute a quorum. (For the definition of ''qualified director,'' see section 1.43 and the related official comment.) These provisions parallel the mechanics for determining entitlement to indemnification (section 8.55) and for authorizing directors' conflicting interest transactions (section 8.62). Subsection (b)(2) is an exception to section 8.25 of the Model Act, which requires the approval of at least a majority of all the directors in office to create a committee and appoint members. This approach has been taken to respond to the criticism expressed in a few cases that special litigation committees suffer from structural bias because of their appointment by vote of directors who at that time are not qualified directors. See Hasan v. Trust Realty Investors, 729 F.2d 372, 376–77 (6th Cir. 1984).

Subsection (e) provides, as an alternative, for a determination by a panel of one or more individuals appointed by the court. The subsection provides for the appointment only upon motion by the corporation. This would not, however, prevent the court on its own initiative from appointing a special master pursuant to applicable state rules of procedure. (Although subsection (b)(2) requires a committee of at least two qualified directors, subsection (e) permits the appointment by the court of only one person in recognition of the potentially increased costs to the corporation for the fees and expenses of any outside person.

This panel procedure may be desirable in a number of circumstances. If there are no qualified directors available, the corporation may not wish to enlarge the board to add qualified directors or may be unable to find persons willing to serve as qualified directors. In addition, even if there are directors who are qualified, they may not be in a position to conduct the inquiry in an expeditious manner.

Appointment by the court should also eliminate any question about the qualifications of the individual or individuals constituting the panel making the determination. Although the corporation may wish to suggest to the court possible appointees, the court will not be bound by those suggestions and, in any case, will want to satisfy itself with respect to each candidate's impartiality. When the court appoints a panel, subsection (e) places the burden on the plaintiff to prove that the requirements of subsection (a) have not been met.

2. Standards to be Applied

Section 7.44(a) requires that the determination, by the appropriate person or persons, be made ''in good faith, after conducting a reasonable inquiry upon which their conclusions are based.'' The phrase ''in good faith'' modifies both the determination and the inquiry. This standard, which is also found in sections 8.30 (general standards of conduct for directors) and 8.51 (authority to indemnify) of the Model Act, is a subjective one, meaning ''honestly or in an honest manner.'' See also ''Corporate Director's Guidebook (Fourth Edition),'' 59 Bus. Law. 1057, 1068 (2004). As stated in Abella v. Universal Leaf Tobacco Co., 546 F.Supp. 795, 800 (E.D. Va. 1982), ''the inquiry intended by this phrase goes to the spirit and sincerity with which the investigation was conducted, rather than the reasonableness of its procedures or basis for conclusions.''

The word ''inquiry''—rather than ''investigation''—has been used to make it clear that the scope of the inquiry will depend upon the issues raised and the knowledge of the group making the determination with respect to the issues. In some cases, the issues may be so simple or the knowledge of the group so extensive that little additional inquiry is required. In other cases, the group may need to engage counsel and other professionals to make an investigation and assist the group in its evaluation of the issues.

The phrase ''upon which its conclusions are based'' requires that the inquiry and the conclusions follow logically. This standard authorizes the court to examine the determination to ensure that it has some support in the findings of the inquiry. The burden of convincing the court about this issue lies with whichever party has the burden under subsection (d). This phrase does not require the persons making the determination to prepare a written report that sets forth their determination and the bases therefor, since circumstances will vary as to the need for such a report. There will be, in all likelihood, many instances where good corporate practice will commend such a procedure.

Section 7.44 is not intended to modify the general standards of conduct for directors set forth in section 8.30 of the Model Act, but rather to make those standards somewhat more explicit in the derivative proceeding context. In this regard, the qualified directors making the determination would be entitled to rely on information and reports from other persons in accordance with section 8.30(d).

Section 7.44 is similar in several respects and differs in certain other respects from the law as it has developed in Delaware and been followed in a number of other states. Under the Delaware cases, the role of the court in reviewing the directors' determination varies depending upon whether the plaintiff is in a demand required or demand excused situation.

Since section 7.42 requires demand in all cases, the distinction between demand-excused and demand-required cases does not apply. Subsections (c) and (d) carry forward that distinction, however, by establishing pleading rules and allocating the burden of proof depending on whether there is a majority of qualified directors on the board. Subsection (c), like Delaware law, assigns to the plaintiff the threshold burden of alleging facts establishing that the majority of the directors on the board are not qualified. If there is a majority, then the burden remains with the plaintiff to plead and establish that the requirements of subsection (a) section 7.44(a) have not been met. If there is not a majority of qualified directors on the board, then the burden is on the corporation to prove that the issues delineated in subsection (a) have been satisfied; that is, the corporation must prove both the eligibility of the decision makers to act on the matter and the propriety of their inquiry and determination.

Thus, the burden of proving that the requirements of subsection (a) have not been met will remain with the plaintiff in several situations. First, where the determination to dismiss the derivative proceeding is made in accordance with subsection (b)(1), the burden of proof will generally remain with the plaintiff since the subsection requires a quorum of qualified directors and a quorum is normally a majority. See section 8.24. The burden will also remain with the plaintiff if a majority of qualified directors constitute a majority of the board. Under subsection (e), the burden of proof also remains with the plaintiff in the case of a determination by a panel appointed by the court.

The burden of proof will shift to the corporation, however, where a majority of the board members are not qualified and the determination is made by a committee under subsection (b)(2). It can be argued that, if the directors making the determination under subsection (b)(2) are independent and have been delegated full responsibility for making the decision, the composition of the entire board is irrelevant. This argument is buttressed by the section's method of appointing the group specified in subsection (b)(2), since subsection (b)(2) departs from the general method of appointing committees and allows only qualified directors, rather than a majority of the entire board, to appoint the committee which will make the determination. Subsection (d)'s response to objections suggesting structural bias is to place the burden of proof on the corporation (despite the fact that the committee making the determination is composed exclusively of qualified directors).

Finally, section 7.44 does not authorize the court to review the reasonableness of the determination to reject a demand or seek dismissal. This contrasts with the approach in some states that permits a court, at least in some circumstances, to review the merits of the determination (see Zapata Corp. v. Maldonado, 430 A.2d 779, 789 (Del. 1981) and is similar to the approach taken in other states (see Auerbach v. Bennett, 393 N.E.2d 994, 1002–03 (N.Y.1979).

3. Pleading

The Model Act previously provided that the complaint in a derivative proceeding must allege with particularity either that demand had been made on the board of directors, together with the board's response, or why demand was excused. This requirement is similar to Rule 23.1 of the Federal Rules of Civil Procedure. Since demand is now required in all cases, this provision is no longer necessary.

Subsection (c) sets forth a modified pleading rule to cover the typical situation where plaintiff makes demand on the board, the board rejects that demand, and the plaintiff commences an action. In that scenario, in order to state a cause of action, subsection (c) requires the complaint to allege with particularity facts demonstrating either (1) that no majority of independent directors exists or (2) why the determination does not meet the standards in subsection (a). Discovery should be available to the plaintiff only after the plaintiff has successfully stated a cause of action by making either of these two showings.

§ 7.45 Discontinuance or Settlement

A derivative proceeding may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the interests of the corporation's shareholders or a class of shareholders, the court shall direct that notice be given to the shareholders affected.

OFFICIAL COMMENT

Section 7.45 follows the Federal Rules of Civil Procedure, and the statutes of a number of states, and requires that all proposed settlements and discontinuances must receive judicial approval. This requirement seems a natural consequence of the proposition that a derivative suit is brought for the benefit of all shareholders and avoids many of the evils of the strike suit by preventing the individual shareholder-plaintiff from settling privately with the defendants.

Section 7.45 also requires notice to all affected shareholders if the court determines that the proposed settlement may substantially affect their interests. This provision permits the court to decide that no notice need be given if, in the court's judgment, the proceeding is frivolous or has become moot. The section also makes a distinction between classes of shareholders, an approach which is not in Federal Rule of Civil Procedure 23.1, but is adapted from the New York and Michigan statutes. This procedure could be used, for example, to eliminate the costs of notice to preferred shareholders where the settlement does not have a substantial effect on their rights as a class, such as their rights to dividends or a liquidation preference.

Unlike the statutes of some states, section 7.45 does not address the issue of which party should bear the cost of giving this notice. That is a matter left to the discretion of the court reviewing the proposed settlement.

§ 7.46 Payment of Expenses

On termination of the derivative proceeding the court may:

(1) order the corporation to pay the plaintiff's expenses incurred in the proceeding if it finds that the proceeding has resulted in a substantial benefit to the corporation;

(2) order the plaintiff to pay any defendant's expenses incurred in defending the proceeding if it finds that the proceeding was commenced or maintained without reasonable cause or for an improper purpose; or

(3) order a party to pay an opposing party's expenses incurred because of the filing of a pleading, motion or other paper, if it finds that the pleading, motion or other paper was not well grounded in

fact, after reasonable inquiry, or warranted by existing law or a good faith argument for the extension, modification or reversal of existing law and was interposed for an improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

OFFICIAL COMMENT

Section 7.46(1) is intended to be a codification of existing case law. See, e.g., Mills v. Electric Auto–Lite Co., 396 U.S. 375 (1970). It provides that the court may order the corporation to pay the plaintiff's reasonable expenses (including counsel fees) if it finds that the proceeding has resulted in a substantial benefit to the corporation. The subsection requires that there be a ''substantial'' benefit to the corporation to prevent the plaintiff from proposing inconsequential changes in order to justify the payment of counsel fees. While the subsection does not specify the method for calculating attorneys' fees since there is a substantial body of court decisions delineating this issue, it does require that the expenses be reasonable which would include taking into account the amount or character of the benefit to the corporation.

Section 7.46(2) provides that on termination of a proceeding the court may require the plaintiff to pay the defendants' reasonable expenses, including attorneys' fees, if it finds that the proceeding ''was commenced or maintained without reasonable cause or for an improper purpose.'' The phrase ''for an improper purpose'' has been added to parallel Federal Rule of Civil Procedure 11 in order to prevent proceedings which may be brought to harass the corporation or its officers. The test in this section is similar to but not identical with the test utilized in section 13.31, relating to dissenters' rights, where the standard for award of expenses and attorneys' fees is that dissenters ''acted arbitrarily, vexatiously or not in good faith'' in demanding a judicial appraisal of their shares. The derivative action situation is sufficiently different from the dissenters' rights situation to justify a different and less onerous test for imposing costs on the plaintiff. The test of section 7.46 that the action was brought without reasonable cause or for an improper purpose is appropriate to deter strike suits, on the one hand, and on the other hand to protect plaintiffs whose suits have a reasonable foundation.

Section 7.46(3) has been added to deal with other abuses in the conduct of derivative litigation which may occur on the part of the defendants and their counsel as well as by the plaintiffs and their counsel. The section follows generally the provisions of Rule 11 of the Federal Rules of Civil Procedure. Section 7.46(3) will not be necessary in states which already have a counterpart to Rule 11.

§ 7.47 Applicability to Foreign Corporations

In any derivative proceeding in the right of a foreign corporation, the matters covered by this subchapter shall be governed by the laws of the jurisdiction of incorporation of the foreign corporation except for sections 7.43, 7.45 and 7.46.

OFFICIAL COMMENT

Section 7.47 clarifies the application of the provisions of subchapter D to foreign corporations. Previous section 7.40 referred to proceedings in the right of both domestic and foreign corporations, but neither the section nor the comment discussed the interaction between section 7.40 as it applied to a foreign corporation and the law of its state of incorporation. Under generally prevailing practice, a court will look to the choice-of-law rules of the forum state to determine which law shall apply. If the issue is ''procedural'', the law of the forum state will apply; if the issue is ''substantive'', relating to the internal affairs of the corporation, the law of the state of incorporation will apply. See, e.g., Hausman v. Buckley, 299 F.2d 696, 700–06 (2d Cir.1962); Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980). Compare Restatement (Second) of Conflict of Laws §§ 302, 303, 304, 306, 309 (1988) (the local law of the state of incorporation will be applied except in the unusual case where, with respect to the particular issue, some other state has a more significant relationship under the principles stated in section 6 of the Restatement to the parties and the corporation or the transaction).

However, the distinction between what is procedural and what is substantive is not clear. See, e.g., Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 555–57 (1949). For example, in Susman v. Lincoln American Corp., 550 F.Supp. 442, 446 n.6 (N.D. Ill. 1982), the court suggested that the standing requirement might be considered a federal procedural question under Federal Rule of Civil Procedure 23.1 and a matter of substantive law under the Delaware statute.

In view of the uncertainties created by these decisions, section 7.47 sets forth a choice of law provision for foreign corporations. It provides, subject to three exceptions, that the matters covered by the subchapter shall be governed by the laws of the jurisdiction of incorporation of the foreign corporation. In this respect, the section is similar to section 901 of the Revised Uniform Limited Partnership Act which provides that the laws of the state under which a foreign limited partnership is organized govern its organization and internal affairs.

The three exceptions to the general rule are areas which are traditionally part of the forum's oversight of the litigation process: section 7.43 dealing with the ability of the court to stay proceedings; section 7.45 setting forth the procedure for settling a proceeding; and section 7.46 providing for the assessment of reasonable expenses (including counsel fees) in certain situations.

SUBCHAPTER E. PROCEEDING TO APPOINT CUSTODIAN OR RECEIVER

§ 7.48. Shareholder Action to Appoint Custodian or Receiver

(a) The [name or describe court or courts] may appoint one or more persons to be custodians, or, if the corporation is insolvent, to be receivers, of and for a corporation in a proceeding by a shareholder where it is established that:

(1) The directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered; or

(2) the directors or those in control of the corporation are acting fraudulently and irreparable injury to the corporation is threatened or being suffered.

(b) The court

(1) may issue injunctions, appoint a temporary custodian or temporary receiver with all the powers and duties the court directs, take other action to preserve the corporate assets wherever located, and carry on the business of the corporation until a full hearing is held;

(2) shall hold a full hearing, after notifying all parties to the proceeding and any interested persons designated by the court, before appointing a custodian or receiver; and

(3) has jurisdiction over the corporation and all of its property, wherever located.

(c) The court may appoint an individual or domestic or foreign corporation (authorized to transact business in this state) as a custodian or receiver and may require the custodian or receiver to post bond, with or without sureties, in an amount the court directs.

(d) The court shall describe the powers and duties of the custodian or receiver in its appointing order, which may be amended from time to time. Among other powers,

(1) a custodian may exercise all of the powers of the corporation, through or in place of its board of directors, to the extent necessary to manage the business and affairs of the corporation; and

(2) a receiver (i) may dispose of all or any part of the assets of the corporation wherever located, at a public or private sale, if authorized by the court; and (ii) may sue and defend in the receiver's own name as receiver in all courts of this state.

(e) The court during a custodianship may redesignate the custodian a receiver, and during a receivership may redesignate the receiver a custodian, if doing so is in the best interests of the corporation.

(f) The court from time to time during the custodianship or receivership may order compensation paid and expense disbursements or reimbursements made to the custodian or receiver from the assets of the corporation or proceeds from the sale of its assets.

CHAPTER 8. DIRECTORS AND OFFICERS

SUBCHAPTER A. BOARD OF DIRECTORS

§ 8.01 Requirement for and Functions of Board of Directors

(a) Except as provided in section 7.32, each corporation must have a board of directors.

(b) All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorized under section 7.32.

(c) In the case of a public corporation, the board's oversight responsibilities include attention to:

(1) business performance and plans;

(2) major risks to which the corporation is or may be exposed;

(3) the performance and compensation of senior officers;

(4) policies and practices to foster the corporation's compliance with law and ethical conduct;

(5) preparation of the corporation's financial statements;

(6) the effectiveness of the corporation's internal controls;

(7) arrangements for providing adequate and timely information to directors; and

(8) the composition of the board and its committees, taking into account the important role of independent directors.

OFFICIAL COMMENT

Section 8.01 requires that every corporation have a board of directors except that a shareholder agreement authorized by section 7.32 may dispense with or limit the authority of the board of directors. Section 8.01(b) also recognizes that the powers of the board of directors may be limited by express provisions in the articles of incorporation or by an agreement among all shareholders under section 7.32.

Obviously, some form of governance is necessary for every corporation. The board of directors is the traditional form of corporate governance but it need not be the exclusive form. Patterns of management may also be tailored to specific needs in connection with family controlled enterprises, wholly or partially owned subsidiaries, or corporate joint ventures through a shareholder agreement under section 7.32.

Under section 7.32, an agreement among all shareholders can provide for a nontraditional form of corporate governance until the corporation becomes a public corporation as defined in section 1.40(18A). This is a change from the 50 or fewer shareholder test in place in section 8.01 prior to 1990. As the number of shareholders increases and a market for the shares develops, there is (i) an opportunity for unhappy shareholders to dispose of shares—a ''market out,'' (ii) a correlative opportunity for others to acquire shares with related expectations regarding the applicability of the statutory norms of governance, and (iii) no real opportunity to negotiate over the terms upon which the enterprise will be conducted. Moreover, tying the availability of nontraditional governance structures to an absolute number of shareholders at the time of adoption took no account of subsequent events, was overly mechanical, and subject to circumvention. If a corporation does not have a shareholders agreement that satisfies the requirements of section 7.32, or if it is a public corporation, it must adopt the traditional board of directors as its governing body.

Section 8.01(b) states that if a corporation has a board of directors ''its business and affairs shall be managed by or under the direction, and subject to the oversight, of its board of directors.'' The phrase ''by or under the direction of'' encompasses the varying functions of boards of directors of different corporations. In some closely held corporations, the board of directors may be involved in the day-to-day business and affairs and it may be reasonable to describe management as being ''by'' the board of directors. But in many other corporations, the business and affairs are managed ''under the direction, and subject to the oversight, of'' the board of directors, since operational management is delegated to executive officers and other professional managers.

While section 8.01(b), in providing for corporate powers to be exercised under the authority of the board of directors, allows the board of directors to delegate to appropriate officers, employees or agents of the corporation authority to exercise powers and perform functions not required by law to be exercised or performed by the board of directors itself, responsibility to oversee the exercise of that delegated authority nonetheless remains with the board of directors. The scope of that oversight responsibility will vary depending on the nature of the corporation's business. For public corporations, subsection (c) provides that the scope of the directors' oversight responsibility includes the matters identified in that subsection. For other corporations, that responsibility may, depending on the circumstances, include some or all of those matters as well. At least for public corporations, subsections (c)(3) and (4) encompass oversight of the corporation's dealings and relationships with its directors and officers, including processes designed to prevent improper related party transactions. See also, chapter 8, subchapter F, sections 8.60 et seq. Subsection (c)(5) encompasses the corporation's compliance with the requirements of sections 16.01 and 16.20, while subsection (c)(6) extends also to the internal control processes in place to provide reasonable assurance regarding the reliability of financial reporting, effectiveness, and efficiency of operations and compliance with applicable laws and regulations. Subsection (c)(7) reflects that the board of directors should devote attention to whether the corporation has information and reporting systems in place to provide directors with appropriate information in a timely manner in order to permit them to discharge their responsibilities. See In re Caremark Int'l Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

Subsection (c)(vii) calls for the board of a public corporation, in giving attention to the composition of the board and its committees, to take into account the important role of independent directors. It is commonly accepted that where ownership is separated from management, as is the case with public corporations, having non-management independent directors who participate actively in the board's oversight functions increases the likelihood that actions taken by the board will serve the best interests of the corporation and its shareholders and generally will be given deference in judicial proceedings. The listing standards of most public securities markets have requirements for independent directors to serve on boards; in many cases, they must constitute a majority of the board, and certain board committees must be composed entirely of independent directors. The listing standards have differing rules as to what constitutes an independent director. The Act does not attempt to define ''independent director.'' Ordinarily, an independent director may not be a present or recent member of senior management. Also, to be considered independent, the individual usually must be free of significant professional, financial or similar relationships—and the director and members of the director's immediate family must be free of similar relationships with the corporation's senior management. Judgment is required to determine independence in light of the particular circumstances, subject to any specific requirements of a listing standard. The qualities of disinterestedness required of directors under the Act for specific purposes are similar but not necessarily identical. For the requirements for a director to be eligible to act in those situations, see section 1.43. An individual who is generally an independent director for purposes of subsection (c) may not be eligible to act in a particular case under those other provisions of the Act. Conversely, a director who is not independent for purposes of subsection (c) (for example, a member of management) may be so eligible in a particular case.

Although delegation does not relieve the board of directors from its responsibilities of oversight, directors should not be held personally responsible for actions or omissions of officers, employees, or agents of the corporation so long as the directors have relied reasonably and in good faith upon these officers, employees, or agents. See sections 8.30 and 8.31 and their Official Comments. Directors generally have the power to probe into day-to-day management to any depth they choose, but they have the obligation to do so only to the extent that the directors' oversight responsibilities may require, or, for example, when they become aware of matters which make reliance on management or other persons unwarranted.

§ 8.02 Qualifications of Directors

The articles of incorporation or bylaws may prescribe qualifications for directors. A director need not be a resident of this state or a shareholder of the corporation unless the articles of incorporation or bylaws so prescribe.

§ 8.03 Number and Election of Directors

(a) A board of directors must consist of one or more individuals, with the number specified in or fixed in accordance with the articles of incorporation or bylaws.

(b) The number of directors may be increased or decreased from time to time by amendment to, or in the manner provided in, the articles of incorporation or the bylaws.

(c) Directors are elected at the first annual shareholders' meeting and at each annual meeting thereafter unless their terms are staggered under section 8.06.

OFFICIAL COMMENT

Section 8.03 prescribes rules for (i) the determination of the size of the board of directors of corporations that have not dispensed with a board of directors under section 7.32(a)(1), and (ii) changes in the number of directors once the board's size has been established.

1. Minimum Number of Directors

Section 8.03(a) provides that the size of the initial board of directors may be ''specified in or fixed in accordance with'' the articles of incorporation or bylaws. The size of the board of directors may thus be fixed initially in one or more of the fundamental corporate documents, or the decision as to the size of the initial board of directors may be made thereafter in the manner authorized in those documents.

Before 1969 the Model Act required a board of directors to consist of at least three directors. Since then, the Model Act (as well as the corporation statutes of an increasing number of states) has provided that the board of directors may consist of one or more members. A board of directors consisting of one or two individuals may be appropriate for corporations with one or two shareholders, or for corporations with more than two shareholders where in fact the full power of management is vested in only one or two persons. The requirement that every corporation have a board of directors of at least three directors may require the introduction into these closely held corporations of persons with no financial interest in the corporation.

2. Changes in the Size of the Board of Directors

Section 8.03(b) provides a corporation with the freedom to design its articles of incorporation and bylaw provisions relating to the size of the board with a view to achieving the combination of flexibility for the board of directors and protection for shareholders that it deems appropriate. The articles of incorporation could provide for a specified number of directors or a variable range board, thereby requiring shareholder action to change the fixed size of the board, to change the limits established for the size of the variable range board or to change from a variable range board to a fixed board or vice versa. An alternative would be to have the bylaws provide for a specified number of directors or a variable range for the board of directors. Any change would be made in the manner provided by the bylaws. The bylaws could permit amendment by the board of directors or the bylaws could require that any amendment, in whole or in part, be made only by the shareholders in accordance with section 10.20(a). Typically the board of directors would be permitted to change the board size within the established variable range. If a corporation wishes to ensure that any change in the number of directors be approved by shareholders, then an appropriate restriction would have to be included in the articles or bylaws.

The board's power to change the number of directors, like all other board powers, is subject to compliance with applicable standards governing director conduct. In particular, it may be inappropriate to change the size of the board for the primary purpose of maintaining control or defeating particular candidates for the board. See Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

Experience has shown, particularly in larger corporations, that it is desirable to grant the board of directors authority to change its size without incurring the expense of obtaining shareholder approval. In closely held corporations, shareholder approval for a change in the size of the board of directors may be readily accomplished if that is desired. In many closely held corporations a board of directors of a fixed size may be an essential part of a control arrangement. In these situations, an increase or decrease in the size of the board of directors by even a single member may significantly affect control. In order to maintain control arrangements dependent on a board of directors of a fixed size, the power of the board of directors to change its own size must be negated. This may be accomplished by fixing the size of the board of directors in the articles of incorporation or by expressly negating the power of the board of directors to change the size of the board, whether by amendment of the bylaws or otherwise. See section 10.20(a).

3. Annual Elections of Directors

Section 8.03(c) makes it clear that all directors are elected annually unless the board is staggered. See section 8.05 and its Official Comment.

§ 8.04 Election of Directors by Certain Classes of Shareholders

If the articles of incorporation authorize dividing the shares into classes, the articles may also authorize the election of all or a specified number of directors by the holders of one or more authorized classes of shares. A class (or classes) of shares entitled to elect one or more directors is a separate voting group for purposes of the election of directors.

§ 8.05 Terms of Directors Generally

(a) The terms of the initial directors of a corporation expire at the first shareholders' meeting at which directors are elected.

(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.

(c) A decrease in the number of directors does not shorten an incumbent director's term.

(d) The term of a director elected to fill a vacancy expires at the next shareholders' meeting at which directors are elected.

(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

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.

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.

§ 8.06 Staggered Terms for Directors

The articles of incorporation may provide for staggering the terms of directors by dividing the total number of directors into two or three groups, with each group containing one-half or one-third of the total, as near as may be. In that event, the terms of directors in the first group expire at the first annual shareholders' meeting after their election, the terms of the second group expire at the second annual shareholders' meeting after their election, and the terms of the third group, if any, expire at the third annual shareholders' meeting after their election. At each annual shareholders' meeting held thereafter, directors shall be chosen for a term of two years or three years, as the case may be, to succeed those whose terms expire.

OFFICIAL COMMENT

Section 8.06 recognizes the practice of ''classifying'' the board or ''staggering'' the terms of directors so that only one-half or one-third of them are elected at each annual shareholders' meeting and directors are elected for two or three-year terms rather than one-year terms.

The traditional purpose of a staggered board has been to assure the continuity and stability of the corporation's business strategies and policies as determined by the board. In recent years the practice has been employed with increasing frequency to ensure that a majority of the board of directors remains in place following a sudden change in shareholdings or a proxy contest. It also reduces the impact of cumulative voting since a greater number of votes is required to elect a director if the board is staggered than is required if the entire board is elected at each annual meeting. A staggered board of directors also can have the effect of making unwanted takeover attempts more difficult, particularly where the articles of incorporation provide that the shareholders may remove directors only with cause or by a supermajority vote, or both.

§ 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.

§ 8.08 Removal of Directors by Shareholders

(a) The shareholders may remove one or more directors with or without cause unless the articles of incorporation provide that directors may be removed only for cause.

(b) If a director is elected by a voting group of shareholders, only the shareholders of that voting group may participate in the vote to remove him.

(c) If cumulative voting is authorized, a director may not be removed if the number of votes sufficient to elect him under cumulative voting is voted against his removal. If cumulative voting is not authorized, a director may be removed only if the number of votes cast to remove him exceeds the number of votes cast not to remove him.

(d) A director may be removed by the shareholders only at a meeting called for the purpose of removing him and the meeting notice must state that the purpose, or one of the purposes, of the meeting is removal of the director.

§ 8.09 Removal of Directors by Judicial Proceeding

(a) The [name or describe] court of the county where a corporation's principal office (or, if none in this state, its registered office) is located may remove a director of the corporation from office in a proceeding commenced by or in the right of the corporation if the court finds that (1) the director engaged in fraudulent conduct with respect to the corporation or its shareholders, grossly abused the position of director, or intentionally inflicted harm on the corporation; and (2) considering the director's course of conduct and the inadequacy of other available remedies, removal would be in the best interest of the corporation.

(b) A shareholder proceeding on behalf of the corporation under subsection (a) shall comply with all of the requirements of subchapter 7D, except 7.41(1).

(c) The court, in addition to removing the director, may bar the director from reelection for a period prescribed by the court.

(d) Nothing in this section limits the equitable powers of the court to order other relief.

OFFICIAL COMMENT

Section 8.09 is designed to operate in the limited circumstance where other remedies are inadequate to address serious misconduct by a director and it is impracticable for shareholders to invoke the usual remedy of removal under section 8.08. In recognition that director election and removal are principal prerogatives of shareholders, section 8.09 authorizes judicial removal of a director who is found to have engaged in serious misconduct as described in subsection (a)(1) if the court also finds that, taking into consideration the director's course of conduct and the inadequacy of other available remedies, removal of the director would be in the best interest of the corporation. Misconduct serious enough to justify the extraordinary remedy of judicial removal does not involve any matter falling within an individual director's lawful exercise of business judgment, no matter how unpopular the director's views may be with the other members of the board. Policy and personal differences among the members of the board of directors should be left to be resolved by the shareholders.

Section 8.09(d) makes it clear that the court is not restricted to the removal remedy in actions under this section but may order any other equitable relief. Where, for example, the complaint concerns an ongoing course of conduct that is harmful to the corporation, the court may enjoin the director from continuing that conduct. In another instance, the court may determine that the director's continuation in office is inimical to the best interest of the corporation. Judicial removal might be the most appropriate remedy in that case if shareholder removal under section 8.08 is impracticable because of situations like the following:

(1) The director charged with serious misconduct personally owns or controls sufficient shares to block removal.

(2) The director was elected by voting group or cumulative voting, and the shareholders with voting power to prevent his removal will exercise that power despite the director's serious misconduct and without regard to what the court deems to be the best interest of the corporation.

(3) A shareholders' meeting to consider removal under section 8.08 will entail considerable expense and a period of delay that will be contrary to the corporation's best interest.

A proceeding under this section may be brought by the board of directors or by a shareholder suing derivatively. If an action is brought derivatively, all of the provisions of subchapter 7D, including dismissal under section 7.44, are applicable to the action with the exception of the contemporaneous ownership requirement of section 7.41(1).

Section 8.09 is designed to interfere as little as possible with the usual mechanisms of corporate governance. Accordingly, except for limited circumstances such as those described above, where shareholders have reelected or declined to remove a director with full knowledge of the director's misbehavior, the court should decline to entertain an action for removal under section 8.09. It is not intended to permit judicial resolution of internal corporate disputes involving issues other than those specified in subsection (a)(1).

§ 8.10 Vacancy on Board

(a) Unless the articles of incorporation provide otherwise, if a vacancy occurs on a board of directors, including a vacancy resulting from an increase in the number of directors:

(1) the shareholders may fill the vacancy;

(2) the board of directors may fill the vacancy; or

(3) if the directors remaining in office constitute fewer than a quorum of the board, they may fill the vacancy by the affirmative vote of a majority of all the directors remaining in office.

(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.

(c) A vacancy that will occur at a specific later date (by reason of a resignation effective at a later date under section 8.07(b) or otherwise) may be filled before the vacancy occurs but the new director may not take office until the vacancy occurs.

§ 8.11 Compensation of Directors

Unless the articles of incorporation or bylaws provide otherwise, the board of directors may fix the compensation of directors.

SUBCHAPTER B. MEETINGS AND ACTION OF THE BOARD

§ 8.20 Meetings

(a) The board of directors may hold regular or special meetings in or out of this state.

(b) Unless the articles of incorporation or bylaws provide otherwise, the board of directors may permit any or all directors to participate in a regular or special meeting by, or conduct the meeting through the use of, any means of communication by which all directors participating may simultaneously hear each other during the meeting. A director participating in a meeting by this means is deemed to be present in person at the meeting.

§ 8.21 Action Without Meeting

(a) Except to the extent that the articles of incorporation or bylaws require that action by the board of directors be taken at a meeting, action required or permitted by this Act to be taken by the board of directors may be taken without a meeting if each director signs a consent describing the action to be taken and delivers it to the corporation.

(b) Action taken under this section is the act of the board of directors when one or more consents signed by all the directors are delivered to the corporation. The consent may specify the time at which the action taken thereunder is to be effective. A director's consent may be withdrawn by a revocation signed by the director and delivered to the corporation prior to delivery to the corporation of unrevoked written consents signed by all the directors.

(c) A consent signed under this section has the effect of action taken at a meeting of the board of directors and may be described as such in any document.

§ 8.22 Notice of Meeting

(a) Unless the articles of incorporation or bylaws provide otherwise, regular meetings of the board of directors may be held without notice of the date, time, place, or purpose of the meeting.

(b) Unless the articles of incorporation or bylaws provide for a longer or shorter period, special meetings of the board of directors must be preceded by at least two days' notice of the date, time, and place of the meeting. The notice need not describe the purpose of the special meeting unless required by the articles of incorporation or bylaws.

§ 8.23 Waiver of Notice

(a) A director may waive any notice required by this Act, the articles of incorporation, or bylaws before or after the date and time stated in the notice. Except as provided by subsection (b), the waiver must be in writing, signed by the director entitled to the notice, and filed with the minutes or corporate records.

(b) A director's attendance at or participation in a meeting waives any required notice to him of the meeting unless the director at the beginning of the meeting (or promptly upon his arrival) objects to holding the meeting or transacting business at the meeting and does not thereafter vote for or assent to action taken at the meeting.

§ 8.24 Quorum and Voting

(a) Unless the articles of incorporation or bylaws require a greater number or unless otherwise specifically provided in this Act, a quorum of a board of directors consists of:

(1) a majority of the fixed number of directors if the corporation has a fixed board size; or

(2) a majority of the number of directors prescribed, or if no number is prescribed the number in office immediately before the meeting begins, if the corporation has a variable-range size board.

(b) The articles of incorporation or bylaws may authorize a quorum of a board of directors to consist of no fewer than one-third of the fixed or prescribed number of directors determined under subsection (a).

(c) If a quorum is present when a vote is taken, the affirmative vote of a majority of directors present is the act of the board of directors unless the articles of incorporation or bylaws require the vote of a greater number of directors.

(d) A director who is present at a meeting of the board of directors or a committee of the board of directors when corporate action is taken is deemed to have assented to the action taken unless: (1) he objects at the beginning of the meeting (or promptly upon his arrival) to holding it or transacting business at the meeting; (2) his dissent or abstention from the action taken is entered in the minutes of the meeting; or (3) he delivers written notice of his dissent or abstention to the presiding officer of the meeting before its adjournment or to the corporation immediately after adjournment of the meeting. The right of dissent or abstention is not available to a director who votes in favor of the action taken.

§ 8.25 Committees

(a) Unless this Act, the articles of incorporation or the bylaws provide otherwise, a board of directors may create one or more committees and appoint one or more members of the board of directors to serve on any such committee.

(b) Unless this Act otherwise provides, the creation of a committee and appointment of members to it must be approved by the greater of (1) a majority of all the directors in office when the action is taken or (2) the number of directors required by the articles of incorporation or bylaws to take action under section 8.24.

(c) Sections 8.20 through 8.24 apply both to committees of the board and to their members.

(d) To the extent specified by the board of directors or in the articles of incorporation or bylaws, each committee may exercise the powers of the board of directors under section 8.01.

(e) A committee may not, however:

(1) authorize or approve distributions, except according to a formula or method, or within limits, prescribed by the board of directors;

(2) approve or propose to shareholders action that this Act requires be approved by shareholders;

(3) fill vacancies on the board of directors or, subject to subsection (g), on any of its committees; or

(4) adopt, amend, or repeal bylaws.

(f) The creation of, delegation of authority to, or action by a committee does not alone constitute compliance by a director with the standards of conduct described in section 8.30.

(g) The board of directors may appoint one or more directors as alternate members of any committee to replace any absent or disqualified member during the member's absence or disqualification. Unless the articles of incorporation or the bylaws or the resolution creating the committee provide otherwise, in the event of the absence or disqualification of a member of a committee, the member or members present at any meeting and not disqualified from voting, unanimously, may appoint another director to act in place of the absent or disqualified member.

OFFICIAL COMMENT

Section 8.25 makes explicit the common law power of a board of directors to act through committees of directors and specifies the powers of the board of directors that are nondelegable, that is, powers that only the full board of directors may exercise. Section 8.25 deals only with board committees exercising the powers or performing the functions of the board of directors; the board of directors or management, independently of section 8.25, may establish nonboard committees composed of directors, employees, or others to exercise corporate powers not required to be exercised by the board of directors.

Section 8.25(b) states that, unless this Act otherwise provides, a committee of the board of directors may be created only by the affirmative vote of a majority of the board of directors then in office, or, if greater, by the number of directors required to take action by the articles of incorporation or the bylaws. This supermajority requirement reflects the importance of the decision to invest board committees with power to act under section 8.25.

Committees of the board of directors are assuming increasingly important roles in the governance of publicly held corporations. See Committee on Corporate Laws, Corporate Director's Guidebook (4th ed. 2004). Nominating and compensation committees, composed primarily or entirely of independent directors, are widely used by public corporations and may be required by listing standards adopted by public securities markets. Such standards, including those mandated by law, also require the appointment of audit committees, composed entirely of independent directors, to perform important functions including the selection and retention of the corporation's external auditors.

Section 8.25(a) permits a committee to consist of a single director. This accommodates situations in which only one director may be present or available to make a decision on short notice, as well as situations in which it is unnecessary or inconvenient to have more than one member on a committee. Committees also are often employed to decide matters in which other members of the board have a conflict of interest; in such a case, a court will typically scrutinize with care the committee's decision when it is the product of a lone director. See, e.g., Lewis v. Fuqua, 502 A.2d 962, 967 (Del. Ch. 1985). Additionally, various sections of the Model Act require the participation or approval of at least two qualified directors in order for the decision of the board or committee to have effect (for the definition of ''qualified director,'' see section 1.43. These include a determination that maintenance of a derivative suit is not in the corporation's best interests (section 7.44(b)(3)), a determination that indemnification is permissible (section 8.55(b)(1)), an approval of a director conflicting interest transaction (section 8.62(a)), and disclaimer of the corporation's interest in a business opportunity (section 8.70(a)).

Section 8.25 limits the role of board committees in light of competing policies: on the one hand, it seems clear that appropriate committee action is not only desirable but is also likely to improve the functioning of larger and more diffuse boards of directors; on the other hand, wholesale delegation of authority to a board committee, to the point of abdication of director responsibility as a board of directors, is manifestly inappropriate and undesirable. Overbroad delegation also increases the potential, where the board of directors is divided, for usurpation of basic board functions by means of delegation to a committee dominated by one faction.

The statement of nondelegable functions set out in section 8.25(e) is based on the principle that prohibitions against delegation to board committees should be limited generally to actions that substantially affect the rights of shareholders or are fundamental to the governance of the corporation. As a result, delegation of authority to committees under section 8.25(e) may be broader than mere authority to act with respect to matters arising within the ordinary course of business.

Section 8.25(e) prohibits delegation of authority with respect to most mergers, sales of substantially all the assets, amendments to articles of incorporation and voluntary dissolution since these require shareholder action. In addition, section 8.25(e) prohibits delegation to a board committee of authority to fill board vacancies, subject to subsection (g), or to amend the bylaws. On the other hand, under section 8.25(e) many actions of a material nature, such as the authorization of long-term debt and capital investment or the issuance of shares, may properly be made the subject of committee delegation. In fact, the list of nondelegable powers has been reduced from the prior formulation of section 8.25(e).

Although section 8.25(e)(1) generally makes nondelegable the decision whether to authorize or approve distributions, including dividends, it does permit the delegation to a committee of power to approve a distribution pursuant to a formula or method or within limits prescribed by the board of directors. Therefore, the board could set a dollar range and timeframe for a prospective dividend and delegate to a committee the authority to determine the exact amount and record and payment dates of the dividend. The board also could establish certain conditions to the payment of a distribution and delegate to a committee the power to determine whether the conditions have been satisfied.

The statutes of several states make nondelegable certain powers not listed in section 8.25(e)—for example, the power to change the principal corporate office, to appoint or remove officers, to fix director compensation, or to remove agents. These are not prohibited by section 8.25(e) since the whole board of directors may reverse or rescind the committee action taken, if it should wish to do so, without undue risk that implementation of the committee action might be irrevocable or irreversible.

Section 8.25(f) makes clear that although the board of directors may delegate to a committee the authority to take action, the designation of the committee, the delegation of authority to it, and action by the committee does not alone constitute compliance by a noncommittee board member with the director's responsibility under section 8.30. On the other hand, a noncommittee director also does not automatically incur personal risk should the action of the particular committee fail to meet the standards of conduct set out in section 8.30. The noncommittee member's liability in these cases will depend upon whether the director's conduct was actionable under section 8.31. Factors to be considered in this regard will include the care used in the delegation to and supervision over the committee, and the amount of knowledge regarding the actions being taken by the committee which is available to the noncommittee director. Care in delegation and supervision may be facilitated, in the usual case, by review of minutes and receipt of other reports concerning committee activities. The enumeration of these factors is intended to emphasize that directors may not abdicate their responsibilities and avoid liability simply by delegating authority to board committees. Rather, a director against whom liability is asserted based upon acts of a committee of which the director is not a member avoids liability under section 8.31 by an appropriate measure of monitoring particularly if the director met the standards contained in section 8.30 with respect to the creation and supervision of the committee.

Section 8.25(f) has no application to a member of the committee itself. The standards of conduct applicable to a committee member are set forth in section 8.30.

Section 8.25(g) is a rule of convenience that permits the board or the other committee members to replace an absent or disqualified member during the time that the member is absent or disqualified. Unless otherwise provided, replacement of an absent or disqualified member is not necessary to permit the other committee members to continue to perform their duties.

SUBCHAPTER C. DIRECTORS

§ 8.30 Standards of Conduct for Directors

(a) Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation.

(b) The members of the board of directors or a committee of the board, when becoming informed in connection with their decision-making function or devoting attention to their oversight function, shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.

(c) In discharging board or committee duties a director shall disclose, or cause to be disclosed, to the other board or committee members information not already known by them but known by the director to be material to the discharge of their decision-making or oversight functions, except that disclosure is not required to the extent that the director reasonably believes that doing so would violate a duty imposed under law, a legally enforceable obligation of confidentiality, or a professional ethics rule.

(d) In discharging board or committee duties a director, who does not have knowledge that makes reliance unwarranted, is entitled to rely on the performance by any of the persons specified in subsection (f)(1) or subsection (f)(3) to whom the board may have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegable under applicable law.

(e) In discharging board or committee duties a director, who does not have knowledge that makes reliance unwarranted, is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (f).

(f) A director is entitled to rely, in accordance with subsection (d) or (e), on:

(1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;

(2) legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise the director reasonably believes are matters (i) within the particular person's professional or expert competence *161 or (ii) as to which the particular person merits confidence; or

(3) a committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence.

OFFICIAL COMMENT

Section 8.30 defines the general standards of conduct for directors. Under subsection (a), each board member must always perform a director's duties in good faith and in a manner reasonably believed to be in the best interests of the corporation. Although each director also has a duty to comply with its requirements, the focus of subsection (b) is on the discharge of those duties by the board as a collegial body. Under subsection (b), the members of the board or a board committee are to perform their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances. This standard of conduct is often characterized as a duty of care. Subsection (c) sets out the responsibility of each director, in discharging board or committee duties, to disclose or cause to be disclosed to the other members of the board or board committee information, of which they are aware, known by the director to be material to their decision-making or oversight responsibilities, subject to countervailing confidentiality duties and appropriate action with respect thereto.

Section 8.30 sets forth the standards of conduct for directors by focusing on the manner in which directors perform their duties, not the correctness of the decisions made. These standards of conduct are based on former section 35 of the 1969 Model Act, a number of state statutes and on judicial formulations of the standards of conduct applicable to directors. Section 8.30 should be read in light of the basic role of directors set forth in section 8.01(b), which provides that the "business and affairs of a corporation shall be managed by or under the direction and subject to the oversight of" the board, as supplemented by various provisions of the Act assigning specific powers or responsibilities to the board. Relevant thereto, directors often act collegially in performing their functions and discharging their duties. If the observance of the directors' conduct is called into question, courts will typically evaluate the conduct of the entire board (or committee). Deficient performance of section 8.30 duties on the part of a particular director may be overcome, absent unusual circumstances, by acceptable conduct (meeting, for example, subsection (b)'s standard of care) on the part of other directors sufficient in number to perform the function or discharge the duty in question. While not thereby remedied, the deficient performance becomes irrelevant in any evaluation of the action taken. (This contrasts with a director's duty of loyalty and fair dealing, which will be evaluated on an individual basis and will also implicate discharge of the director's duties under subsection (a).) Further relevant thereto, the board may delegate or assign to appropriate officers, employees or agents of the corporation the authority or duty to exercise powers that the law does not require it to retain. Since the directors are entitled to rely thereon absent knowledge making reliance unwarranted, deficient performance of the directors' section 8.30 duties will not result from their delegatees' actions or omissions so long as the board complied with the standards of conduct set forth in section 8.30 in delegating responsibility and, where appropriate, monitoring performance of the duties delegated.

In earlier versions of the Model Act the duty of care element was included in subsection (a), with the text reading: ''[a] director shall discharge his duties ... with the care an ordinarily prudent person in a like position would exercise under similar circumstances.'' The use of the phrase ''ordinarily prudent person'' in a basic guideline for director conduct, suggesting caution or circumspection vis-à-vis danger or risk, has long been problematic given the fact that risk-taking decisions are central to the directors' role. When coupled with the exercise of ''care,'' the prior text had a familiar resonance long associated with the field of tort law. See the Official Comment to section 8.31. The further coupling with the phrasal verb ''shall discharge'' added to the inference that former section 8.30(a)'s standard of conduct involved a negligence standard, with resultant confusion. In order to facilitate its understanding and analysis, independent of the other general standards of conduct for directors, the duty of care element has been set forth as a separate standard of conduct in subsection (b).

Long before statutory formulations of directors' standards of conduct, courts would invoke the business judgment rule in evaluating directors' conduct and determining whether to impose liability in a particular case. The elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts. Section 8.30 does not try to codify the business judgment rule or to delineate the differences between that defensive rule and the section's standards of director conduct. Section 8.30 deals only with standards of conduct the level of performance expected of every director entering into the service of a corporation and undertaking the role and responsibilities of the office of director. The section does not deal directly with the liability of a director although exposure to liability will usually result from a failure to honor the standards of conduct required to be observed by subsection (a). See section 8.31(a)(1) and clauses (i) and (ii)(A) of section 8.31(a)(2). The issue of directors' liability is addressed in sections 8.31 and 8.33 of this subchapter. Section 8.30 does, however, play an important role in evaluating a director's conduct and the effectiveness of board action. It has relevance in assessing, under section 8.31, the reasonableness of a direct or's belief. Similarly, it has relevance in assessing a director's timely attention to appropriate inquiry when particular facts and circumstances of significant concern materialize. It serves as a frame of reference for determining, under section 8.33(a), liability for an unlawful distribution. Finally, section 8.30 compliance may have a direct bearing on a court's analysis where transactional justification (e.g., a suit to enjoin a pending merger) is at issue.

A director complying with the standard of care expressed in subsection (b) is entitled to rely (under subsection (c)) upon board functions performed pursuant to delegated authority by, and to rely (under subsection (d)) upon information, opinions, reports or statements, including financial statements and other financial data, provided by, the persons or committees specified in the relevant parts of subsection (e). Within this authorization, the right to rely applies to the entire range of matters for which the board of directors is responsible. However, a director so relying must be without knowledge that would cause that reliance to be unwarranted. Section 8.30 expressly prevents a director from ''hiding his or her head in the sand'' and relying on the delegation of board functions, or on information, opinions reports or statements, when the director has actual knowledge that makes (or has a measure of knowledge that would cause a person, in a like position under similar circumstances, to undertake reasonable inquiry that would lead to information making) reliance unwarranted. Subsection (a)'s standards of good faith and reasonable belief in the best interests of the corporation also apply to a director's reliance under subsections (d), (e), and (f).

1. Section 8.30(a)

Section 8.30(a) establishes the basic standards of conduct for all directors. Its command is to be understood as peremptory—its obligations are to be observed by every director—and at the core of the subsection's mandate is the requirement that, when performing directors' duties, a director shall act in good faith coupled with conduct reasonably believed to be in the best interests of the corporation. This mandate governs all aspects of directors' duties: the duty of care, the duty to become informed, the duty of inquiry, the duty of informed judgment, the duty of attention, the duty of loyalty, the duty of fair dealing and, finally, the broad concept of fiduciary duty that the courts often use as a frame of reference when evaluating a director's conduct. These duties do not necessarily compartmentalize and, in fact, tend to overlap. For example, the duties of care, inquiry, becoming informed, attention and informed judgment all relate to the board's decisionmaking function, whereas the duties of attention, becoming informed and inquiry relate to the board's oversight function.

Two of the phrases chosen to specify the manner in which a director's duties are to be discharged deserve further comment:

(1) The phrase ''reasonably believes'' is both subjective and objective in character. Its first level of analysis is geared to what the particular director, acting in good faith, actually believes—not what objective analysis would lead another director (in a like position and acting in similar circumstances) to conclude. The second level of analysis is focused specifically on ''reasonably.'' While a director has wide discretion in marshalling the evidence and reaching conclusions, whether a director's belief is reasonable (i.e., could—not would a reasonable person in a like position and acting in similar circumstances have arrived at that belief) ultimately involves an overview that is objective in character.

(2) The phrase ''best interests of the corporation'' is key to an explication of a director's duties. The term ''corporation'' is a surrogate for the business enterprise as well as a frame of reference encompassing the shareholder body. In determining the corporation's ''best interests,'' the director has wide discretion in deciding how to weigh near term opportunities versus long term benefits as well as in making judgments where the interests of various groups within the shareholder body or having other cognizable interests in the enterprise may differ.

As a generalization, section 8.30 operates as a ''baseline'' principle governing director conduct ''when discharging the [ongoing] duties of a director'' in circumstances uncomplicated by self interest taint. The Model Act recognizes, however, that directors' personal interests may not always align with the corporation's best interests and provides procedures by which interest-conflict transactions can be processed. See subchapter D (derivative proceedings) of chapter 7 and subchapter E (indemnification), subchapter F (directors' conflicting interest transactions) and subchapter G (business opportunities) of this chapter 8. Those procedures generally contemplate that the interested director will not be involved in taking action on the interest-conflict transaction. And the common law has recognized that other interest-conflict situations may arise which do not entail a "transaction" by or with the corporation (see subchapter G of this chapter 8 (discussing the corporate opportunity doctrine)). The interested director is relieved of the duty to act in connection with the matter on behalf of the corporation (specifically, the traditional mandate to act in the corporation's best interests), given the inherent conflict. However, the interested director is still expected to act in good faith, and that duty is normally discharged by observing the obligation of fair dealing. In the case of interest conflict transactions, where there is a conflicting interest with respect to the corporation under section 8.60(1), the interested director's conduct is governed by subchapter F of this chapter 8. The duty of fair dealing is embedded in the subsection 8.60(4) provision calling for the interested director to make the required disclosure as to the conflicting interest and the transaction and, if one of the two safe harbor procedures is not properly observed, the interested director must prove the fairness (i.e., procedure, involving good faith among other aspects, as well as price) of the transaction to the corporation. In other cases, Section 8.30's standards of conduct are overlaid by various components of the duty to act fairly, the particular thrusts of which will depend upon the kind of interested director's conduct at issue and the circumstances of the case. As a general rule, the duty of fair dealing is normally discharged by the interested director through appropriate disclosure to the other directors considering the matter followed by abstention from participation in any decisionmaking relevant thereto. If and to the extent that the interested director's action respecting the matter goes further, the reasonableness of the director's belief as to the corporation's best interests, in respect of the action taken, should be evaluated on the basis of not only the director's honest and good faith belief but also on considerations bearing on the fairness of the transaction or conduct to the corporation.

2. Section 8.30(b)

Section 8.30(b) establishes a general standard of care for directors in the context of their dealing with the board's decisionmaking and oversight functions. While certain aspects will involve individual conduct (e.g., preparation for meetings), these functions are generally performed by the board through collegial action, as recognized by the reference in subsection (b) to board and committee "members" and "their duties." In contrast with subsection (a)'s individual conduct mandate, section 8.30(b) has a two-fold thrust: it provides a standard of conduct for individual action and, more broadly, it states a conduct obligation—"shall discharge their duties"—concerning the degree of care to be collegially used by the directors when performing those functions. It provides that directors have a duty to exercise "the care that a person in a like position would reasonably believe appropriate under similar circumstances."

The traditional formulation for a director's standard (or duty) of care has been geared to the "ordinarily prudent person." For example, the Model Act's prior formulation (in former section 8.30(a)(2)) referred to "the care an ordinarily prudent person in a like position would exercise under similar circumstances," and almost all state statutes that include a standard of care reflect parallel language. The phrase ''ordinarily prudent person'' constitutes a basic frame of reference grounded in the field of tort law and provides a primary benchmark for determining negligence. For this reason, its use in the standard of care for directors, suggesting that negligence is the proper determinant for measuring deficient (and thus actionable) conduct, has caused confusion and misunderstanding. Accordingly, the phrase ''ordinarily prudent person'' has been removed from the Model Act's standard of care and in its place ''a person in a like position'' has been substituted. The standard is not what care a particular director might believe appropriate in the circumstances but what a person—in a like position and acting under similar circumstances—would reasonably believe to be appropriate. Thus, the degree of care that directors should employ, under subsection (b), involves an objective standard.

Some state statutes have used the words ''diligence,'' ''care,''and ''skill'' to define the duty of care. There is very little authority as to what ''skill'' and ''diligence,'' as distinguished from ''care,'' can be required or properly expected of corporate directors in the performance of their duties. ''Skill,'' in the sense of technical competence in a particular field, should not be a qualification for the office of director. The concept of ''diligence'' is sufficiently subsumed within the concept of ''care.'' Accordingly, the words ''diligence'' and ''skill'' are not used in section 8.30's standard of care.

The process by which a director becomes informed, in carrying out the decisionmaking and oversight functions, will vary. Relevant thereto, the directors' decisionmaking function is established in large part by various sections of the Act: the issuance of shares (6.21); distributions (6.40); dismissal of derivative proceedings (7.44); indemnification (8.55); interested transaction authorization (8.62); articles of incorporation amendments (10.02 and 10.03); bylaw amendments (10.20); mergers (11.01); share exchanges (11.02); asset sales and mortgages (12.01 and 12.02); and dissolution (14.02). The director's oversight function is established under section 8.01. In relying on the performance by management of delegated or assigned section 8.01 duties (including, for example, matters of law and legal compliance), as authorized by subsection (d), directors may depend upon the presumption of regularity absent knowledge or notice to the contrary. In discharging the section 8.01 duties associated with the board's oversight function, the standard of care entails primarily a duty of attention. In contrast with the board's decisionmaking function, which generally involves informed action at a point in time, the oversight function is concerned with a continuum and the duty of attention accordingly involves participatory performance over a period of time.

Several of the phrases chosen to define the standard of conduct in section 8.30(b) deserve specific mention:

(1) The phrase ''becoming informed,'' in the context of the decisionmaking function, refers to the process of gaining sufficient familiarity with the background facts and circumstances in order to make an informed judgment. Unless the circumstances would permit a reasonable director to conclude that he or she is already sufficiently informed, the standard of care requires every director to take steps to become informed about the background facts and circumstances before taking action on the matter at hand. The process typically involves review of written materials provided before or at the meeting and attention to/participation in the deliberations leading up to a

vote. It can involve consideration of information and data generated by persons other than legal counsel, public accountants, etc., retained by the corporation, as contemplated by subsection (e)(2); for example, review of industry studies or research articles prepared by unrelated parties could be very useful. It can also involve direct communications, outside of the boardroom, with members of management or other directors. There is no one way for ''becoming informed,'' and both the method and measure—''how to'' and ''how much''—are matters of reasonable judgment for the director to exercise.

(2) The phrase ''devoting attention,'' in the context of the oversight function, refers to concern with the corporation's information and reporting systems and not to proactive inquiry searching out system inadequacies or noncompliance. While directors typically give attention to future plans and trends as well as current activities, they should not be expected to anticipate the problems which the corporation may face except in those circumstances where something has occurred to make it obvious to the board that the corporation should be addressing a particular problem. The standard of care associated with the oversight function involves gaining assurances from management and advisers that systems believed appropriate have been established coupled with ongoing monitoring of the systems in place, such as those concerned with legal compliance or internal controls followed up with a proactive response when alerted to the need for inquiry.

(3) The reference to ''person,'' without embellishment, is intended to avoid implying any qualifications, such as specialized expertise or experience requirements, beyond the basic director attributes of common sense, practical wisdom, and informed judgment.

(4) The phrase ''reasonably believe appropriate'' refers to the array of possible options that a person possessing the basic director attributes of common sense, practical wisdom and informed judgment would recognize to be available, in terms of the degree of care that might be appropriate, and from which a choice by such person would be made. The measure of care that such person might determine to be appropriate, in a given instance, would normally involve a selection from the range of options and any choice within the realm of reason would be an appropriate decision under the standard of care called for under subsection (b). However, a decision that is so removed from the realm of reason or so unreasonable as to fall outside the permissible bounds of sound discretion, and thus an abuse of discretion, will not satisfy the standard.

(5) The phrase ''in a like position'' recognizes that the ''care'' under consideration is that which would be used by the ''person'' if he or she were a director of the particular corporation.

(6) The combined phrase ''in a like position . . . under similar circumstances'' is intended to recognize that (a) the nature and extent of responsibilities will vary, depending upon such factors as the size, complexity, urgency, and location of activities carried on by the particular corporation, (b) decisions must be made on the basis of the information known to the directors without the benefit of hindsight, and (c) the special background, qualifications, and management responsibilities of a particular director may be relevant in evaluating that director's compliance with the standard of

care. Even though the combined phrase is intended to take into account the special background, qualifications and management responsibilities of a particular director, it does not excuse a director lacking business experience or particular expertise from exercising the basic director attributes of common sense, practical wisdom, and informed judgment.

3. Section 8.30(c)

A duty to disclose information that a director knows to be material to the oversight or decision-making functions of the board or committee has always been embraced in the standards of conduct set forth in subsections (a) and (b). Subsection (c) makes explicit this existing duty of disclosure among directors. Thus, for example, when a member of the board knows information that the director recognizes is material to a decision by the board to approve financial statements of the corporation, the director is obligated to see to it that such information is provided to the other members of the board. So long as that disclosure is accomplished, the action required of the director can occur through direct statements in meetings of the board, or by any timely means, including for example, communicating the information to the chairman of the board or the chairman of a committee, or to the corporation's general counsel, and requesting that the recipient inform the other board or committee members of the disclosed information.

Subsection (c) recognizes that a duty of confidentiality can override a director's obligation to share with other directors information pertaining to a current corporate matter and that a director is not required to make such disclosure to the extent the director reasonably believes that such a duty of confidentiality prohibits it. In some circumstances, a duty of confidentiality may even prohibit disclosure of the nature or the existence of the duty itself. Ordinarily, however, a director who withholds material information based on a reasonable belief that a duty of confidentiality prohibits disclosure should advise the other directors of the existence and nature of that duty. Under the standards of conduct set forth in section 8.30(a), the director may also be required to take other action in light of the confidentiality restraint. The precise nature of that action must, of necessity, depend on the specific circumstances. Depending on the nature of the material information and of the matter before the board of directors or committee of the board, such action may include abstention or absence from all or a portion of the other directors' deliberation or vote on the matter to which the undisclosed information is material, or even resignation as a director. See Official Comment to section 8.62. Finally, a duty of confidentiality may not form the basis for the limitation on disclosure unless it is entered into and relied upon in good faith.

The required disclosure (as defined in section 8.60(7)) that must be made under section 8.62(a) in connection with a director's conflicting interest transaction, and the exceptions to the required disclosure in that context under section 8.62(b), have elements that parallel the disclosure obligation of directors under section 8.30(c). The demands of selection 8.62, however, are more detailed and specific. They apply to just one situation—a director's conflict of interest transaction—while the requirements of section 8.30(c) apply generally to all other decision-making and oversight functions. For example, the specific requirements of section 8.62(a)(1) for a deliberation and vote outside the presence of the conflicted director are not imposed universally for all decision-making matters or for oversight matters that do not involve a decision. To the extent they may be different from the generally applicable provisions of section 8.30(c), the specific provisions of subchapter F control and are exclusive with respect to director conflicting interest transactions

The duty of disclosure a director owes to other directors as contemplated by Section 8.30(c) is to be distinguished from a common law duty the board may have to cause the corporation to make disclosures to shareholders. For example, some courts have recognized and enforced such a duty in cases where shareholder action is being sought. *See, e.g., Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983). The Act does not seek to codify such a duty in general terms, but leaves its existence and scope, the circumstances for its application, and the consequences of any failure to satisfy it, to be developed by courts on a case-by-case basis.

4. Section 8.30(d)

The delegation of authority and responsibility under subsection (d) may take the form of (i) formal action through a board resolution, (ii) implicit action through the election of corporate officers (e.g., chief financial officer or controller) or the appointment of corporate managers (e.g., credit manager), or (iii) informal action through a course of conduct (e.g., involvement through corporate officers and managers in the management of a significant 50%-owned joint venture). A director may properly rely on those to whom authority has been delegated pursuant to subsection (d) respecting particular matters calling for specific action or attention in connection with the directors' decisionmaking function as well as matters on the board's continuing agenda, such as legal compliance and internal control, in connection with the directors' oversight function. Delegation should be carried out in accordance with the standard of care set forth in section 8.30(b).

By identifying those upon whom a director may rely in connection with the discharge of duties, section 8.30(d) does not limit the ability of directors to delegate their powers under section 8.01(b) except where delegation is expressly prohibited by the Act or otherwise by applicable law (see, e.g., section 8.25(e) and § 11 of the Securities Act of 1933). See section 8.25 and its Official Comment for detailed consideration of delegation to board committees of the authority of the board under section 8.01 and the duty to perform one or more of the board's functions. And by employing the concept of delegation, section 8.30(c) does not limit the ability of directors to establish baseline principles as to management responsibilities. Specifically, section 8.01(b) provides that "all corporate powers shall be exercised by or under the authority of" the board, and a basic board function involves the allocation of management responsibilities and the related assignment (or delegation) of corporate powers. For example, a board can properly decide to retain a third party to assume responsibility for the administration of designated aspects of risk management for the corporation (e.g., health insurance or disability claims). This would involve the directors in the exercise of judgment in connection with the decision-making function pursuant to subsection (b) (i.e., the assignment of authority to exercise corporate powers to an agent). See the Official Comment to section 8.01. It would not entail impermissible delegation to a person specified in subsection (f)(2) pursuant to subsection (d) of a board function for which the directors by law have a duty to perform. They have the corporate power (under section 8.01(b)) to perform the task but administration of risk management is not a board function coming within the ambit of directors' duties; together with many similar management responsibilities, they may assign the task in the context of the allocation of corporate powers exercised under the authority of the board. This illustration highlights the distinction between delegation of a board function and assignment of authority to exercise corporate powers.

Although the board may delegate the authority or duty to perform one or more of its functions, reliance on delegation under subsection (d) may not alone constitute compliance with section 8.30 and reliance on the action taken by the delegatee may not alone constitute compliance by the directors or a noncommittee board member with section 8.01 responsibilities. On the other hand, should the board committee or the corporate officer or employee performing the function delegated fail to meet section 8.30's standard of care, noncompliance by the board with section 8.01 will not automatically result. Factors to be considered, in this regard, will include the care used in the delegation to and supervision over the delegatee, and the amount of knowledge regarding the particular matter which is available to the particular director. Care in delegation and supervision includes appraisal of the capabilities and diligence of the delegatee in light of the subject and its relative importance and may be facilitated, in the usual case, by receipt of reports concerning the delegatee's activities. The enumeration of these factors is intended to emphasize that directors may not abdicate their responsibilities and avoid accountability simply by delegating authority to others. Rather, a director charged with accountability based upon acts of others will fulfill the director's duties if the standards contained in section 8.30 are met.

5. Section 8.30(e)

Reliance under subsection (e) on a report, statement, opinion, or other information is permitted only if the director has read the information, opinion, report or statement in question, or was present at a meeting at which it was orally presented, or took other steps to become generally familiar with it. A director must comply with the general standard of care of section 8.30(b) in making a judgment as to the reliability and competence of the source of information upon which the director proposes to rely or, as appropriate, that it otherwise merits confidence.

6. Section 8.30(f).

Reliance on one or more of the corporation's officers or employees, pursuant to the intracorporate frame of reference of subsection (f)(1), is conditioned upon a reasonable belief as to the reliability and competence of those who have undertaken the functions performed or who prepared or communicated the information, opinions, reports or statements presented. In determining whether a person is "reliable," the director would typically consider (i) the individual's background experience and scope of responsibility within the corporation in gauging the individual's familiarity and knowledge respecting the subject matter and (ii) the individual's record and reputation for honesty, care and ability in discharging responsibilities which he or she undertakes. In determining whether a person is "competent," the director would normally take into account the same considerations and, if expertise should be relevant, the director would consider the individual's technical skills as well. Recognition in the statute of the right of one director to rely on the expertise and experience of another director, in the context of board or committee deliberations, is unnecessary, for the group's reliance on shared experience and wisdom is an implicit underpinning of director conduct. In relying on another member of the board, a director would quite properly take advantage of the colleague's knowledge and experience in becoming informed about the matter at hand before taking action; however, the director would be expected to exercise independent judgment when it comes time to vote.

Subsection (f)(2), which has an extra-corporate frame of reference, permits reliance on outside advisers retained by the corporation, including persons specifically engaged to advise the board or a board committee. Possible advisers include not only those in the professional disciplines customarily supervised by state authorities, such as lawyers, accountants, and engineers, but also those in other fields involving special experience and skills, such as investment bankers, geologists, management consultants, actuaries, and real estate appraisers. The adviser could be an individual or an organization, such as a law firm. Reliance on a nonmanagement director, who is specifically engaged (and, normally, additionally compensated) to undertake a special assignment or a particular consulting role, would fall within this outside adviser frame of reference. The concept of "expert competence" embraces a wide variety of qualifications and is not limited to the more precise and narrower recognition of experts under the Securities Act of 1933. In this respect, subsection (f)(2) goes beyond the reliance provision found in many existing state business corporation acts. In addition, a director may also rely on outside advisers where skills or expertise of a technical nature is not a prerequisite, or where the person's professional or expert competence has not been established, so long as the director reasonably believes the person merits confidence. For example, a board might choose to assign to a private investigator the duty of inquiry (e.g., follow up on rumors about a senior executive's "grand lifestyle") and properly rely on the private investigator's report. And it would be entirely appropriate for a director to rely on advice concerning highly technical aspects of environmental compliance from a corporate lawyer in the corporation's outside law firm, without due inquiry concerning that particular lawyer's technical competence, where the director reasonably believes the lawyer giving the advice is appropriately informed by reason of resources known to be available from that adviser's legal organization or through other means and therefore merits confidence.

Subsection (f)(3) permits reliance on a board committee when it is submitting recommendations for action by the full board of directors as well as when it is performing supervisory or other functions in instances where neither the full board of directors nor the committee takes dispositive action. For example, the compensation committee typically reviews proposals and makes recommendations for action by the full board of directors. In contrast, there may be reliance upon an investigation undertaken by a board committee and reported to the full board, which forms the basis for a decision by the board of directors not to take dispositive action. Another example is reliance on a committee of the board of directors, such as a corporate audit committee, with respect to the board's ongoing role of oversight of the accounting and auditing functions of the corporation. In addition, where reliance on information or materials prepared or presented by a board committee is not involved, in connection with board action, a director may properly rely on oversight monitoring or dispositive action by a board committee (of which the director is not a member) empowered to act pursuant to authority delegated under section 8.25 or acting with the acquiescence of the board of directors. See the Official Comment to section 8.25. A director may similarly rely on committees not created under section 8.25 which have nondirector members. In parallel with subsection (f)(2)(ii), the concept of ''confidence'' is substituted for ''competence'' in order to avoid any inference that technical skills are a prerequisite. In the usual case, the appointment of committee members or the reconstitution of the membership of a standing committee (e.g., the audit committee), following an annual shareholders' meeting, would alone manifest the noncommittee members' belief that the committee ''merits confidence.'' However, the reliance contemplated by subsection (f)(3) is geared to the point in time when the board takes action or the period of time over which a committee is engaged in an oversight function; consequently, the judgment to be made (i.e., whether a committee ''merits confidence'') will arise at varying points in time. After making an initial judgment that a committee (of which a director is not a member) merits confidence, the director may depend upon the presumption of regularity absent knowledge or notice to the contrary.

7. Application to Officers

Section 8.30 generally deals only with directors. Section 8.42 and its Official Comment explain the extent to which the provisions of section 8.30 apply to officers.

§ 8.31 Standards of Liability for Directors

(a) A director shall not be liable to the corporation or its shareholders for any decision to take or not to take action, or any failure to take any action, as a director, unless the party asserting liability in a proceeding establishes that:

(1) no defense interposed by the director based on (i) any provision in the articles of incorporation authorized by section 2.02(b)(4), or (ii) the protection afforded by section 8.61 for action taken in compliance with section 8.62 or section 8.63), or (iii) the protection afforded by section 8.70, precludes liability; and

(2) the challenged conduct consisted or was the result of:

(i) action not in good faith; or

(ii) a decision

(A) which the director did not reasonably believe to be in the best interests of the corporation, or

(B) as to which the director was not informed to an extent the director reasonably believed appropriate in the circumstances; or

(iii) a lack of objectivity due to the director's familial, financial or business relationship with, or a lack of independence due to the director's domination or control by, another person having a material interest in the challenged conduct

(A) which relationship or which domination or control could reasonably be expected to have affected the director's judgment respecting the challenged conduct in a manner adverse to the corporation, and

(B) after a reasonable expectation to such effect has been established, the director shall not have established that the challenged conduct was reasonably believed by the director to be in the best interests of the corporation; or

(iv) a sustained failure of the director to devote attention to ongoing oversight of the business and affairs of the corporation, or a failure to devote timely attention, by making (or causing to be made) appropriate inquiry, when particular facts and circumstances of significant concern materialize that would alert a reasonably attentive director to the need therefore; or

(v) receipt of a financial benefit to which the director was not entitled or any other breach of the director's duties to deal fairly with the corporation and its shareholders that is actionable under applicable law.

(b) The party seeking to hold the director liable:

(1) for money damages, shall also have the burden of establishing that:

(i) harm to the corporation or its shareholders has been suffered, and

(ii) the harm suffered was proximately caused by the director's challenged conduct; or

(2) for other money payment under a legal remedy, such as compensation for the unauthorized use of corporate assets, shall also have whatever persuasion burden may be called for to establish that the payment sought is appropriate in the circumstances; or

(3) for other money payment under an equitable remedy, such as profit recovery by or disgorgement to the corporation, shall also have whatever persuasion burden may be called for to establish that the equitable remedy sought is appropriate in the circumstances.

(c) Nothing contained in this section shall (1) in any instance where fairness is at issue, such as consideration of the fairness of a transaction to the corporation under section 8.61(b)(3), alter the burden of proving the fact or lack of fairness otherwise applicable, (2) alter the fact or lack of liability of a director under another section of this Act, such as the provisions governing the consequences of an unlawful distribution under section 8.33 or a transactional interest under section 8.61, or (3) affect any rights to which the corporation or a shareholder may be entitled under another statute of this state or the United States.

OFFICIAL COMMENT

Subsections (a) and (b) of section 8.30 establish standards of conduct that are central to the role of directors. Section 8.30(b)'s standard of conduct is frequently referred to as a director's duty of care. The employment of the concept of "care," if considered in the abstract, suggests a tort law/negligence-based analysis looking toward a finding of fault and damage recovery where the duty of care has not been properly observed and loss has been suffered. But the Model Act's desired level of director performance, with its objectively based standard of conduct ("the care that a person in a like position would reasonably believe appropriate under similar circumstances"), does not carry with it the same type of result-oriented liability analysis. The courts recognize that boards of directors and corporate managers make numerous decisions that involve the balancing of risks and benefits for the enterprise. Although some decisions turn out to be unwise or the result of a mistake of judgment, it is not reasonable to reexamine an unsuccessful decision with the benefit of hindsight. As observed in Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982): "Whereas an automobile driver who makes a mistake in judgment as to speed or distance injuring a pedestrian will likely be called upon to respond in damages, a corporate [director or] officer who makes a mistake in judgment as to economic conditions, consumer tastes or production line efficiency will rarely, if ever, be found liable for damages suffered by the corporation." Therefore, as a general rule, a director is not exposed to personal liability for injury or damage caused by an unwise decision. While a director is not personally responsible for unwise decisions or mistakes of judgment—and conduct conforming with the standards of section 8.30 will almost always be protected—a director can be held liable for misfeasance or nonfeasance in performing the duties of a director. And while a director whose performance meets the standards of section 8.30 should have no liability, the fact that a director's performance fails to reach that level does not automatically establish personal liability for damages that the corporation may have suffered as a consequence.

* * *

Note on Directors' Liability

A director's financial risk exposure (e.g., in a lawsuit for money damages suffered by the corporation or its shareholders claimed to have resulted from misfeasance or nonfeasance in connection with the performance of the director's duties) can be analyzed as follows:

1. Articles of incorporation limitation. If the corporation's articles of incorporation contain a provision eliminating its directors' liability to the corporation or its shareholders for money damages, adopted pursuant to section 2.02(b)(4), there is no liability unless the director's conduct involves one of the prescribed exceptions that preclude the elimination of liability. See section 2.02 and its Official Comment.

2. Director's conflicting interest transaction harbor. If the matter at issue involves a director's conflicting interest transaction (as defined in section 8.60(2)) and a safe harbor procedure under section 8.61 involving action taken in compliance with section 8.62 or 8.63 has been properly

implemented, there is no liability for the interested director arising out of the transaction. See subchapter F of this chapter 8.

3. Business opportunities safe harbor. Similarly, if the matter involves a director's taking of a business opportunity and a safe harbor procedure under section 8.70 has been properly implemented, there is no liability for the director arising out of the taking of the business opportunity. See subchapter G of this chapter 8.

4. Business judgment rule. If an articles of incorporation provision adopted pursuant to section 2.02 or a safe harbor procedure under section 8.61 does not shield the director's conduct from liability, this standard of judicial review for director conduct deeply rooted in the case law presumes that, absent self-dealing or other breach of the duty of loyalty, directors' decisionmaking satisfies the applicable legal requirements. A plaintiff challenging the director's conduct in connection with a corporate decision, and asserting liability by reason thereof, encounters certain procedural barriers. In the first instance, many jurisdictions have special pleading requirements that condition the ability to pursue the challenge on the plaintiff's bringing forward specific factual allegations that put in question the availability of the business judgment presumption. Assuming the suit survives a motion to dismiss for failure to state (in satisfaction of such a condition) an actionable claim, the plaintiff has the burden of overcoming that presumption of regularity.

5. Damages and proximate cause. If the business judgment rule does not shield the directors' decisionmaking from liability, as a general rule it must be established that money damages were suffered by the corporation or its shareholders and those damages resulted from and were legally caused by the challenged act or omission of the director.

6. Other liability for money payment. Aside from a claim for damages, the director may be liable to reimburse the corporation pursuant to a claim under quantum meruit (the reasonable value of services) or quantum valebant (the reasonable value of goods and materials) if corporate resources have been used without proper authorization. In addition, the corporation may be entitled to short-swing profit recovery, stemming from the director's trading in its securities, under § 16(b) of the Securities Exchange Act of 1934.

7. Equitable profit recovery or disgorgement. An equitable remedy compelling the disgorgement of the director's improper financial gain or entitling the corporation to profit recovery, where directors' duties have been breached, may require the payment of money by the director to the corporation.

8. Corporate indemnification. If the court determines that the director is liable, the director may be indemnified by the corporation for any payments made and expenses incurred, depending upon the circumstances, if a third-party suit is involved. If the proceeding is by or in the right of the corporation, the director may be reimbursed for reasonable expenses incurred in connection with the proceeding if ordered by a court under section 8.54(a)(3).

9. Insurance. To the extent that corporate indemnification is not available, the director may be reimbursed for the money damages for which the director is accountable, together with proceeding related expenses, if the claim/grounds for liability come within the coverage under directors' and officers' liability insurance that has been purchased by the corporation pursuant to section 8.57.

* * *

Section 8.31 includes steps (1) through (6) in the analysis of a director's liability exposure set forth in the above Note. In establishing general standards of director liability under the Model Act, the section also serves the important purpose of providing clarification that the general standards of conduct set forth in section 8.30 are not intended to codify the business judgment rule—a point as to which there has been confusion on the part of some courts (notwithstanding a disclaimer of that purpose and effect in the prior Official Comment to section 8.30). For example, one court viewed the standard of care set forth in Washington's business corporation act (a provision based upon and almost identical to the prior section 8.30(a)—which read ''A director shall discharge his duties as a director . . .: (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner he reasonably believes to be in the best interests of the corporation'') as having codified the business judgment rule. See Seafirst Corp. v. Jenkins, 644 F. Supp. 1152, 1159 (W.D. Wash. 1986). (A later court characterized this view as a mistaken assumption and recognized the disclaimer made in section 8.30's Official Comment. See Shinn v. Thrust IV Inc., 786 P. 2d 285, 290 n.1 (Wash. App. 1990).) Another court declared ''Section 309 [a standard of conduct almost identical to the prior section 8.30(a)] codifies California's business judgment rule.'' See Gaillard v. Natomas Co., 208 Cal. App. 3d 1250, 1264 (1989). The Court of Appeals of New York referred to that state's statutory standard of care for directors, a formulation set forth in NYBCL § 717 that is similar to the prior section 8.30(a), as ''New York's business judgment rule.'' See Lindner Fund, Inc. v. Waldbaum, Inc., 624 N.E. 2d 160, 161 (1993). In contrast, another court considering New York's conduct standard observed:

A board member's obligation to a corporation and its shareholders has two prongs, generally characterized as the duty of care and the duty of loyalty. The duty of care refers to the responsibility of a corporate fiduciary to exercise, in the performance of his tasks, the care that a reasonably prudent person in a similar position would use under similar circumstances. See NYBCL § 717. In evaluating a manager's compliance with the duty of care, New York courts adhere to the business judgment rule, which ''bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes.'' Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984) [quoting Auerbach v. Bennett, 47 N.Y. 2d 619, 629 (1979)].

Sections 8.30 and 8.31 adopt the approach to director conduct and director liability taken in the Norlin decision. See section 8.30 and its Official Comment with respect to the standards of conduct for directors. For a detailed analysis of how and why standards of conduct and standards of liability diverge in corporate law, see Melvin A. Eisenberg, The Divergence of Standards of Conduct and Standards of Review in Corporate Law, 62 Fordham L. Rev. 437 (1993).

The Model Act does not undertake to prescribe detailed litigation procedures. However, it does deal with requirements applicable to shareholder derivative suits (see sections 7.40–7.47) and section 8.31 builds on those requirements. If any of (i) a liability-eliminating provision included in the corporation's articles of incorporation, pursuant to section 2.02(b)(4), (ii) protection for a director's conflicting interest transaction afforded by section 8.61(b)(1) or section 8.61(b)(2), or (iii) protection for a disclaimer of the corporation's interest transaction afforded by section 8.70 is interposed by a defendant director as a bar to the challenge of his or her conduct, the plaintiff's role in satisfying the requirement of subsection (a)(1)—i.e., establishing that the articles of incorporation provision or the safe harbor provision interposed does not apply—would be governed by the court's procedural rules. Parenthetically, where fairness of a director's conflicting interest transaction can be established, protection from liability is also afforded by section 8.61(b)(3). If it is asserted by a defendant director as a defense, it is important to note that subsection (a)(2)(v) rather than subsection (a)(1) would be implicated and the burden of establishing that the transaction was fair to the corporation—and, therefore, no improper financial benefit was received—is placed on the interested director under section 8.61(b)(3). Similarly, the local pleading and other rules would govern the plaintiff's effort to satisfy subsection (a)(2)'s requirements. Consistent with the general rules of civil procedure, the plaintiff generally has the burden under subsection (b) of proving that the director's deficient conduct caused harm resulting in monetary damage or calls for monetary reimbursement; in the alternative, the circumstances may justify or require an equitable remedy.

1. Section 8.31(a)

If a provision in the corporation's articles of incorporation (adopted pursuant to section 2.02(b)(4)) shelters the director from liability for money damages, or if a safe harbor provision, under subsection (b)(1) or (b)(2) of section 8.61 or 8.70, shelters the director's conduct in connection with a conflicting interest transaction or the taking of a business opportunity, and such defense applies to all claims in plaintiff's complaint, there is no need to consider further the application of section 8.31's standards of liability. In that event, the court would presumably grant the defendant director's motion for dismissal or summary judgment (or the equivalent) and the proceeding would be ended. If the defense applies to some but not all of plaintiff's claims, defendant is entitled to dismissal or summary judgment with respect to those claims. Termination of the proceeding or dismissal of claims on the basis of an articles of incorporation provision or safe harbor will not automatically follow, however, if the party challenging the director's conduct can assert any of the valid bases for contesting the availability of the liability shelter. Absent such a challenge, the relevant shelter provision is self-executing and the individual director's exoneration from liability is automatic. Further, under both section 8.61 and section 8.70, the directors approving the conflicting interest transaction will presumably be protected as well, for compliance with the relevant standards of conduct under section 8.30 is important for their action to be effective and, as noted above, conduct meeting section 8.30's standards will almost always be protected.

If a claim of liability arising out of a challenged act or omission of a director is not resolved and disposed of under subsection (a)(1), subsection (a)(2) provides the basis for evaluating whether the conduct in question can be challenged.

* * *

Note on the Business Judgment Rule

Over the years, the courts have developed a broad common law concept geared to business judgment. In basic principle, a board of directors enjoys a presumption of sound business judgment and its decisions will not be disturbed (by a court substituting its own notions of what is or is not sound business judgment) if they can be attributed to any rational business purpose. See Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). Relatedly, it is presumed that, in making a business decision, directors act in good faith, on an informed basis, and in the honest belief that the action taken is in the best interests of the corporation. See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1983). When applied, this principle operates both as a procedural rule of evidence and a substantive rule of law, in that if the plaintiff fails to rebut the presumption that the directors acted in good faith, in the corporation's best interest and on an informed basis, the business judgment standard protects both the directors and the decisions they make. See Citron v. Fairchild Camera & Instrument Corp., 569 A. 2d 53, 64 (Del. 1989).

Some have suggested that, within the business judgment standard's broad ambit, a distinction might usefully be drawn between that part which protects directors from personal liability for the decision they make and the part which protects the decision itself from attack. See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A. 2d 173, 180 n.10 (Del. 1986). While these two objects of the business judgment standard's protection are different, and judicial review might result in the decision being enjoined but no personal liability (or vice versa), their operative elements are identical (i.e., good faith, disinterest, informed judgment and ''best interests''). As a consequence, the courts have not observed any distinction in terminology and have generally followed the practice of referring only to the business judgment rule, whether dealing with personal liability issues or transactional justification matters.

While, in substance, the operative elements of the standard of judicial review commonly referred to as the business judgment rule have been widely recognized, courts have used a number of different word formulations to articulate the concept. The formulation adopted in § 4.01(c) of The American Law Institute's PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (1994) provides that a director who makes a business judgment **in good faith** (an obvious prerequisite) fulfills the duty of care standard if the director:

(1) is not interested [as defined] in the subject of the business judgment;

(2) is informed with respect to the subject of the business judgment to the extent the director . . . reasonably believes to be appropriate under the circumstances; and

(3) rationally believes that the business judgment is in the best interests of the corporation.

Referring to clause (2) above, the decisionmaking process is to be reviewed on a basis that is to a large extent individualized in nature (''informed . . . to the extent the director . . . reasonably believes to be appropriate under the circumstances'')—as contrasted with the traditional objectively based duty of care standard (e.g., the prior section 8.30(a)'s ''care . . . an ordinarily prudent person

. . . would exercise''). An ''ordinarily prudent person'' might do more to become better informed, but if a director believes, in good faith, that the director can make a sufficiently informed business judgment, the director will be protected so long as that belief is within the bounds of reason. Referring to clause (3) above, the phrase ''rationally believes'' is stated in the PRINCIPLES to be a term having ''both an objective and subjective content. A director . . . must actually believe that the business judgment is in the best interests of the corporation and that belief must be rational,'' 1 PRINCIPLES, at 179. Others see that aspect to be primarily geared to the process employed by a director in making the decision as opposed to the substantive content of the board decision made. See Aronson v. Lewis, supra, at 812 (''The business judgment rule is . . . a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. . . . Absent an abuse of discretion, that judgment will be respected by the courts.'') In practical application, an irrational belief would in all likelihood constitute an abuse of discretion. Compare In Re Caremark International Inc. Derivative Litigation (September 25, 1996) (1996 Del. Ch. LEXIS 125 at p. 27: ''whether a judge or jury considering the matter after the fact . . . believes a decision substantively wrong, or degrees of wrong extending through ''stupid'' to ''egregious'' or ''irrational'', provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a good faith effort to advance corporate interests . . . the business judgment rule is process oriented and informed by a deep respect for all good faith board decisions.'')

* * *

Section 8.31 does not codify the business judgment rule as a whole. The section recognizes the common law doctrine and provides guidance as to its application in dealing with director liability claims. Because the elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts, it would not be desirable to freeze the concept in a statute. For example, in recent years the Delaware Supreme Court has established novel applications of the concept to various transactional justification matters, such as the role of special litigation committees and change-of-control situations. See Zapata Corporation v. Maldonado, 430 A. 2d 779 (1981), and Unocal Corp. v. Mesa Petroleum Co., 493 A. 2d 946 (1985), respectively. Under Zapata, a rule that applies where there is no disinterested majority on the board appointing the special litigation committee, there is no presumption of regularity and the corporation must bear the burden of proving the independence of the committee, the reasonableness of its investigation, and the reasonableness of the bases of its determination that dismissal of the derivative litigation is in the best interests of the corporation. Under Unocal, the board must first establish reasonable grounds for believing an unsolicited takeover bid poses a danger to corporate policy and effectiveness, and a reasonable relationship of defensive measures taken to the threat posed, before the board's action will be entitled to the business judgment presumptions. The business judgment concept has been employed in countless legal decisions and is a topic that has received a great deal of scholarly attention. For an exhaustive treatment of the subject, see D. Block, N. Barton & S. Radin, The Business Judgment Rule: Fiduciary Duties of Corporate Directors (4th ed. 1993 & Supp. 1995). While codification of the business judgment rule in section 8.31 is expressly disclaimed, its principal elements, relating to personal liability issues, are embedded in subsection (a)(2).

(a) Good faith

The expectation that a director's conduct will be in good faith is an overarching element of his or her baseline duties. Relevant thereto, it has been stated that a lack of good faith is presented where a board ''lacked an actual intention to advance corporate welfare'' and ''bad faith'' is presented where ''a transaction . . . is authorized for some purpose other than a genuine attempt to advance corporate welfare or is known to constitute a violation of applicable positive law.'' See Gagliardi v. TriFoods Int'l Inc., 683 A.2d 1049 (Del. Ch. 1996). If a director's conduct can be successfully challenged pursuant to other clauses of subsection (a)(2), there is a substantial likelihood that the conduct in question will also present an issue of good faith implicating clause 2(i). Conduct involving knowingly illegal conduct that exposes the corporation to harm will constitute action not in good faith, and belief that decisions made (in connection with such conduct) were in the best interests of the corporation will be subject to challenge as well. If subsection (a)(2) included only clause 2(i), much of the conduct with which the other clauses are concerned could still be considered pursuant to the subsection, on the basis that such conduct evidenced the actor's lack of good faith. Accordingly, the canon of construction known as ejusdem generis has substantial relevance in understanding the broad overlap of the good faith element with the various other subsection (a)(2) clauses. Where conduct has not been found deficient on other grounds, decisionmaking outside the bounds of reasonable judgment—an abuse of discretion perhaps explicable on no other basis—can give rise to an inference of bad faith. That form of conduct (characterized by the court as ''constructive fraud'' or ''reckless indifference'' or ''deliberate disregard'' in the relatively few case precedents) giving rise to an inference of bad faith will also raise a serious question whether the director could have reasonably believed that the best interests of the corporation would be served. If a director's conflicting interest transaction is determined to be manifestly unfavorable to the corporation, giving rise to an inference of bad faith tainting the directors' action approving the transaction under section 8.62, the safe harbor protection afforded by section 8.61 for both the transaction and the conflicted director would be in jeopardy. See the Official Comment to section 8.61. Depending on the facts and circumstances, the directors who approve a director's conflicting interest transaction that is manifestly unfavorable to the corporation may be at risk under clause (2)(i).

(b) Reasonable belief

A director should reasonably believe that his or her decision will be in the best interests of the corporation and a director should become sufficiently informed, with respect to any action taken or not taken, to the extent he or she reasonably believes appropriate in the circumstances. In each case, the director's reasonable belief calls for a subjective belief and, so long as it is his or her honest and good faith belief, a director has wide discretion. However, in the rare case where a decision respecting the corporation's best interests is so removed from the realm of reason (e.g., corporate waste), or a belief as to the sufficiency of the director's preparation to make an informed judgment is so unreasonable as to fall outside the permissible bounds of sound discretion (e.g., a clear case is presented if the director has undertaken no preparation and is woefully uninformed), the director's judgment will not be sustained.

(c) Lack of objectivity or independence

If a director has a familial, financial or business relationship with another person having a material interest in a transaction or other conduct involving the corporation, or if the director is dominated or controlled by another person having such a material interest, there is a potential for that conflicted interest or divided loyalty to affect the director's judgment. If the matter at issue involves a director's transactional interest, such as a ''director's conflicting interest transaction'' (see section 8.60(2)) in which a ''related person'' (see section 8.60(3)) is involved, it will be governed by section 8.61; otherwise, the lack of objectivity due to a relationship's influence on the director's judgment will be evaluated, in the context of the pending conduct challenge, under section 8.31. If the matter at issue involves lack of independence, the proof of domination or control and its influence on the director's judgment will typically entail different (and perhaps more convincing) evidence than what may be involved in a lack of objectivity case. The variables are manifold, and the facts must be sorted out and weighed on a case-by-case basis. If that other person is the director's spouse or employer, the concern that the director's judgment might be improperly influenced would be substantially greater than if that person is the spouse of the director's stepgrandchild or the director's partner in a vacation timeshare. When the party challenging the director's conduct can establish that the relationship or the domination or control in question could reasonably be expected to affect the director's judgment respecting the matter at issue in a manner adverse to the corporation, the director will then have the opportunity to establish that the action taken by him or her was reasonably believed to be in the best interests of the corporation. The reasonableness of the director's belief as to the corporation's best interests, in respect of the action taken, should be evaluated on the basis of not only the director's honest and good faith belief but also on considerations bearing on the fairness to the corporation of the transaction or other conduct involving the corporation that is at issue.

(d) Improper financial benefit

Subchapter F of chapter 8 of the Model Act deals in detail with directors' transactional interests. Its coverage of those interests is exclusive and its safe harbor procedures for directors' conflicting interest transactions (as defined)—providing shelter from legal challenges based on interest conflicts, when properly observed—will establish a director's entitlement to any financial benefit gained from the transactional event. A director's conflicting interest transaction that is not protected by the fairness standard set forth in section 8.61(b)(3), pursuant to which the conflicted director may establish the transaction to have been fair to the corporation, would often involve receipt of a financial benefit to which the director was not entitled (i.e., the transaction was not ''fair'' to the corporation). Unauthorized use of corporate assets, such as aircraft or hotel suites, would also provide a basis for the proper challenge of a director's conduct. There can be other forms of improper financial benefit not involving a transaction with the corporation or use of its facilities, such as where a director profits from unauthorized use of proprietary information.

(e) Financial benefit and material interest

A director is expected to observe an obligation of undivided loyalty to the corporation and, while the law will not concern itself with trifling deviations (de minimis non curat lex), there is no materiality threshold that applies to a financial benefit to which a director is not properly entitled. The Model Act observes this principle in several places (e.g., the exception to liability elimination prescribed in section 2.02(b)(4)(A) and the indemnification restriction in section 8.51(d)(2), as well as the liability standard in subsection (a)(2)(v)). In contrast, there is a materiality threshold for the interest of another in a transaction or conduct where a director's lack of objectivity or lack of independence has been asserted under subsection (a)(2)(iii). In the typical case, analysis of another's interest would first consider the materiality of the transaction or conduct at issue—in most cases, any transaction or other action involving the attention of the board or one of its committees will cross the materiality threshold, but not always—and would then consider the materiality of that person's interest therein. The possibility that another's interest in a transaction or conduct that is not material, or that an immaterial interest of another in a transaction or conduct, would adversely affect a director's judgment is sufficiently remote that it should not be made subject to judicial review.

(f) Sustained inattention

The director's role involves two fundamental components: the decisionmaking function and the oversight function. In contrast with the decisionmaking function, which generally involves action taken at a point in time, the oversight function under section 8.01(b) involves ongoing monitoring of the corporation's business and affairs over a period of time. This involves the duty of ongoing attention, when actual knowledge of particular facts and circumstances arouse suspicions which indicate a need to make inquiry. As observed by the Supreme Court of New Jersey in Francis v. United Jersey Bank, 432 A.2d 814, 822 (Sup. Ct. 1981):

> Directors are under a continuing obligation to keep informed about the activities of the corporation.... Directors may not shut their eyes to corporate misconduct and then claim that because they did not see the misconduct, they did not have a duty to look. The sentinel asleep at his post contributes nothing to the enterprise he is charged to protect.... Directorial management does not require a detailed inspection of day-to-day activities, but rather a general monitoring of corporate affairs and policies.

While the facts will be outcome determinative, deficient conduct involving a sustained failure to exercise oversight—where found actionable—has typically been characterized by the courts in terms of abdication and continued neglect of a director's duty of attention, not a brief distraction or temporary interruption. However, embedded in the oversight function is the need to inquire when suspicions are aroused. This duty is not a component of ongoing oversight, and does not entail proactive vigilance, but arises when, and only when, particular facts and circumstances of material concern (e.g., evidence of embezzlement at a high level or the discovery of significant inventory shortages) suddenly surface.

(g) Other breaches of a director's duties

Subsection (a)(2)(v) is, in part, a catchall provision that implements the intention to make section 8.31 a generally inclusive provision but, at the same time, to recognize the existence of other breaches of commonlaw duties that can give rise to liability for directors. As developed in the case law, these actionable breaches include authorized use of corporate property or information, unfair competition with the corporation and taking of a corporate opportunity. In the latter case, the director is alleged to have wrongfully diverted a business opportunity as to which the corporation has a prior right. Section 8.70 provides a safe harbor mechanism for a director who wishes to take advantage of a business opportunity, regardless of whether such opportunity would be characterized as a "corporate opportunity" under existing case law. Note that section 8.70(b) provides that the fact that a director did not employ the safe harbor provisions of section 8.70 does not create an inference that the opportunity should have first been presented to the corporation or alter the burden of proof otherwise applicable to establish a breach of the director's duty to the corporation.

(h) Fairness

Pursuant to section 8.61(b)(3), an interested director (or the corporation, if it chooses) can gain protection for a director's conflicting interest transaction by establishing that it was fair to the corporation. (The concept of "fair" and "fairness," in this and various other contexts, can take into account both fair price and fair dealing on the part of the interested director. See the Official Comment to section 8.61.) Under case law, personal liability as well as transactional justification issues will be subject to a fairness standard of judicial review if the plaintiff makes out a credible claim of breach of the duty of loyalty or if the presumptions of the business judgment standard (e.g., an informed judgment) are overcome, with the burden of proof shifting from the plaintiff to the defendant. In this respect, the issue of fairness is relevant to both subsection (a) and subsection (b). Within the ambit of subsection (a)(2), a director can often respond to the challenge that his or her conduct was deficient by establishing that the transaction or conduct at issue was fair to the corporation. See Kahn v. Lynch Communications Systems, Inc. 669 A.2d 79 (Del. 1995). Cf. Cede & Co. v. Technicolor Inc., 634 A.2d 345 (Del. 1993) (when the business judgment rule is rebutted procedurally the burden shifts to the defendant directors to prove the "entire fairness" of the challenged transaction). It is to be noted, however, that fairness may not be relevant to the matter at issue (see, e.g., clause (iv) of subsection (a)(2)). If the director is successful in establishing fairness, where the issue of fairness is relevant, then it is unlikely that the complainant can establish legal liability or the appropriateness of an equitable remedy under subsection (b).

(i) Director conduct

Subsection (a)(2) deals, throughout, with a director's action that is taken or not taken. To the extent that the director's conduct involves a breach of his or her duty of care or duty of attention within the context of collegial action by the board or one of its committees, proper performance of the relevant duty through the action taken by the director's colleagues can overcome the consequences of his or her deficient conduct. For example, where a director's conduct can be challenged under subsection (a)(2)(ii)(B) by reason of having been uninformed about the decision—he or she did not read the merger materials distributed prior to the meeting, arrived late at the board meeting just in time for the vote but, nonetheless, voted for the merger solely because the others were in favor—the favorable action by a quorum of properly informed directors would ordinarily protect the director against liability. When the director's conduct involves the duty of fair dealing within the context of action taken by the board or one of its committees, the wiser choice will usually be for the director not to participate in the collegial action. That is to say, where a director may have a conflicting interest or a divided loyalty, or even where there may be grounds for the issue to be raised, the better course to follow is usually for the director to disclose the conduct related facts and circumstances posing the possible compromise of his or her independence or objectivity, and then to withdraw from the meeting (or, in the alternative, to abstain from the deliberations and voting). The board members free of any possible taint can then take appropriate action as contemplated by section 8.30. (If a director's conflicting interest transaction is involved, it will be governed by subchapter F of this chapter and the directors' action will be taken pursuant to section 8.62 (or the board can refer the matter for shareholder's action respecting the transaction under section 8.63). In this connection, particular reference is made to the definition of ''qualified director'' in section 1.43.) If this course is followed, the director's conduct respecting the matter in question will in all likelihood be beyond challenge.

2. Section 8.31(b)

After satisfying the burden of establishing that the conduct of the director is challengeable under subsection (a), the plaintiff, in order to hold the director liable for money damages under clause (b)(1), has the further burden of establishing that: (i) harm (measurable in money damages) has been suffered by the corporation or its shareholders and (ii) the director's challenged conduct was the proximate cause of that harm. The concept of ''proximate cause'' is a term of art that is basic to tort law, and the cases providing content to the phrase represent well developed authority to which a court will undoubtedly refer. A useful approach for the concept's application, for purposes of subsection (b)(1), would be that the challenged conduct must have been a ''substantial factor in producing the harm.'' See Francis v. United Jersey Bank, supra, 432 A.2d at 829. Similarly, the plaintiff has the burden of establishing money payment is due from the director pursuant to clause (b)(2). If, while challengeable, the conduct at issue caused no harm under clause (b)(1) or does not provide the basis for other legal remedy under clause (b)(2), but may provide the basis for an equitable remedy under clause (b)(3), the plaintiff must satisfy whatever further burden of persuasion may be indicated to establish that imposition of the remedy sought is appropriate in the circumstances. In Brophy v. Cities Service Co, 70 A.2d 5, 8 (Del. Ch. 1949), an employee was required to account for profits derived from the use of the corporation's confidential plans to reacquire its securities through open market purchases. Notwithstanding the fact that harm to the corporation had not been established, the Chancellor observed: ''[p]ublic policy will not permit an employee occupying a position of trust and confidence toward his employer to abuse that relation to his own profit, regardless of whether his employer suffers a loss.'' Once actionable conduct that provides the basis for an equitable remedy under clause (b)(3) has been established, its appropriateness will often be clear and, if so, no further advocacy on the part of the plaintiff will be required.

3. Section 8.31(c)

While section 8.31 addresses director liability to the corporation or its shareholders under the Model Act—and related case law dealing with interpretation by the courts of their states' business corporation acts or dealing with corporate governance concepts coming within the common law's ambit—it does not limit any liabilities or foreclose any rights expressly provided for under other law. For example, directors can have liability (i) to shareholders (as well as former shareholders), who purchased their shares in a registered public offering, under § 11 of the Securities Act of 1933 and (ii) to the corporation, for short swing profit recovery, under § 16(b) of the Securities Exchange Act of 1934. Subsection (c) merely acknowledges that those rights are unaffected by section 8.31. And directors can have liability to persons other than the corporation and its shareholders, such as (i) employee benefit plan participants and beneficiaries (who may or may not be shareholders), if the directors are determined to be fiduciaries under the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001–1461 (1988 & Supp. IV 1992), (ii) government agencies for regulatory violations or (iii) individuals claiming damages for injury governed by tort law concepts (e.g., libel or slander).

As discussed above in the Official Comment to section 8.31(a), the concept of ''fairness'' is often relevant to whether a director will have liability if his or her conduct is challenged. Specifically, a director can successfully defend a financial interest in a transaction with the corporation by establishing that it was fair to the corporation. See section 8.61 and its Official Comment. More generally, the courts have resorted to a fairness standard of review where the business judgment rule has been inapplicable. See Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983). In the usual case, the defendant seeking to justify challenged conduct, on the basis of fairness, has the burden of proving that it was fair to the corporation. Subsection (c) expressly disclaims any intention to shift the burden of proof otherwise applicable where the question of the fairness of a transaction or other challenged conduct is at issue.

Finally, the Model Act deals expressly with certain aspects of director liability in other sections. For example, a director has a duty to observe the limitations on shareholder distributions set forth in section 6.40 and, if a director votes for or assents to a distribution in violation thereof, the director has personal liability as provided in section 8.33. And section 8.61 channels all directors' transactional interests into the exclusive treatment for directors' conflicting interest transactions that is therein provided, rejecting an award of damages or other sanctions for interests that do not come within its conceptual framework. Subsection (c) expressly acknowledges that the liability standard provided in section 8.33 and the exclusive treatment for directors' transactional interests provided in section 8.61 are unaffected by section 8.31.

§ 8.33 Directors' Liability for Unlawful Distributions

(a) A director who votes for or assents to a distribution in excess of what may be authorized and made pursuant to section 6.40(a) or 14.09(a) is personally liable to the corporation for the amount of the distribution that exceeds what could have been distributed without violating section 6.40(a) or 14.09(a) if the party asserting liability establishes that when taking the action the director did not comply with section 8.30.

(b) A director held liable under subsection (a) for an unlawful distribution is entitled to:

(1) contribution from every other director who could be held liable under subsection (a) for the unlawful distribution; and

(2) recoupment from each shareholder of the prorata portion of the amount of the unlawful distribution the shareholder accepted, knowing the distribution was made in violation of section 6.40(a) or 14.09(a).

(c) A proceeding to enforce:

(1) the liability of a director under subsection (a) is barred unless it is commenced within two years after the date (i) on which the effect of the distribution was measured under section 6.40(e) or (g), (ii) as of which the violation of section 6.40(a) occurred as the consequence of disregard of a restriction in the articles of incorporation, or (iii) on which the distribution of assets to shareholders under section 14.09(a) was made; or

(2) contribution or recoupment under subsection (b) is barred unless it is commenced within one year after the liability of the claimant has been finally adjudicated under subsection (a).

OFFICIAL COMMENT

Although the revisions to the financial provisions of the Model Act have simplified and rationalized the rules for determining the validity of distributions (see section 6.40) and 14.09, the possibility remains that a distribution may be made in violation of these rules. Section 8.33 provides that if it is established a director failed to meet the relevant standards of conduct of section 8.30 (e.g., good faith, reasonable care, warranted reliance) and voted for or assented to an unlawful distribution, the director is personally liable for the portion of the distribution that exceeds the maximum amount that could have been lawfully distributed.

A director whose conduct, in voting for or assenting to a distribution, is challenged under section 8.33 will have all defenses which would ordinarily be available, including the common law business judgment rule. Relevant thereto, however, there would be common issues posed by (i) a defense geared to compliance with section 8.30 (e.g., reasonable care under subsection (b) and warranted reliance under subsections (d) and (e)) and, in the alternative, (ii) a defense relying on the business judgment rule's shield (e.g., informed judgment). Thus, section 8.30 compliance will in most cases make resort to the business judgment rule's shield unnecessary.

A director who is compelled to restore the amount of an unlawful distribution to the corporation is entitled to contribution from every other director who could have been held liable for the unlawful distribution. The director may also recover the prorata portion of the amount of the unlawful distribution from any shareholder who accepted the distribution knowing that its payment was in violation of the statute. A shareholder (other than a director) who receives a payment not knowing of its invalidity is not subject to recoupment under subsection (b)(2). Although no attempt has been made in the Model Act to work out in detail the relationship between the right of recoupment from shareholders and the right of contribution from directors, it is expected that a court will equitably apportion the obligations and benefits arising from the application of the principles set forth in this section.

Section 8.33(c) limits the time within which a proceeding may be commenced against a director for an unlawful distribution to two years after the date on which the effect of the distribution was measured or breach of a restriction in the articles of incorporation occurred. Although a statute of limitations provision is a novel concept for the Model Act, a substantial minority of jurisdictions have provisions limiting the time within which an action may be brought on account of an unlawful distribution. Section 8.33(c) also limits the time within which a proceeding for contribution or recoupment may be made to one year after the date on which the liability of the claimant has been finally determined and adjudicated. This one year period specified in clause (2) may end within or extend beyond the two year period specified in clause (1).

SUBCHAPTER D. OFFICERS

§ 8.40 Officers

(a) A corporation has the offices described in its bylaws or designated by the board of directors in accordance with the bylaws.

(b) The board of directors may elect individuals to fill one or more offices of the corporation. An officer may appoint one or more officers if authorized by the bylaws or the board of directors.

(c) The bylaws or the board of directors shall assign to one of the officers responsibility for preparing minutes of the directors' and shareholders' meetings and for maintaining and authenticating the records of the corporation required to be kept under sections 16.01(a) and 16.01(e).

(d) The same individual may simultaneously hold more than one office in a corporation.

OFFICIAL COMMENT

Section 8.40 permits every corporation to designate the offices it wants. The designation may be made in the bylaws or by the board of directors consistently with the bylaws. This is a departure from earlier versions of the Model Act and most state corporation acts, which require certain offices, usually the president, the secretary and the treasurer, and generally authorize the corporation to designate additional offices. Experience has shown, however, that little purpose is served by a statutory requirement that there be certain offices, and statutory requirements may sometimes create problems of apparent authority or confusion with nonstatutory offices the corporation desires to create.

Section 8.40(b) indicates that, while it is generally the responsibility of the board of directors to elect officers, an officer may appoint one or more officers if authorized by the bylaws or the board of directors.

The board of directors, as well as duly authorized officers, employees or agents, may also appoint other agents for the corporation. Nothing in this section is intended to limit the authority of a board of directors to organize its own internal affairs, including designating officers of the board.

The bylaws or the board of directors must assign to an officer the responsibility to prepare minutes and authenticate the corporate records referred to in sections 16.01(a) and (e); the person performing this function is referred to as the ''secretary'' of the corporation throughout the Model Act. See section 1.40. Under the Act, a corporation may have this and all other corporate functions performed by a single individual.

The person who is designated by the bylaws or the board to have responsibility for preparing minutes of meetings and maintaining the corporate records has authority to bind the corporation by that officer's authentication under this section. This assignment of authority, traditionally vested in the corporate ''secretary,'' allows third persons to rely on authenticated records without inquiry as to their truth or accuracy.

§ 8.41 Functions of Officers

Each officer has the authority and shall perform the functions set forth in the bylaws or, to the extent consistent with the bylaws, the functions prescribed by the board of directors or by direction of an officer authorized by the board of directors to prescribe the functions of other officers.

§ 8.42 Standards of Conduct for Officers

(a) An officer, when performing in such capacity, has the duty to act:

(1) in good faith;

(2) with the care that a person in a like position would reasonably exercise under similar circumstances; and

(3) in a manner the officer reasonably believes to be in the best interests of the corporation.

(b) The duty of an officer includes the obligation:

(1) to inform the superior officer to whom, or the board of directors or the committee thereof to which, the officer reports of information about the affairs of the corporation known to the officer, within the scope of the officer's functions, and known to the officer to be material to such superior officer, board or committee; and

(2) to inform his or her superior officer, or another appropriate person within the corporation, or the board of directors, or a committee thereof, of any actual or probable material violation of law involving the corporation or material breach of duty to the corporation by an officer, employee, or agent of the corporation, that the officer believes has occurred or is about to occur.

(c) In discharging his or her duties, an officer who does not have knowledge that makes reliance unwarranted is entitled to rely on:

(1) the performance of properly delegated responsibilities by one or more employees of the corporation whom the officer reasonably believes to be reliable and competent in performing the responsibilities delegated; or

(2) information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by one or more employees of the corporation whom the officer reasonably believes to be reliable and competent in the matters presented or by legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise the officer reasonably believes are matters (i) within the particular person's professional or expert competence or (ii) as to which the particular person merits confidence.

(d) An officer shall not be liable to the corporation or its shareholders for any decision to take or not to take action, or any failure to take any action, as an officer, if the duties of the office are performed in compliance with this section. Whether an officer who does not comply with this section shall have liability will depend in such instance on applicable law, including those principles of § 8.31 that have relevance.

OFFICIAL COMMENT

Subsection (a) provides that an officer, when performing in such officer's official capacity, shall meet standards of conduct generally similar to those expected of directors under section 8.30. Consistent with the principles of agency, which generally govern the conduct of corporate employees, an officer is expected to observe the duties of obedience and loyalty and to act with the care that a person in a like position would reasonably exercise under similar circumstances. See RESTATEMENT (SECOND) OF AGENCY § 379(1) (1957) (''Unless otherwise agreed, a paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform and, in addition, to exercise any special skill that he has''). This section is not intended to modify, diminish or qualify the duties or standards of conduct that maybe imposed upon specific officers by other law or regulation.

The common law, including the law of agency, has recognized a duty on the part of officers and key employees to disclose to their superiors material information relevant to the affairs of the agency entrusted to them. See RESTATEMENT (SECOND) OF AGENCY § 381; A. Gilchrist Sparks, III & Lawrence A. Hamermesh,*Common Law Duties of Non–Director Corporate Officers*, 48 BUS. LAW. 215, 226–29 (1992). This duty is implicit in, and embraced under, the broader standard of subsection (a). New subsection (b) sets forth explicitly this disclosure obligation by confirming that the officer's duty includes the obligation (i) to keep superior corporate authorities informed of material information within the officer's sphere of functional responsibilities, and (ii) to inform the relevant superior authority, or other appropriate person within the corporation, of violations of law or breaches of duty that the officer believes have occurred or are about to occur (i.e., more likely than not to occur) and are or would be material to the corporation. Subsection (b)(1) specifies that business information shall be transmitted through the officer's regular reporting channels. Subsection (b)(2) specifies the reporting responsibility differently with respect to actual or probable material violations of law or material breaches of duty. The use of the term ''appropriate'' in subsection (b)(2) is intended to accommodate both the normative standard that may have been set up by the corporation for reporting potential violations of law or duty to a specified person, such as an ombudsperson, ethics officer, internal auditor, general counsel or the like, and situations where there is no designated person but the officer's immediate superior is not appropriate (for example, because the officer believes that individual is complicit in the unlawful activity or breach of duty).

Subsection (b)(1) should not be interpreted so broadly as to discourage efficient delegation of functions. It addresses the flow of information to the board of directors and to superior officers necessary to enable them to perform their decision-making and oversight functions. See the Official Comment to section 8.31. The officer's duties under subsection (b) may not be negated by agreement; however, their scope under subsection (b)(1) may be shaped by prescribing the scope of an officer's functional responsibilities.

With respect to the duties under subsection (b)(2), codes of conduct or codes of ethics, such as those adopted by many large corporations, may prescribe the circumstances in which and mechanisms by which officers and employees may discharge their duty to report material information to superior officers or board of directors, or to other designated persons.

The term ''material'' modifying violations of law or breaches of duty in subsection (b)(2) denotes a qualitative as well as quantitative standard. It relates not only to the potential direct financial impact on the corporation, but also to the nature of the violation or breach. For example, an embezzlement of $10,000, or even less, would be material because of the seriousness of the offense, even though the amount involved would not be material to the financial positions or results of operations of the corporation.

The duty under subsection (b)(2) is triggered by an officer's subjective belief that a material violation of law or breach of duty actually or probably has occurred or is likely to occur. This duty is not triggered by objective knowledge concepts, such as whether the officer should have concluded that such misconduct was occurring. The subjectivity of the trigger under subsection (b)(2), however, does not excuse officers from their obligations under subsection (a) to act in good faith and with due care in the performance of the functions assigned to them, including oversight duties within their respective areas of responsibility. There may be occasions when the principles applicable under section 8.30(c) limiting the duty of disclosure by directors where a duty of confidentiality is overriding may also apply to officers. See the Official Comment to section 8.30(c).

An officer's ability to rely on others in meeting the standards prescribed in section 8.42 may be more limited, depending upon the circumstances of the particular case, than the measure and scope of reliance permitted a director under section 8.30, in view of the greater obligation the officer may have to be familiar with the affairs of the corporation. The proper delegation of responsibilities by an officer, separate and apart from the exercise of judgment as to the delegatee's reliability and competence, is concerned with the procedure employed. This will involve, in the usual case, sufficient communication to the end that the delegatee understands the scope of the assignment and, in turn, manifests to the officer a willingness and commitment to undertake its performance. The entitlement to rely upon employees assumes that a delegating officer will maintain a sufficient level of communication with the officer's subordinates to fulfill his or her supervisory responsibilities. The definition of "employee" in section 1.40(8) includes an officer; accordingly, section 8.42 contemplates the delegation of responsibilities to other officers as well as to non-officer employees.

It is made clear, in subsection (d), that performance meeting the section's standards of conduct will eliminate an officer's exposure to any liability to the corporation or its shareholders. In contrast, an officer failing to meet its standards will not automatically face liability. Deficient performance of duties by an officer, depending upon the facts and circumstances, will normally be dealt with through intracorporate disciplinary procedures, such as reprimand, compensation adjustment, delayed promotion, demotion or discharge. These procedures may be subject to (and limited by) the terms of an officer's employment agreement. See section 8.44.

In some cases, failure to observe relevant standards of conduct can give rise to an officer's liability to the corporation or its shareholders. A court review of challenged conduct will involve an evaluation of the particular facts and circumstances in light of applicable law. In this connection, subsection (d) recognizes that relevant principles of section 8.31, such as duties to deal fairly with the corporation and its shareholders and the challenger's burden of establishing proximately caused harm, should be taken into account. In addition, the business judgment rule will normally apply to decisions within an officer's discretionary authority. Liability to others can also arise from an officer's own acts or omissions (e.g., violations of law or tort claims) and, in some cases, an officer with supervisory responsibilities can have risk exposure in connection with the acts or omissions of others.

The Official Comment to section 8.30 supplements this Official Comment to the extent that it can be appropriately viewed as generally applicable to officers as well as to directors.

§ 8.43 Resignation and Removal of Officers

(a) An officer may resign at any time by delivering notice to the corporation. A resignation is effective when the notice is delivered unless the notice specifies a later effective time. If a resignation is made effective at a later time and the board or the appointing officer accepts the future effective time, the board or the appointing officer may fill the pending vacancy before the effective time if the board or the appointing officer provides that the successor does not take office until the effective time.

(b) An officer may be removed at any time with or without cause by: (i) the board of directors; (ii) the officer who appointed such officer, unless the bylaws or the board of directors provide otherwise; or (iii) any other officer if authorized by the bylaws or the board of directors.

(c) In this section, ''appointing officer'' means the officer (including any successor to that officer) who appointed the officer resigning or being removed.

OFFICIAL COMMENT

Section 8.43(a) is consistent with current practice and declaratory of current law. It recognizes: that corporate officers may resign; that, with the consent of the board of directors or the appointing officer, they may resign effective at a later date; and that a future vacancy may be filled to become effective as of the effective date of the resignation.

In part because of the unlimited power of removal confirmed by section 8.43(b), a board of directors may enter into an employment agreement with the holder of an office that extends beyond the term of the board of directors. This type of contract is binding on the corporation even if the articles of incorporation or bylaws provide that officers are elected for a term shorter than the period of the employment contract. If a later board of directors refuses to reelect that person as an officer, the person has the right to sue for damages but not for specific performance of the contract.

Section 8.43(b) is consistent with current practice and declaratory of current law. It recognizes that the officers of the corporation are subject to removal by the board of directors and, in certain instances, by other officers. It provides the corporation with the flexibility to determine when, if ever, an officer will be permitted to remove another officer. To the extent that the corporation wishes to permit an officer, other than the appointing officer, to remove another officer, the bylaws or a board resolution should set forth clearly the persons having removal authority.

A person may be removed from office irrespective of contract rights or the presence or absence of ''cause'' in a legal sense. Section 8.44 provides that removal from office of a holder who has contract rights is without prejudice to whatever rights the former officer may assert in a suit for damages for breach of contract.

§ 8.44 Contract Rights of Officers

(a) The appointment of an officer does not itself create contract rights.

(b) An officer's removal does not affect the officer's contract rights, if any, with the corporation. An officer's resignation does not affect the corporation's contract rights, if any, with the officer.

SUBCHAPTER E. INDEMNIFICATION

§ 8.50 Subchapter Definitions

In this subchapter:

(1) ''Corporation'' includes any domestic or foreign predecessor entity of a corporation in a merger.

(2) ''Director'' or ''officer'' means an individual who is or was a director or officer, respectively, of a corporation or who, while a director or officer of the corporation, is or was serving at the corporation's request as a director, officer, partner, trustee, employee, or agent of another domestic or foreign corporation, partnership, joint venture, trust, employee benefit plan, or other entity. A director or officer is considered to be serving an employee benefit plan at the corporation's request if the individual's duties to the corporation also impose duties on, or otherwise involve services by, the individual to the plan or to participants in or beneficiaries of the plan. ''Director'' or ''officer'' includes, unless the context requires otherwise, the estate or personal representative of a director or officer.

(3) ''Expenses'' includes counsel fees.

(4) ''Liability'' means the obligation to pay a judgment, settlement, penalty, fine (including an excise tax assessed with respect to an employee benefit plan), or reasonable expenses incurred with respect to a proceeding.

(5) ''Official capacity'' means: (i) when used with respect to a director, the office of director in a corporation; and (ii) when used with respect to an officer, as contemplated in section 8.56, the office in a corporation held by the officer. ''Official capacity'' does not include service for any other domestic or foreign corporation or any partnership, joint venture, trust, employee benefit plan, or other entity.

(6) ''Party'' means an individual who was, is, or is threatened to be made, a defendant or respondent in a proceeding.

(7) ''Proceeding'' means any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, arbitrative, or investigative and whether formal or informal.

§ 8.51 Permissible Indemnification

(a) Except as otherwise provided in this section, a corporation may indemnify an individual who is a party to a proceeding because he is a director against liability incurred in the proceeding if:

(1)(i) he conducted himself in good faith; and

(ii) he reasonably believed:

(A) in the case of conduct in his official capacity, that his conduct was in the best interests of the corporation; and

(B) in all other cases, that his conduct was at least not opposed to the best interests of the corporation; and

(iii) in the case of any criminal proceeding, he had no reasonable cause to believe his conduct was unlawful; or

(2) he engaged in conduct for which broader indemnification has been made permissible or obligatory under a provision of the articles of incorporation (as authorized by section 2.02(b)(5)).

(b) A director's conduct with respect to an employee benefit plan for a purpose he reasonably believed to be in the interests of the participants in, and the beneficiaries of, the plan is conduct that satisfies the requirement of subsection (a)(1)(ii)(B).

(c) The termination of a proceeding by judgment, order, settlement, or conviction, or upon a plea of nolo contendere or its equivalent, is not, of itself, determinative that the director did not meet the relevant standard of conduct described in this section.

(d) Unless ordered by a court under section 8.54(a)(3), a corporation may not indemnify a director:

(1) in connection with a proceeding by or in the right of the corporation, except for reasonable expenses incurred in connection with the proceeding if it is determined that the director has met the relevant standard of conduct under subsection (a); or

(2) in connection with any proceeding with respect to conduct for which he was adjudged liable on the basis that he received a financial benefit to which he was not entitled, whether or not involving action in his official capacity.

OFFICIAL COMMENT

1. Section 8.51(a)

Subsection 8.51(a) permits, but does not require, a corporation to indemnify directors if the standards of subsection (a)(1) or of a provision of the articles referred to in subsection (a)(2) are met. This authorization is subject to any limitations set forth in the articles of incorporation pursuant to section 8.58(c). Absent any such limitation, the standards for indemnification of directors contained in this subsection define the outer limits for which discretionary indemnification is permitted under the Model Act. Conduct which does not meet one of these standards is not eligible for permissible indemnification under the Model Act, although court-ordered indemnification may be available under section 8.54(a)(3). Conduct that falls within these outer limits does not automatically entitle directors to indemnification, although a corporation may obligate itself to indemnify directors to the maximum extent permitted by applicable law. See section 8.58(a). No such obligation, however, may exceed these outer limits. Absent such an obligatory provision, section 8.52 defines much narrower circumstances in which directors are entitled as a matter of right to indemnification.

Some state statutes provide separate, but usually similarly worded, standards for indemnification in third-party suits and indemnification in suits brought by or in the right of the corporation. Section 8.51 makes clear that the outer limits of conduct for which indemnification is permitted should not be dependent on the type of proceeding in which the claim arises. To prevent circularity in recovery, however, section 8.51(d)(1) limits indemnification in connection with suits brought by or in the right of the corporation to expenses incurred and excludes amounts paid to settle such suits or to satisfy judgments. In addition, to discourage wrongdoing, section 8.51(d)(2) bars indemnification where the director has been adjudged to have received a financial benefit to which he is not entitled. Nevertheless, a court may order certain relief from these limitations under section 8.54(a)(3).

The standards of conduct described in subsections (a)(1)(i) and (a)(1)(ii)(A) that must be met in order to permit the corporation to indemnify a director are closely related, but not identical, to the standards of conduct imposed on directors by section 8.30. Section 8.30(a) requires a director acting in his official capacity to discharge his duties in good faith, with due care (i.e., that which an ordinarily prudent person in a like position would exercise under similar circumstances) and in a manner he reasonably believes to be in the corporation's best interests. Unless authorized by a charter provision adopted pursuant to subsection (a)(2), it would be difficult to justify indemnifying a director who has not met any of these standards. It would not, however, make sense to require a director to meet all these standards in order to be indemnified because a director who meets all three of these standards would have no liability, at least to the corporation, under the terms of section 8.30(d).

Section 8.51(a) adopts a middle ground by authorizing discretionary indemnification in the case of a failure to meet the appropriate care standard of section 8.30(b) because public policy would not be well served by an absolute bar. A director's potential liability for conduct which does not on each and every occasion satisfy the appropriate care requirement of section 8.30(b), or which with the benefit of hindsight could be so viewed, would in all likelihood deter qualified individuals from serving as directors and inhibit some who serve from taking risks. Permitting indemnification against such liability tends to counter these undesirable consequences. Accordingly, section 8.51(a) authorizes indemnification at the corporation's option even though section 8.30's appropriate care requirement is not met, but only if the director satisfies the "good faith" and "corporation's best interests" standards. This reflects a judgment that, balancing public policy considerations, the corporation may indemnify a director who does not satisfy the appropriate care test but not one who fails either of the other two standards.

As in the case of section 8.30, where the concept of good faith is also used, no attempt is made in section 8.51 to provide a definition. The concept involves a subjective test, which would permit indemnification for "a mistake of judgment," in the words of the Official Comment to section 8.31, even though made unwisely or negligently by objective standards. Section 8.51 also requires, as does section 8.30, a "reasonable" belief that conduct when acting in the director's official capacity was in the corporation's best interests. It then adds a provision, not found in section 8.30, relating to criminal proceedings that requires the director to have had no "reasonable cause" to believe that his conduct was unlawful. These both involve objective standards applicable to the director's belief concerning the effect of his conduct. Conduct includes both acts and omissions.

Section 8.51(a)(1)(ii)(B) requires, if not acting in the director's official capacity, that the action be "at least not opposed to" the corporation's best interests. This standard is applicable to the director when serving another entity at the request of the corporation or when sued simply because of the director's status. The words ''at least'' qualify ''not opposed to'' in order to make it clear that this standard is an outer limit for conduct other than in an official capacity. While this subsection is directed at the interests of the indemnifying (i.e., requesting) corporation, a director serving another entity by request remains subject to the provisions of the law governing his service to that entity, including provisions dealing with conflicts of interest. Compare sections 8.60–8.63. Should indemnification from the requesting corporation be sought by a director for acts done while serving another entity, which acts involved breach of the duty of loyalty owed to that entity, nothing in section 8.51(a)(1)(ii)(B) would preclude the requesting corporation from considering, in assessing its own best interests, whether the fact that its director had engaged in a violation of the duty owed to the other entity was in fact ''opposed to'' the interests of the indemnifying corporation. Receipt of an improper financial benefit from a subsidiary would normally be opposed to the best interests of the parent.

Section 8.51 also permits indemnification in connection with a proceeding involving an alleged failure to satisfy legal standards other than the standards of conduct in section 8.30, e.g., violations of federal securities laws and environmental laws. It should be noted, however, that the Securities and Exchange Commission takes the position that indemnification against liabilities under the Securities Act of 1933 is against public policy and requires that, as a condition for accelerating the effectiveness of a registration statement under the Act, the issuer must undertake that, unless in the opinion of its counsel the matter has been settled by controlling precedent, it will submit to a court the question whether such indemnification is against public policy as expressed in the Act. 17 C.F.R. § 229.512(h) (1993).

In addition to indemnification under section 8.51(a)(1), section 8.51(a)(2) permits indemnification under the standard of conduct set forth in a charter provision adopted pursuant to section 2.02(b)(5). Based on such a charter provision, section 8.51(a)(2) permits indemnification in connection with claims by third parties and, through section 8.56, applies to officers as well as directors. (This goes beyond the scope of a charter provision adopted pursuant to section 2.02(b)(4), which can only limit liability of directors against claims by the corporation or its shareholders.) Section 8.51(a)(2) is subject to the prohibition of subsection (d)(1) against indemnification of settlements and judgments in derivative suits. It is also subject to the prohibition of subsection (d)(2) against indemnification for receipt of an improper financial benefit; however, this prohibition is already subsumed in the exception contained in section 2.02(b)(5)(A).

2. Section 8.51(b)

As discussed in the Official Comment to section 8.50(2), ERISA requires that a ''fiduciary'' (as defined in ERISA) discharge his duties ''solely in the interest'' of the participants in and beneficiaries of an employee benefit plan. Section 8.51(b) makes clear that a director who is serving as a trustee or fiduciary for an employee benefit plan under ERISA meets the standard for indemnification under section 8.51(a) if he reasonably believes his conduct was in the best interests of the participants in and beneficiaries of the plan.

This standard is arguably an exception to the more general standard that conduct not in an official corporate capacity is indemnifiable if it is ''at least not opposed to'' the best interests of the corporation. However, a corporation that causes a director to undertake fiduciary duties in connection with an employee benefit plan should expect the director to act in the best interests of the plan's beneficiaries or participants. Thus, subsection (b) establishes and provides a standard for indemnification that is consistent with the statutory policies embodied in ERISA. See Official Comment to section 8.50(2).

3. Section 8.51(c)

The purpose of section 8.51(c) is to reject the argument that indemnification is automatically improper whenever a proceeding has been concluded on a basis that does not exonerate the director claiming indemnification. Even though a final judgment or conviction is not automatically determinative of the issue of whether the minimum standard of conduct was met, any judicial determination of substantive liability would in most instances be entitled to considerable weight. By the same token, it is clear that the termination of a proceeding by settlement or plea of nolo contendere should not of itself create a presumption either that conduct met or did not meet the relevant standard of subsection (a) since a settlement or nolo plea may be agreed to for many reasons unrelated to the merits of the claim. On the other hand, a final determination of non-liability (including one based on a liability-limitation provision adopted under section 2.02(b)(4)) or an acquittal in a criminal case automatically entitles the director to indemnification of expenses under section 8.52.

Section 8.51(c) applies to the indemnification of expenses in derivative proceedings (as well as to indemnification in third-party suits). The most likely application of this subsection in connection with a derivative proceeding will be to a settlement since a judgment or order would normally result in liability to the corporation and thereby preclude indemnification for expenses under section 8.51(d)(1), unless ordered by a court under section 8.54(a)(3). In the rare event that a judgment or order entered against the director did not include a determination of liability to the corporation, the entry of the judgment or order would not be determinative that the director failed to meet the relevant standard of conduct.

4. Section 8.51(d)

This subsection makes clear that indemnification is not permissible under section 8.51 in two situations: (i) a proceeding brought by or in the right of a corporation that results in a settlement or a judgment against the director and (ii) a proceeding that results in a judgment that the director received an improper financial benefit as a result of his conduct.

Permitting indemnification of settlements and judgments in derivative proceedings would give rise to a circularity in which the corporation receiving payment of damages by the director in the settlement or judgment (less attorneys' fees) would then immediately return the same amount to the director (including attorneys' fees) as indemnification. Thus, the corporation would be in a poorer economic position than if there had been no proceeding. This situation is most egregious in the case of a judgment against the director. Even in the case of a settlement, however, prohibiting indemnification is not unfair. Under the revised procedures of section 7.44, upon motion by the corporation, the court must dismiss any derivative proceeding which independent directors (or a court-appointed panel) determine in good faith, after a reasonable inquiry, is not in the best interests of the corporation. Furthermore, under section 2.02(b)(4), the directors have the opportunity to propose to shareholders adoption of a provision limiting the liability of directors in derivative proceedings. In view of these considerations, it is unlikely that directors will be unnecessarily exposed to meritless actions. In addition, if directors were to be indemnified for amounts paid in settlement, the dismissal procedures in section 7.44 might not be fully employed since it could be less expensive for the corporation to indemnify the directors immediately for the amount of the claimed damages rather than bear the expense of the inquiry required by section 7.44. The result could increase the filing of meritless derivative proceedings in order to generate small but immediately paid attorneys' fees. Despite the prohibition on indemnification of a settlement or a judgment in a derivative proceeding, subsection (d)(1) permits indemnification of the related reasonable expenses incurred in the proceeding so long as the director meets the relevant standard of conduct set forth in section 8.51(a). In addition, indemnification of derivative expenses and amounts paid in settlement where the relevant standard was not met may be ordered by a court under section 8.54(a)(3).

Indemnification under section 8.51 is also prohibited if there has been an adjudication that a director received an improper financial benefit (i.e., a benefit to which he is not entitled), even if, for example, the director acted in a manner not opposed to the best interests of the corporation. For example, improper use of inside information for financial benefit should not be an action for which the corporation may elect to provide indemnification, even if the corporation was not thereby harmed. Given the express language of section 2.02(b)(5) establishing the outer limit of an indemnification provision contained in the articles of incorporation, a director found to have received an improper financial benefit would not be permitted indemnification under subsection (a)(2). Although it is unlikely that a director found to have received an improper financial benefit could meet the standard in subsection (a)(1)(ii)(B); this limitation is made explicit in section 8.51(d)(2). Section 8.54(a)(3) permits a director found liable in a proceeding referred to in subsection (d)(2) to petition a court for a judicial determination of entitlement to indemnification for reasonable expenses. The language of section 8.51(d)(2) is based on section 2.02(b)(4)(A) and, thus, the same standards should be used in interpreting the application of both provisions. Although a settlement may create an obligation to pay money, it should not be construed for purposes of this subchapter as an adjudication of liability.

§ 8.52 Mandatory Indemnification

A corporation shall indemnify a director who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which he was a party because he was a director of the corporation against reasonable expenses incurred by him in connection with the proceeding.

OFFICIAL COMMENT

Section 8.51 determines whether indemnification may be made voluntarily by a corporation if it elects to do so. Section 8.52 determines whether a corporation must indemnify a director for his expenses; in other words, section 8.52 creates a statutory right of indemnification in favor of the director who meets the requirements of that section. Enforcement of this right by judicial proceeding is specifically contemplated by section 8.54(a)(1). Section 8.54(b) gives the director a statutory right to recover expenses incurred by him in enforcing his statutory right to indemnification under section 8.52.

The basic standard for mandatory indemnification is that the director has been ''wholly successful, on the merits or otherwise,'' in the defense of the proceeding. The word ''wholly'' is added to avoid the argument accepted in Merritt–Chapman & Scott Corp. v. Wolfson, 321 A.2d 138 (Del. 1974), that a defendant may be entitled to partial mandatory indemnification if, by plea bargaining or otherwise, he was able to obtain the dismissal of some but not all counts of an indictment. A defendant is ''wholly successful'' only if the entire proceeding is disposed of on a basis which does not involve a finding of liability. A director who is precluded from mandatory indemnification by this requirement may still be entitled to permissible indemnification under section 8.51(a) or court ordered indemnification under section 8.54(a)(3).

The language in earlier versions of the Model Act and in many other state statutes that the basis of success may be ''on the merits or otherwise'' is retained. While this standard may result in an occasional defendant becoming entitled to indemnification because of procedural defenses not related to the merits, e.g., the statute of limitations or disqualification of the plaintiff, it is unreasonable to require a defendant with a valid procedural defense to undergo a possibly prolonged and expensive trial on the merits in order to establish eligibility for mandatory indemnification.

§ 8.53 Advance for Expenses

(a) A corporation may, before final disposition of a proceeding, advance funds to pay for or reimburse the reasonable expenses incurred by an individual who is a party to the proceeding because that individual is a member of the board of directors if the director delivers to the corporation:

(1) a written affirmation of the director's good faith belief that the relevant standard of conduct described in section 8.51 has been met by the director or that the proceeding involves conduct for which liability has been eliminated under a provision of the articles of incorporation as authorized by section 2.02(b)(4); and

(2) a written undertaking of the director to repay any funds advanced if the director is not entitled to mandatory indemnification under section 8.52 and it is ultimately determined under section 8.54 or section 8.55 that the director has not met the relevant standard of conduct described in section 8.51.

(b) The undertaking required by subsection (a)(2) must be an unlimited general obligation of the director but need not be secured and may be accepted without reference to the financial ability of the director to make repayment.

(c) Authorizations under this section shall be made:

(1) by the board of directors:

(i) if there are two or more qualified directors, by a majority vote of all the qualified directors (a majority of whom shall for such purpose constitute a quorum) or by a majority of the members of a committee of two or more qualified directors appointed by such a vote; or

(ii) if there are fewer than two qualified directors, by the vote necessary for action by the board in accordance with section 8.24(c), in which authorization directors who are not qualified directors may participate; or

(2) by the shareholders, but shares owned by or voted under the control of a director who at the time is not a qualified director may not be voted on the authorization.

§ 8.54 Court–Ordered Indemnification and Advance for Expenses

(a) A director who is a party to a proceeding because he is a director may apply for indemnification or an advance for expenses to the court conducting the proceeding or to another court of competent jurisdiction. After receipt of an application and after giving any notice it considers necessary, the court shall:

(1) order indemnification if the court determines that the director is entitled to mandatory indemnification under section 8.52;

(2) order indemnification or advance for expenses if the court determines that the director is entitled to indemnification or advance for expenses pursuant to a provision authorized by section 8.58(a); or

(3) order indemnification or advance for expenses if the court determines, in view of all the relevant circumstances, that it is fair and reasonable

(i) to indemnify the director, or

(ii) to advance expenses to the director, even if he has not met the relevant standard of conduct set forth in section 8.51(a), failed to comply with section 8.53 or was adjudged liable in a proceeding referred to in subsection 8.51(d)(1) or (d)(2), but if he was adjudged so liable his indemnification shall be limited to reasonable expenses incurred in connection with the proceeding.

(b) If the court determines that the director is entitled to indemnification under subsection (a)(1) or to indemnification or advance for expenses under subsection (a)(2), it shall also order the corporation to pay the director's reasonable expenses incurred in connection with obtaining court-ordered indemnification or advance for expenses. If the court determines that the director is entitled to indemnification or advance for expenses under subsection (a)(3), it may also order the corporation to pay the director's reasonable expenses to obtain court-ordered indemnification or advance for expenses.

§ 8.55 Determination and Authorization of Indemnification

(a) A corporation may not indemnify a director under section 8.51 unless authorized for a specific proceeding after a determination has been made that indemnification is permissible because the director has met the relevant standard of conduct set forth in section 8.51.

(b) The determination shall be made:

(1) if there are two or more qualified directors, by the board of directors by a majority vote of all the qualified directors (a majority of whom shall for such purpose constitute a quorum), or by a majority of the members of a committee of two or more qualified directors appointed by such a vote;

(2) by special legal counsel:

(i) selected in the manner prescribed in subdivision (1); or

(ii) if there are fewer than two qualified directors, selected by the board of directors (in which selection directors who are not qualified directors may participate); or

(3) by the shareholders, but shares owned by or voted under the control of a director who at the time is not a qualified director may not be voted on the determination.

(c) Authorization of indemnification shall be made in the same manner as the determination that indemnification is permissible, except that if there are fewer than two qualified directors or if the determination is made by special legal counsel, authorization of indemnification shall be made by those entitled to select special legal counsel under subsection (b)(2)(ii).

§ 8.56 Indemnification of Officers

(a) A corporation may indemnify and advance expenses under this subchapter to an officer of the corporation who is a party to a proceeding because he is an officer of the corporation

(1) to the same extent as a director; and

(2) if he is an officer but not a director, to such further extent as may be provided by the articles of incorporation, the bylaws, a resolution of the board of directors, or contract except for (A) liability in connection with a proceeding by or in the right of the corporation other than for reasonable expenses incurred in connection with the proceeding or (B) liability arising out of conduct that constitutes (i) receipt by him of a financial benefit to which he is not entitled, (ii) an intentional infliction of harm on the corporation or the shareholders, or (iii) an intentional violation of criminal law.

(b) The provisions of subsection (a)(2) shall apply to an officer who is also a director if the basis on which he is made a party to the proceeding is an act or omission solely as an officer.

(c) An officer of a corporation who is not a director is entitled to mandatory indemnification under section 8.52, and may apply to a court under section 8.54 for indemnification or an advance for expenses, in each case to the same extent to which a director may be entitled to indemnification or advance for expenses under those provisions.

§ 8.57 Insurance

A corporation may purchase and maintain insurance on behalf of an individual who is a director or officer of the corporation, or who, while a director or officer of the corporation, serves at the corporation's request as a director, officer, partner, trustee, employee, or agent of another domestic or foreign corporation, partnership, joint venture, trust, employee benefit plan, or other entity, against liability asserted against or incurred by him in that capacity or arising from his status as a director or officer, whether or not the corporation would have power to indemnify or advance expenses to him against the same liability under this subchapter.

§ 8.58 Variation by Corporate Action; Application of Subchapter

(a) A corporation may, by a provision in its articles of incorporation or bylaws or in a resolution adopted or a contract approved by its board of directors or shareholders, obligate itself in advance of the act or omission giving rise to a proceeding to provide indemnification in accordance with section 8.51 or advance funds to pay for or reimburse expenses in accordance with section 8.53. Any such obligatory provision shall be deemed to satisfy the requirements for authorization referred to in section 8.53(c) and in section 8.55(c). Any such provision that obligates the corporation to provide indemnification to the fullest extent permitted by law shall be deemed to obligate the corporation to advance funds to pay for or reimburse expenses in accordance with section 8.53 to the fullest extent permitted by law, unless the provision specifically provides otherwise.

(b) Any provision pursuant to subsection (a) shall not obligate the corporation to indemnify or advance expenses to a director of a predecessor of the corporation, pertaining to conduct with respect to the predecessor, unless otherwise specifically provided. Any provision for indemnification or advance for expenses in the articles of incorporation, bylaws, or a resolution of the board of directors or shareholders of a predecessor of the corporation in a merger or in a contract to which the predecessor is a party, existing at the time the merger takes effect, shall be governed by section 11.07(a)(4).

(c) A corporation may, by a provision in its articles of incorporation, limit any of the rights to indemnification or advance for expenses created by or pursuant to this subchapter.

(d) This subchapter does not limit a corporation's power to pay or reimburse expenses incurred by a director or an officer in connection with his appearance as a witness in a proceeding at a time when he is not a party.

(e) This subchapter does not limit a corporation's power to indemnify, advance expenses to or provide or maintain insurance on behalf of an employee or agent.

OFFICIAL COMMENT

Section 8.58(a) authorizes a corporation to make obligatory the permissive provisions of subchapter E in advance of the conduct giving rise to the request for assistance. Many corporations have adopted such provisions, often with shareholder approval. An obligatory provision satisfies the requirements for authorization in subsection (c) of sections 8.53 and 8.55, but compliance would still be required with subsections (a) and (b) of these sections.

Section 8.58(a) further provides that a provision requiring indemnification to the fullest extent permitted by law shall be deemed, absent an express statement to the contrary, to include an obligation to advance expenses under section 8.53. This provision of the statute is intended to avoid a decision such as that of the Delaware Supreme Court in Advanced Mining Systems, Inc. v. Fricke, 623 A.2d 82 (Del. 1992). If a corporation provides for obligatory indemnification and not for obligatory advance for expenses, the provision should be reviewed to ensure that it properly reflects the intent in light of the third sentence of section 8.58(a). Also, a corporation should consider whether obligatory expense advance is intended for direct suits by the corporation as well as for derivative suits by shareholders in the right of the corporation. In the former case, assuming compliance with subsections (a) and (b) of section 8.53, the corporation could be required to fund the defense of a defendant director even where the board of directors has already concluded that he has engaged in significant wrongdoing. See Official Comment to section 8.53.

Section 8.58(b) provides that an obligatory indemnification provision as authorized by subsection (a) does not, unless specific provision is made to the contrary, bind the corporation with respect to a predecessor. An obligatory indemnification provision of a predecessor is treated as a liability (to the extent it is one) under section 11.07(a)(4), which governs the effect of a merger.

Section 8.58(c) permits a corporation to limit the right of the corporation to indemnify or advance expenses by a provision in its articles of incorporation. As provided in section 10.09, no such limitation will affect rights in existence when the provision becomes effective pursuant to section 1.23.

Section 8.58(d) makes clear that subchapter E deals only with actual or threatened defendants or respondents in a proceeding, and that expenses incurred by a director in connection with appearance as a witness may be indemnified without regard to the limitations of subchapter E. Indeed, most of the standards described in sections 8.51 and 8.54(a) by their own terms can have no meaningful application to a director whose only connection with a proceeding is that he has been called as a witness.

Subchapter E does not regulate the power of the corporation to indemnify or advance expenses to employees and agents. That subject is governed by the law of agency and related principles and frequently by contractual arrangements between the corporation and the employee or agent. Section 8.58(e) makes clear that, while indemnification, advance for expenses, and insurance for employees and agents are beyond the scope of this subchapter, the elaboration in subchapter E of standards and procedures for indemnification, expense advance, and insurance for directors and officers is not in any way intended to cast doubt on the power of the corporation to indemnify or advance expenses to or purchase and maintain insurance for employees and agents under section 3.02 or otherwise.

§ 8.59 Exclusivity of Subchapter

A corporation may provide indemnification or advance expenses to a director or an officer only as permitted by this subchapter.

SUBCHAPTER F. DIRECTORS' CONFLICTING INTEREST TRANSACTIONS

INTRODUCTORY COMMENT

1. Purposes and Special Characteristics of Subchapter F

The common law, drawing by analogy on the fiduciary principles of the law of trusts, initially took the position that any transaction between a corporation and a director of that corporation was contaminated by the director's conflicting interest, that the transaction was null and void or voidable and, suggesting by implication, that the interested director who benefited from the transaction could be required to disgorge any profits and be held liable for any damages. Eventually, it was perceived that a flat void/voidable rule could work against a corporation's best interests. Although self-interested transactions carry a potential for injury to the corporation, they also carry a potential for benefit. A director who is self-interested may nevertheless act fairly, and there may be cases where a director either owns a unique asset that the corporation needs or is willing to offer the corporation more favorable terms than are available on the market (for example, where the director is more confident of the corporation's financial ability to perform than a third person would be). Accordingly, the courts dropped the flat void/voidable rule, and substituted in its stead the rule that a self-interested transaction will be upheld if the director shoulders the burden of showing that the transaction was fair.

Later still, the Model Act and the state legislatures entered the picture by adopting statutory provisions that sheltered the transaction from any challenge that the transaction was void or voidable where it was approved by disinterested directors or shareholders. Until 1989, the successive Model Act provisions concerning director conflict-of-interest transactions and the statutory provisions in force in most states reflected basically the same objective; that is, their safe-harbor procedures concentrated on protection for the transaction, with no attention given to the possible vulnerability of the director whose conflicting interest would give rise to the transaction's potential challenge. However, in 1989 the relevant provisions were significantly reworked in subchapter F of

Chapter 8. Four basic elements in the architecture of the 1989 version of subchapter F distinguished the approach of the subchapter from most other statutory provisions of the time.

First, most other statutory provisions did not define what constituted a director's conflict-of-interest transaction. In contrast, subchapter F defined, with bright-line rules, the transactions that were to be treated as director's conflict-of-interest transactions.

Second, because most other statutory provisions did not define what constitutes a director's conflict-of-interest transaction, they left open how to deal with transactions that involved only a relatively minor conflict. In contrast, subchapter F explicitly provided that a director's transaction that was not within the statutory definition of a director's conflict of interest transaction was not subject to judicial review for fairness on the ground that it involved a conflict of interest (although circumstances that fall outside the statutory definition could, of course, afford the basis for a legal attack on the transaction on some other ground), even if the transaction involved some sort of conflict lying outside the statutory definition, such as a remote familial relationship.

Third, subchapter F made explicit, as many other statutory provisions did not, that if a director's conflict-of-interest transaction, as defined, was properly approved by disinterested (or ''qualified'') directors or shareholders, the conflicted director could not be subject to an award of damages or other sanctions with respect thereto (although the director could be subject to claims on some basis other than the conflict).

Bright-line provisions of any kind represent a trade-off between the benefits of certainty, and the danger that some transactions or conduct that fall outside the area circumscribed by the bright-lines may be so similar to the transaction and conduct that fall within the area that different treatment may seem anomalous. Subchapter F reflected the considered judgment that in corporate matters, where planning is critical, the clear and important efficiency gains that result from certainty through defining director's conflict-of-interest transactions clearly exceeded any potential and uncertain efficiency losses that might occasionally follow from excluding other director's transactions from judicial review for fairness on conflict-of-interest grounds.

The 2004 revisions of subchapter F rest on the same basic judgment that animated the original subchapter. Accordingly, the revisions made do not alter the fundamental elements and approach of the subchapter. However, the revisions refine the definition of director's conflict-of-interest transactions, simplify the text of the statute, and, within the basic approach of the original subchapter, make various clarifying and substantive changes throughout the text and comments. One of these substantive changes expands the category of persons whose interest in a transaction will be attributed to the director for purposes of subchapter F. At the same time, the revisions delete coverage of a director's interest that lies outside the transaction itself but might be deemed to be ''closely related to the transaction.'' The latter phraseology was determined to be excessively vague and unhelpful. In combination, these revisions clarify the coverage of subchapter F, while ensuring that a transaction that poses a significant risk of adversely affecting a director's judgment will not escape statutory coverage.

2. Scope of Subchapter F

The focus of subchapter F is sharply defined and limited.

First, the subchapter is targeted on legal challenges based on interest conflicts only. Subchapter F does not undertake to define, regulate, or provide any form of procedure regarding other possible claims. For example, subchapter F does not address a claim that a controlling shareholder has violated a duty owed to the corporation or minority shareholders.

Second, subchapter F does not shield misbehavior by a director or other person that is actionable under other provisions of the Model Act, such as section 8.31, or under other legal rules, regardless of whether the misbehavior is incident to a transaction with the corporation and regardless of whether the rule is one of corporate law.

Third, subchapter F does not preclude the assertion of defenses, such as statute of limitations or failure of a condition precedent, that are based on grounds other than a director's conflicting interest in the transaction.

Fourth, the subchapter is applicable only when there is a ''transaction'' by or with the corporation. For purposes of subchapter F, ''transaction'' generally connotes negotiations or a consensual arrangements between the corporation and another party or parties that concern their respective and differing economic rights or interests—not simply a unilateral action by the corporation or a director, but rather a ''deal.'' Whether safe harbor procedures of some kind might be available to the director and the corporation with respect to non-transactional matters is discussed in numbered paragraph 4 of this Introductory Comment.

Fifth, subchapter F deals with directors only. Correspondingly, subchapter F does not deal with controlling shareholders in their capacity as such. If a corporation is wholly owned by a parent corporation or other person, there are no outside shareholders who might be injured as a result of transactions entered into between the corporation and the owner of its shares. However, transactions between a corporation and a parent corporation or other controlling shareholder who owns less than all of its shares may give rise to the possibility of abuse of power by the controlling shareholder. Subchapter F does not speak to proceedings brought on that basis because section 8.61 concerns only proceedings that are brought on the ground that a ''director has an interest respecting the transaction.''

Sixth, it is important to stress that the voting procedures and conduct standards prescribed in subchapter F deal solely with the complicating element presented by the director's conflicting interest. A transaction that receives favorable directors' or shareholders' action complying with subchapter F may still fail to satisfy a different quorum requirement or to achieve a different vote that may be needed for substantive approval of the transaction under other applicable statutory provisions or under the articles of incorporation, and vice versa. (Under the Model Act, latitude is granted for setting higher voting requirements and different quorum requirements in the articles of incorporation. See sections 2.02(b)(2) and 7.27.)

Seventh, a few corporate transactions or arrangements in which directors inherently have a special personal interest are of a unique character and are regulated by special procedural provisions of the Model Act. See sections 8.51 and 8.52 dealing with indemnification arrangements and section 7.40 dealing with termination of derivative proceedings by board action. Any corporate transactions or arrangements affecting directors that are governed by such regulatory sections of the Act are not governed by subchapter F.

3. Structure of Subchapter F

Subchapter F has only four parts. Definitions are in section 8.60. Section 8.61 prescribes what a court may or may not do in various situations. Section 8.62 prescribes procedures for action by boards of directors or duly authorized committees regarding a director's conflicting interest transaction. Section 8.63 prescribes corresponding procedures for shareholders. Thus, the most important operative section of the subchapter is section 8.61.

4. Non–Transactional Situations Involving Interest Conflicts

Many situations arise in which a director's personal economic interest is or may be adverse to the economic interest of the corporation, but which do not entail a "transaction" by or with the corporation. How does the subchapter bear upon these situations?

Corporate Opportunity

The corporate opportunity doctrine is anchored in a significant body of case law clustering around the core question whether the corporation has a legitimate interest in a business opportunity, either because of the nature of the opportunity or the way in which the opportunity came to the director, of such a nature that the corporation should be afforded prior access to the opportunity before it is pursued (or, to use the case law's phrase, "usurped") by a director. Because judicial determinations in this area often seem to be driven by the particular facts of a case, outcomes are often difficult to predict.

The subchapter, as such, does not apply by its terms to corporate or business opportunities since no transaction between the corporation and the director is involved in the taking of an opportunity. However, new subchapter G of chapter 8 of the Model Act provides, in effect, that the safe harbor procedures of section 8.62 or 8.63 may be employed, at the interested director's election, to protect the taking of a business opportunity that might be challenged under the doctrine. Otherwise, subchapter F has no bearing on enterprise rights or director obligations under the corporate opportunity doctrine.

Other Situations

Many other kinds of situations can give rise to a clash of economic interest between a director and the corporation. For example, a director's personal financial interests can be impacted by a non-transactional policy decision of the board, such as where it decides to establish a divisional headquarters in the director's small hometown. In other situations, simple inaction by a board might work to a director's personal advantage, or a flow of ongoing business relationships between a director and that director's corporation may, without centering upon any discrete "transaction," raise questions of possible favoritism, unfair dealing, or undue influence. If a director decides to engage in business activity that directly competes with the corporation's own business, his economic interest in that competing activity ordinarily will conflict with the best interests of the corporation and put in issue the breach of the director's duties to the corporation. Basic conflicts and improprieties can also arise out of a director's personal appropriation of corporate assets or improper use of corporate proprietary or inside information.

The circumstances in which such non-transactional conflict situations should be brought to the board or shareholders for clearance, and the legal effects, if any, of such clearance, are matters for development under the common law and lie outside the ambit of subchapter F. While these non-transactional situations are unaffected one way or the other by the provisions of subchapter F, a court may well recognize that subchapter F procedures provide a useful analogy for dealing with such situations. Where similar procedures are followed the court may, in its discretion, accord to them an effect similar to that provided by subchapter F.

NOTE

In the Official Comments to subchapter F sections, the director who has a conflicting interest is for convenience referred to as ''the director'' or ''D'', and the corporation of which he or she is a director is referred to as ''the corporation'' or ''X Co.'' Another corporation dealing with X Co. is referred to as ''Y Co.'' A subsidiary of the corporation is referred to as ''S Co.''

§ 8.60 Subchapter Definitions

In this subchapter:

(1) ''Director's conflicting interest transaction'' means a transaction effected or proposed to be effected by the corporation (or by an entity controlled by the corporation)

(i) to which, at the relevant time, the director is a party; or

(ii) respecting which, at the relevant time, the director had knowledge and a material financial interest known to the director; or

(iii) respecting which, at the relevant time, the director knew that a related person was a party or had a material financial interest.

(2) ''Control'' (including the term ''controlled by'') means (i) having the power, directly or indirectly, to elect or remove a majority of the members of the board of directors or other governing body of an entity, whether through ownership of voting shares or interests, by contract, or otherwise, or (ii) being subject to a majority of the risk of loss from the entity's activities or entitled to receive a majority of the entity's residual returns.

(3) ''Relevant time'' means (i) the time at which directors' action respecting the transaction is taken in compliance with section 8.62, or (ii) if the transaction is not brought before the board of directors of the corporation (or its committee) for action under section 8.62, at the time the corporation (or an entity controlled by the corporation) becomes legally obligated to consummate the transaction.

(4) ''Material financial interest'' means a financial interest in a transaction that would reasonably be expected to impair the objectivity of the director's judgment when participating in action on the authorization of the transaction.

(5) ''Related person'' means:

(i) the director's spouse;

(ii) a child, stepchild, grandchild, parent, step parent, grandparent, sibling, step sibling, half sibling, aunt, uncle, niece or nephew (or spouse of any thereof) of the director or of the director's spouse;

(iii) an individual living in the same home as the director;

(iv) an entity (other than the corporation or an entity controlled by the corporation) controlled by the director or any person specified above in this subdivision (5);

(v) a domestic or foreign (A) business or nonprofit corporation (other than the corporation or an entity controlled by the corporation) of which the director is a director, (B) unincorporated entity of which the director is a general partner or a member of the governing body, or (C) individual, trust or estate for whom or of which the director is a trustee, guardian, personal representative or like fiduciary; or

(vi) a person that is, or an entity that is controlled by, an employer of the director.

(5) ''Fair to the corporation'' means, for purposes of section 8.61(b)(3), that the transaction as a whole was beneficial to the corporation, taking into appropriate account whether it was (i) fair in terms of the director's dealings with the corporation, and (ii) comparable to what might have been obtainable in an arm's length transaction, given the consideration paid or received by the corporation.

(6) ''Required disclosure'' means disclosure of (i) the existence and nature of the director's conflicting interest, and (ii) all facts known to the director respecting the subject matter of the transaction that a director free of such conflicting interest would reasonably believe to be material in deciding whether or not to proceed with the transaction.

OFFICIAL COMMENT

The definitions set forth in section 8.60 apply only to subchapter F's provisions and, except to the extent relevant to subchapter G, have no application elsewhere in the Model Act. (For the meaning and use of certain terms used below, such as ''D,'' ''X Co.'' and ''Y Co.'', see the Note at the end of the Introductory Comment of subchapter F.)

1. Director's Conflicting Interest Transaction

The definition of ''director's conflicting interest transaction'' in subdivision (1) is the core concept underlying subchapter F, demarcating the transactional area that lies within—and without—the scope of the subchapter's provisions. The definition operates preclusively in that, as used in section 8.61, it denies the power of a court to invalidate transactions or otherwise to remedy conduct that falls outside the statutory definition of ''director's conflicting interest transaction'' solely on the ground that the director has a conflict of interest in the transaction. (Nevertheless, as stated in the Introductory Comment, the transaction might be open to attack under rules of law concerning director misbehavior other than rules based solely on the existence of a conflict of interest transaction, as to which subchapter F is preclusive

a. Transaction

For a director's conflicting interest transaction to arise, there must first be a transaction effected or proposed to be effected by the corporation or an entity controlled by the corporation to which the director or a related person is a party or in which the director or a related person has a material financial interest. As discussed in the Introductory Comment, the provisions of subchapter F do not apply where there is no ''transaction'' by the corporation—no matter how conflicting the director's interest may be. For example, a corporate opportunity doctrine usurped by a director by definition does not involve a transaction by the corporation, and thus is not covered by subchapter F, even though it may be proscribed under fiduciary duty principles.

Moreover, for purposes of subchapter F, ''transaction'' means (and requires a bilateral (or multilateral) arrangement to which the corporation or an entity controlled by the corporation is a party. Subchapter F does not apply to transactions to which the corporation is not a party. Thus, a purchase or sale by the director of the corporation's shares on the open market or from or to a third party is not a ''director's conflicting interest transaction'' within the meaning of subchapter F because the corporation is not a party to the transaction.

b. Party to the transaction—the corporation

In the usual case, the transaction in question would be by X Co. Assume, however, that X Co. controls the vote for directors of S Co. D wishes to sell a building D owns to X Co. and X Co. is willing to buy it. As a business matter, it makes no difference to X Co. whether it takes the title directly or indirectly through its subsidiary S. Co. or some other entity that X Co. controls. The applicability of subchapter F does not depend upon that formal distinction, because the subchapter F does not depend upon that formal distinction, because the subchapter includes within its operative framework transactions by entities controlled by X Co. Thus, subchapter F would apply to a sale of the building by D to S Co.

c. Party to the transaction—the director or a related person

To constitute a director's conflicting interest transaction, D (the director identified in the subchapter from time to time as a ''conflicted director'') must, at the relevant time, (i) be a party to the transaction, or (ii) know of the transaction and D's material financial interest in it, or (iii) know that a related person of D was a party to the transaction or (iv) know that a related person of D has a material financial interest in the transaction. A material financial interest (as defined in subdivision (4)) is one that would reasonably be expected to impair the objectivity of the director's judgment if D were to participate in action by the directors (or by a committee thereof) taken on the authorization of the transaction.

Routine business transactions frequently occur between companies with overlapping directors. If X Co. and Y Co. have routine, frequent business dealings whose terms are dictated by competitive market forces, then even if a director of X Co. has a relevant relationship with Y Co., the transactions would almost always be defensible, regardless of approval by disinterested directors or shareholders, on the ground that they are "fair." For example, a common transaction involves a purchase of the corporation's product line by Y Co., or perhaps by D or a related person, at prices normally charged by the corporation. In such circumstances, it usually will not be difficult for D to show that the transaction was on arms-length terms and was fair. Even a purchase by D of a product of X Co. at a usual "employee's discount," while technically assailable as a conflicting interest transaction, would customarily be viewed as a routine incident of the office of director and, thus, "fair" to the corporation.

D can have a conflicting interest in two ways.

First, a conflicting interest can arise under either subdivision 1(i) or (ii). This will be the case if, under clause (i), the transaction is between D and X Co. A conflicting interest also will arise under clause (ii) if D is not a party to the transaction, but knows about it and knows that he or she has a material financial interest in it. The personal economic stake of the director must be in the transaction itself—that is, the director's gain must flow directly from the transaction. A remote gain (for example, a future reduction in tax rates in the local community) is not enough to give rise to a conflicting interest under subdivision (1)(ii).

Second, a conflicting interest for D can arise under subdivision 1(iii) from the involvement in the transaction of a "related person" of D that is either a party to the transaction or has "material financial interest" in it. "Related person" is defined in subdivision (5).

Circumstances may arise where a director could have a conflicting interest under more than one clause of subdivision (1). For example, if Y Co. is a party to or interested in the transaction with X Co. and Y Co. is a related person of D, the matter would be governed by subdivision 1(iii), but D also may have a conflicting interest under subdivision (1)(ii) if D's economic interest in Y Co. is sufficiently material and if the importance of the transaction to Y Co. is sufficiently material.

A director may have relationships and linkages to persons and institutions that are not specified in subdivision (1)(iii). Such relationships and linkages fall outside subchapter F because the categories of persons described in subdivision (1)(iii) constitute the exclusive universe for purposes of subchapter F. For example, in a challenged transaction between X Co. and Y Co., suppose the court confronts the argument that D also is a major creditor of Y Co. and that creditor status in Y Co. gives D a conflicting interest. The court should rule that D's creditor status in Y Co. does not fit any category of subdivision (1); and therefore, the conflict of interest claim must be rejected by reason of section 8.61(a). The result would be different if Y Co.'s debt to D were of such economic significance to D that it would either fall under subdivision (1)(ii) or, if it placed D in control of Y Co., it would fall under subdivision (1)(iii) (because Y Co. is a related person of D under subdivision (5)(iv)). To explore the example further, if D is also a shareholder of Y Co., but D does not have a material financial interest in the transaction and does not control Y Co., no director's conflicting interest transaction arises and the transaction cannot be challenged on conflict of interest grounds. To avoid any appearance of impropriety, D, nonetheless, should consider recusal from the other directors' deliberations and voting on the transaction between X Co. and Y Co.

It should be noted that any director's interest in a transaction that meets the criteria of section 8.60(10 is considered a director's conflicting interest transaction.'' If the director's interest satisfies those criteria, subchapter F draws no distinction between a director's interest that clashes with the interests of the corporation and a director's interest that coincides with, or is parallel to, or even furthers the interests of the corporation. In any of these cases, if the director's ''interest'' is present, a ''conflict'' will exist.

2. Control

The definition of ''control'' in subdivision (2) contains two independent clauses. The first clause addresses possession of the voting or other power, directly or indirectly, to elect or remove a majority of the members of an entity's governing body. That power can arise, for example, from articles of incorporation or a shareholders' agreement. The second clause addresses the circumstances where a person is (i) subject to a majority of the risk of loss from the entity's activities, or (ii) entitled to receive a majority of the entity's residual returns. The second clause of the definition includes, among other circumstances, complex financial structures that do not have voting interests or a governing body in the traditional sense, such as special purpose entities. Although the definition of ''control'' operates independently of the accounting rules adopted by the U.S. accounting profession, it is consistent with the relevant generally accepted accounting principle (made effective in 2003) that governs when an entity must be included in consolidated financial statements.

3. Relevant Time

The definition of director's conflicting interest transaction requires that, except where he or she is a party, the director know of the transaction. It also requires that where not a party, the director know of the transaction either at the time it is brought before the corporation's board of directors or, if it is not brought before the corporation's board of directors (or a committee thereof), at the time the corporation (or an entity controlled by the corporation) becomes legally bound to consummate the transaction. Where the director lacks such knowledge, the risk to the corporation that the director's judgment might be improperly influenced, or the risk of unfair dealing by the director, is not present. In a corporation of significant size, routine transactions in the ordinary course of business, which typically involve decisionmaking at lower management levels, normally will not be known to the director and, if that is the case, will be excluded from the ''knowledge'' requirement of the definition in subdivision (1)(ii) or (iii).

4. Material Financial Interest

The ''interest'' of a director or a related person in a transaction can be direct or indirect (e.g., as an owner of an entity or a beneficiary of a trust or estate), but it must be financial for there to exist a ''director's conflicting interest transaction.'' Thus, for example, an interest in a transaction between X Co. and a director's alma mater, or any other transaction involving X Co. and a party with which D might have emotional involvement but no financial interest, would not give rise to a director's conflicting interest transaction. Moreover, whether a financial interest is material does not turn on any assertion by the possibly conflicted director that the interest in question would not impair his or her objectivity if called upon to vote on the authorization of the transaction. Instead, assuming a court challenge asserting the materiality of the financial interest, the standard calls upon the trier of fact to determine whether the objectivity of a reasonable director in similar circumstances would reasonably be expected to have been impaired by the financial interest when voting on the matter. Thus, the standard is objective, not subjective.

Under subdivision (1)(ii), at the relevant time a director must have knowledge of his or her financial interest in the transaction in addition to knowing about the transaction itself. As a practical matter, a director could not be influenced by a financial interest about which that director had no knowledge. For example, the possibly conflicted director might know about X Co.'s transaction with Y Co., but might not know that his or her money manager recently established a significant position in Y Co. stock for the director's portfolio. In such circumstances, the transaction with Y Co. would not give the director a ''material financial interest'', notwithstanding the portfolio investment's significance. Analytically, if the director did not know about the Y Co. portfolio investment, it could not reasonably be expected to impair the objectivity of that director's judgment.

Similarly, under subdivision (1)(iii), a director must know about his or her related person's financial interest in the transaction for the matter to give rise to a ''material financial interest'' under subdivision (4). If there is such knowledge and ''interest'' (i.e., the financial interest could be expected to influence the director's judgment), then the matter involves a director's conflicting interest transaction under subdivision (1).

5. Related Person

Six categories of ''related person'' of the director are set out in subdivision (5). These categories are specific, exclusive and preemptive.

The first three categories involve closely related family, or near-family, individuals as specified in clauses (i) through (iii). The clauses are exclusive insofar as family relationships are concerned and include adoptive relationships. The references to a ''spouse'' include a common law spouse. Clause (iii) covers personal, as opposed to business, relationships; for example, clause (iii) does not cover a lessee.

Regarding the subcategories of persons described in clause (v) from the perspective of X Co., certain of D's relationships with other entities and D's fiduciary relationships are always a sensitive concern, separate and apart from whether D has a financial interest in the transaction. Clause (v) reflects the policy judgment that D cannot escape D's legal obligation to act in the best interests of another person for whom D has such a relationship and, accordingly, that such a relationship (without regard to any financial interest on D's part) should cause the relevant entity to have ''related person'' status.

The term ''employer'' as used in subdivision (5)(vi) is not separately defined but should be interpreted sensibly in light of the purpose of the subdivision. The relevant inquiry is whether D, because of an employment relationship with an employer who has a significant stake in the outcome of the transaction, is likely to be influenced to act in the interest of that employer rather than in the interest of X Co.

6. Fair to the Corporation

The term ''fair'' accords with traditional language in the case law, but for purposes of subchapter F it also has a special meaning. The transaction, viewed as a whole, must have been beneficial to the corporation, in addition to satisfying the traditional ''fair price'' and ''fair dealing'' concepts. In determining whether the transaction was beneficial, the consideration and other terms of the transaction and the process (including the conflicted director's dealings with the corporation) are relevant, but whether the transaction advanced the corporation's commercial interests is to be viewed ''as a whole.''

In considering the ''fairness'' of the transaction, the court will be required to consider not only the market fairness of the terms of the deal—whether it is comparable to what might have been obtainable in an arm's length transaction—but also (as the board would have been required to do) whether the transaction was one that was reasonably likely to yield favorable results (or reduce detrimental results). Thus, if a manufacturing company that lacks sufficient working capital allocates some of its scarce funds to purchase a sailing yacht owned by one of its directors, it will not be easy to persuade the court that the transaction was ''fair'' in the sense that it was reasonably made to further the business interests of the corporation. The facts that the price paid for the yacht was a ''fair'' market price, and that the full measure of disclosures made by the director is beyond challenge, may still not be enough to defend and uphold the transaction.

a. Consideration and other terms of the transaction

The fairness of the consideration and other transaction terms are to be judged at the relevant time. The relevant inquiry is whether the consideration paid or received by the corporation or the benefit expected to be realized by the corporation was adequate in relation to the obligations assumed or received or other consideration provided by or to the corporation. If the issue in a transaction is the ''fairness'' of a price, ''fair'' is not to be taken to imply that there is one single ''fair'' price, all others being ''unfair.'' It is settled law that a ''fair'' price is any price within a range that an unrelated party might have been willing to pay or willing to accept, as the case may be, for the relevant property, asset, service or commitment, following a normal arm's-length business negotiation. The same approach applies not only to gauging the fairness of price, but also to the fairness evaluation of any other key term of the deal.

Although the ''fair'' criterion used to assess the consideration under section 8.61(b)(3) is also a range rather than a point, the width of that range may be narrower than would be the case in an arm's-length transaction. For example, the quality and completeness of disclosures, if any, made by the conflicted director that bear upon the consideration in question are relevant in determining whether the consideration paid or received by the corporation. Although otherwise commercially reasonable, was ''fair for purposes of section 8.61(b)(3).

b. Process of decision and the director's conduct

In some circumstances, the behavior of the director having the conflicting interest may affect the finding and content of "fairness." Fair dealing requires that the director make required disclosure (per subdivision (7)) at the relevant time (per subdivision (3)) even if the director plays no role in arranging or negotiating the terms of the transaction. One illustration of unfair dealing is the director's failure to disclose fully the director's interest or hidden defects known to the director regarding the transaction. Another illustration would be the exertion by the director of improper pressure upon the other directors or other parties that might be involved with the transaction. Whether a transaction can be successfully challenged by reason of deficient or improper conduct, notwithstanding the fairness of the economic terms, will turn on the court's evaluation of the conduct and its impact on the transaction.

7. Required Disclosure

A critically important element of subchapter F's safe harbor procedures is that those acting for the corporation be able to make an informed judgment. In view of this requirement, subdivision (7) defines "required disclosure" to mean disclosure of all facts known to D about the subject of the transaction that a director free of the conflicting interest would reasonably believe to be material to the decision whether to proceed with the transaction. For example, if D knows that the land the corporation is proposing to buy from D is sinking into an abandoned coal mine, D must disclose not only D's interest in the transaction but also that the land is subsiding. As a director of X Co., D may not invoke caveat emptor. On the other hand, D does not have any obligation to reveal the price that D paid for the property ten years ago, or the fact that D inherited the property, because that information is not material to the board's evaluation of the property and its business decision whether to proceed with the transaction. Further, while material facts respecting the subject of the transaction must be disclosed, D is not required to reveal personal or subjective information that bears upon D's negotiating position (such as, for example, D's urgent need for cash, or the lowest price D would be willing to accept). This is true even though such information would be highly relevant to the corporation's decisionmaking in the sense that, if the information were known to the corporation, it could enable the corporation to hold out for more favorable terms.

§ 8.61 Judicial Action

(a) A transaction effected or proposed to be effected by a corporation (or by an entity controlled by the corporation) may not be the subject of equitable relief or give rise to an award of damages or other sanctions against a director of the corporation, in a proceeding by a shareholder or by or in the right of the corporation, on the ground that the director has an interest respecting the transaction if it is not a director's conflicting interest transaction.

(b) A director's conflicting interest transaction may not be the subject of equitable relief, or give rise to an award of damages or other sanctions against a director, in a proceeding by a shareholder or by or in the right of the corporation, on the ground that the director has an interest respecting the transaction, if:

(1) directors' action respecting the transaction was taken in compliance with section 8.62 at any time; or

(2) shareholders' action respecting the transaction was taken in compliance with section 8.63 at any time; or

(3) the transaction, judged according to the circumstances at the relevant time, is established to have been fair to the corporation.

OFFICIAL COMMENT

Section 8.61 is the operational section of subchapter F as it prescribes the judicial consequences of the other sections.

Speaking generally:

(i) If the section 8.62 or section 8.63 procedures are complied with, or if it is established that at the relevant time a director's conflicting interest transaction was fair to the corporation, then a director's conflicting interest transaction is immune from attack on the ground of an interest of the director. However, the narrow scope of subchapter F must again be strongly emphasized; if the transaction is vulnerable to attack on some other ground, observance of F's procedures does not make it less so.

(ii) If a transaction is *not* a director's conflicting interest transaction as defined in section 8.60(1), then the transaction may *not* be enjoined, rescinded, or made the basis of other sanction *on the ground of a conflict of interest of a director, whether or not it went through the procedures of subchapter F.* In that sense, subchapter F is specifically intended to be both comprehensive and exclusive.

(iii) If a director's conflicting interest transaction that was not at any time the subject of action taken in compliance with section 8.62 or section 8.63, is challenged on grounds of the director's conflicting interest and is not shown to be fair to the corporation, then the court may take such remedial action as it considers appropriate under the applicable law of the jurisdiction.

1. Section 8.61(a)

As previously noted, section 8.61(a) makes clear that a transaction between a corporation and another person cannot be the subject of equitable relief, or give rise to an award of damages or other sanctions against a director, on the ground that the director has an interest respecting the transaction, unless the transaction falls within the bright-line definition of "director's conflicting interest transaction" in section 8.60. So, for example, a transaction will not constitute a director's conflicting interest transaction and, therefore, will not be subject to judicial review on the ground that a director had an interest in the transaction, where the transaction is made with a relative of a director who is not one of the relatives specified in section 8.60(5), or on the ground of an alleged interest other than a material financial interest, such as a financial interest of the director that is not material, as defined in section 8.60(4), or a nonfinancial interest. (As noted in the Introductory Comment, however, subchapter F does not apply to, and therefore does not preclude, a challenge to such a transaction based on grounds other than the director's interest.)

If there is reason to believe that the fairness of a transaction involving D could be questioned, D is well advised to subject the transaction to the safe harbor procedures of subchapter F. Sometimes, a director may be uncertain whether a particular person would be held to fall within a related person category, or whether the scale of the financial interest is material as defined in Section 8.60. In such circumstances, the obvious avenue to follow is to clear the matter with qualified directors under section 8.62 or with the holders of qualified shares under section 8.63. If it is later judicially determined that a conflicting interest in the challenged transaction did exist, the director will have safe harbor protection. It may be expected, therefore, that the procedures of section 8.62 (and, to a lesser extent, section 8.63) will probably be used for many transactions that may lie outside the sharp definitions of section 8.60—a result that is healthy and constructive.

It is important to stress that subchapter F deals only with ''transactions.'' If a non-transactional corporate decision is challenged on the ground that D has a conflicting personal stake in it, subsection 8.61(a) is irrelevant.

2. Section 8.61(b)

Clause (1) of subsection (b) provides that if a director has a conflicting interest respecting a transaction, neither the transaction nor the director is legally vulnerable on the ground of the director's conflict if the procedures of section 8.62 have been properly followed. If board action under section 8.62(b)(1) is interposed as a defense in a proceeding challenging a director's conflicting interest transaction, the plaintiff then bears the burden of overcoming that defense under section 8.31.

Challenges to that board action may be based on a failure to meet the specific requirements of section 8.62 or to conform with general standards of director conduct. For example, a challenge addressed to section 8.62 compliance might question whether the acting directors were ''qualified directors'' or might dispute the quality and completeness of the disclosures made by D to the qualified directors. If such a challenge is successful, the board action is ineffective for purposes of subsection (b)(1) and both D and the transaction may be subject to the full range of remedies that might apply, absent the safe harbor, unless the fairness of the transaction can be established under subsection (b)(3). The fact that a transaction has been nominally passed through safe harbor procedures does not preclude a subsequent challenge based on any failure to meet the requirements of section 8.62. Recognizing the importance of traditional corporate procedures where the economic interests of a fellow director are concerned, a challenge to the effectiveness of board action for purposes of subsection (b)(1) might also assert that, while the conflicted director's conduct in connection with the process of approval by qualified directors may have been consistent with the statute's expectations, the qualified directors dealing with the matter did not act in good faith or on reasonably inquiry. The kind of relief that may be appropriate when qualified directors have approved a transaction but have not acted in good faith or have failed to become reasonably informed—and, again, where the fairness of he transaction has not been established under subsection (b)(3)—will depend heavily on the facts of the individual case; therefore, it must be largely a matter of sound judicial discretion.

Clause (2) of subsection (b) regarding shareholders' approval of the transaction is the matching piece to clause (1) regarding directors' approval.

The language "at any time" in clauses (1) and (2) of subsection (b) permits the directors or the shareholders to ratify a director's conflicting interest transaction after the fact for purposes of subchapter F. However, good corporate practice is to obtain appropriate approval prior to consummation of a director's conflicting interest transaction.

Clause (3) of subsection (b) provides that a director's conflicting interest transaction will be secure against the imposition of legal or equitable relief if it is established that, although neither directors' nor shareholders' action was taken in compliance with sections 8.62 or 8.63, the transaction was fair to the corporation within the meaning of section 8.60(6). Under section 8.61(b)(3) the interested director has the burden of establishing that the transaction was fair.

* * *

Note on Directors' Compensation

Directors' fees and similar forms of director compensation are typically set by the board and are specially authorized (though not regulated) by sections 8.11 and 8.57 of the Model Act. Although in the usual case a corporation's directors' compensation practices fall within normal patterns and their fairness can be readily established, they do involve a conflicting interest on the part of most if not all of the directors and, in a given case, may be abused. Therefore, while as a matter of practical necessity these practices will normally be generally accepted in principle, it must be kept in mind that board action on directors' compensation and benefits would be subject to judicial sanction if they are not favorably acted upon by shareholders pursuant to section 8.63 or if they are not in the circumstances fair to the corporation pursuant to section 8.61(b)(3).

§ 8.62 Directors' Action

(a) Directors' action respecting a director's conflicting interest transaction is effective for purposes of section 8.61(b)(1) if the transaction has been authorized by the affirmative vote of a majority (but no fewer than two) of the qualified directors who voted on the transaction, after required disclosure by the conflicted director of information not already known by such qualified directors, or after modified disclosure in compliance with subsection (b), provided that:

(1) the qualified directors have deliberated and voted outside the presence of and without the participation by any other director; and

(2) where the action has been taken by a committee, all members of the committee were qualified directors, and either (i) the committee was composed of all the qualified directors on the board of directors or (ii) the members of the committee were appointed by the affirmative vote of a majority of the qualified directors on the board.

(b) Notwithstanding subsection (a), when a transaction is a director's conflicting interest transaction only because a related person described in clause (v) or clause (vi) of section 8.05(5) is a party to or has a material financial interest in the transaction, the conflicted director is not obligated to make required disclosure to the extent that the director reasonably believes that doing so would violate a duty imposed under law, a legally enforceable obligation of confidentiality, or a professional ethics rule, provided that the conflicted director discloses to the qualified directors voting on the transaction:

(1) all information required to be disclosed that is not so violative,

(2) the existence and nature of the director's conflicting interest, and

(3) the nature of the conflicted director's duty not to disclose the confidential information

(c) A majority (but no fewer than two) of all the qualified directors on the board of directors, or on the committee, constitutes a quorum for purposes of action that complies with this section.

(d) Where directors' action under this section does not satisfy a quorum or voting requirement applicable to the authorization of the transaction by reason of the articles of incorporation, the bylaws or a provision of law, independent action to satisfy those authorization requirements must be taken by the board of directors or a committee, in which action directors who are not qualified directors may participate.

OFFICIAL COMMENT

Section 8.62 provides the procedure for action by the board of directors or by a board committee under subchapter F. In the normal course this section, together with section 8.61(b), will be the key method for addressing directors' conflicting interest transactions. Any discussion of section 8.62 must be conducted in light of the overarching requirements that directors act in good faith and on reasonable inquiry. Director action that does not comply with those requirements, even if otherwise in compliance with section 8.62, will be subject to challenge and not be given effect under section 8.62. See the Official Comment to section 8.61(b).

1. Section 8.62(a)

The safe harbor for directors' conflicting interest transactions will be effective under section 8.62 if and only if it is authorized by qualified directors. (For the definition of ''qualified director,'' see section 1.43 and the related official comment.) Obviously, safe harbor protection cannot be provided by fellow directors who themselves are not qualified directors; only qualified directors can do so under subsection (a). The definition of ''qualified director'' in section 1.43 excludes a conflicted director but its exclusions go significantly further, i.e., beyond the persons specified in the categories of section 8.60(5) for purposes of the ''related person'' definition. For example, if any familial or financial connection or employment or professional relationship with D would be likely to impair the objectivity of the director's judgment when participating in a vote on the transaction, that director would not be a qualified director.

Action by the board of directors is effective for purposes of section 8.62 if the transaction is approved by the affirmative vote of a majority (but not less than two) of the qualified directors on the board. Action may also be taken by a duly authorized committee of the board but, for the action to be effective, all members of the committee must be qualified directors and the committee must either be composed of all of the qualified directors on the board or must have been appointed by the affirmative vote of a majority of the qualified directors on the board. This requirement for effective committee action is intended to preclude the appointment as committee members of a favorably inclined minority from among all the qualified directors. Except to the limited extent found in subsection (b), authorization by the qualified directors acting on the matter must be preceded by required disclosure pursuant to subsection (a) followed by deliberation and voting outside the presence of and without the participation by, any other director. Should there be more than one conflicted director interested in the transaction, the need for required disclosure would apply to each. After the qualified directors have had the opportunity to question the conflicted director about the material facts communicated about the transaction, action complying with subsection (a) may be taken at any time before or after the time it becomes a legal obligation. A written record of the qualified directors' deliberations and action is strongly encouraged.

2. Section 8.62(b)

Subsection (b) is a special provision designed to accommodate, in a practical way, situations where a director who has a conflicting interest is not able to comply fully with the disclosure requirement of subsection (a) because of an extrinsic duty of confidentiality that such director reasonably believes to exist. The director may, for example, be prohibited from making full disclosure because of legal restrictions that happen to apply to the transaction (e.g., grand jury seal or national security statute) or professional canon (e.g. attorney-client privilege). The most frequent use of subsection (b), however, will likely involve common directors who find themselves in a position of dual fiduciary obligations that clash. If D is also a director of Y Co., D may have acquired privileged information from one or both directorships relevant to a transaction between X Co. and Y Co., that D cannot reveal to one without violating a fiduciary duty owed to the other. In such circumstance, subsection (b) enables the conflicting interest complication to be presented for consideration under subsection (a) and thereby enables X Co. (and Y Co.) and D to secure for the transaction the protection afforded by subchapter F even though D cannot, by reason of applicable law, confidentiality strictures or a professional ethics rule, make the full disclosure otherwise required.

To comply with subsection (b), D must (i) notify the qualified directors who are to vote on the transaction respecting the conflicting interest, (ii) disclose to them all information required to be disclosed that does not violate the duty not to disclose, as the case may be, to which D reasonably believes he or she is subject, and (iii) inform them of the nature of the duty (e.g., that the duty arises out of an attorney-client privilege or out of a duty as a director of Y Co. that prevents D from making required disclosure as otherwise mandated by clause (ii) of section 8.60(7)). D must then play no personal role in the board's (or committee's) ultimate deliberations or action. The purpose of subsection (b) is to make it clear that the provisions of subchapter F may be employed to ''safe harbor'' a transaction in circumstances where a conflicted director cannot, because of enforced fiduciary silence, disclose all the known facts.[1] Of course, if D invokes subsection (b) and does not make required disclosure before leaving the meeting, the qualified directors may decline to act on the transaction out of concern that D knows (or may know) something they do not. On the other hand, if D is subject to an extrinsic duty of confidentiality but has no knowledge of material facts that should otherwise be disclosed, D would normally state just that and subsection (b) would be irrelevant. Having disclosed the existence and nature of the conflicting interest, D would thereby comply with section 8.60(7).

While subchapter F explicitly contemplates that subsection (b) will apply to the frequently recurring situation where transacting corporations have common directors (or where a director of one party is an officer of the other), it should not otherwise be read as attempting to address the scope, or mandate the consequences, of various silence-privileges. That is a topic reserved for local law.

Subsection (b) is available to D if a transaction is a director's conflicting interest transaction only because a related person described in section 8.60(5)(v) or (vi) is a party to or has a material financial interest in the transaction. Its availability is so limited because in those instances a director owes a fiduciary duty to such a related person. If D or a related person of D other than a related person described in section 8.60(b)(v) or (vi) is a party to or has a material financial interest in the transaction, D's only options are satisfying the required disclosure obligation on an unrestricted basis, abandoning the transaction, or accepting the risk of establishing fairness under section 8.61(b)(3), if the transaction is challenged in a court proceeding.

Whenever a conflicted director proceeds in the manner provided in subsection (b), the other directors should recognize that the conflicted director may have information that in usual circumstances D would be required to reveal to the qualified directors who are acting on the transaction—information that could well indicate that the transaction would be either favorable or unfavorable for X Co.

3. Section 8.62(c)

Subsection (c) states the special quorum requirement for action by qualified directors to be effective under section 8.62. Obviously, conflicted directors are excluded. Also excluded are board members who, while not conflicted directors, are not eligible to be qualified directors. As stated in subsection (a), the qualified directors taking action respecting a director's conflicting interest transaction are to deliberate and vote outside the presence of, and without participation by, any other member of the board.

4. Section 8.62(d)

This subsection underscores the fact that the director's voting procedures and requirements set forth in subsections (a) through (c) treat only the director's conflicting interest. A transaction authorized by qualified directors in accordance

1. A director could, of course, encounter the same problem of mandated silence with regard to any matter that comes before the board; that is, the problem of forced silence can arise in situations other than transactions involving a conflicting interest of a director. It could happen that at the same board meeting of X Co. at which D invokes section 8.62(b), another director who has absolutely no financial interest in the transaction might conclude that under local law he is bound to silence (because of attorney-client privilege, for example) and under general principles of sound director conduct would withdraw from participation in the board's deliberations and action.

with subchapter F may still need to satisfy different voting and quorum requirements in order to achieve substantive approval of the transaction under other applicable statutory provisions or provisions contained in X Co.'s articles of incorporation or bylaws, and vice versa. Thus, in any case where the quorum and/or voting requirements for substantive approval of a transaction differ from the quorum and/or voting requirements for ''safe harbor'' protection under section 8.62, the directors may find it necessary to conduct (and record in the minutes of the proceedings) two separate votes—one for section 8.62 purposes and the other for substantive approval purposes.

§ 8.63 Shareholders' Action

(a) Shareholders' action respecting a director's conflicting interest transaction is effective for purposes of section 8.61(b)(2) if a majority of the votes entitled to be cast by the holders of all qualified shares are in favor of the transaction after (1) notice to shareholders describing the action to be taken respecting the transaction, (2) provision to the corporation of the information referred to in subsection (b), and (3) communication to the shareholders entitled to vote on the transaction of the information that is the subject of required disclosure, to the extent the information is not known by them.

(b) A director who has a conflicting interest respecting the transaction shall, before the shareholders' vote, inform the secretary or other officer or agent of the corporation authorized to tabulate votes, in writing, of the number of shares that the director knows are not qualified shares under subsection (c), and the identity of the holders of those shares.

(c) For purposes of this section: (1) ''holder'' means and ''held by'' refers to shares held by both a record shareholder (as defined in section 13.01(7)) and a beneficial shareholder (as defined in section 13.01(2)); and (2) ''qualified shares'' means all shares entitled to be voted with respect to the transaction except for shares that the secretary or other officer or agent of the corporation authorized to tabulate votes either knows, or under subsection (b) is notified, are held by (A) a director who has a conflicting interest respecting the transaction or (B) a related person of the director (excluding a person described in clause (vi) of Section 8.60(5)).

(d) A majority of the votes entitled to be cast by the holders of all qualified shares constitutes a quorum for purposes compliance with this section. Subject to the provisions of subsection (e), shareholders' action that otherwise complies with this section is not affected by the presence of holders, or by the voting, of shares that are not qualified shares.

(e) If a shareholders' vote does not comply with subsection (a) solely because of a director's failure to comply with subsection (b), and if the director establishes that the failure was not intended to influence and did not in fact determine the outcome of the vote, the court may take such action respecting the transaction and the director, and may give such effect, if any, to the shareholders' vote, as the court considers appropriate in the circumstances.

(f) Where shareholders' action under this section does not satisfy a quorum or voting requirement applicable to the authorization of the transaction by reason of the article of incorporation, the bylaws or a provision of law, independent action satisfy those authorization requirements must be taken by the shareholders, in which action shares that are not qualified shares may participate.

OFFICIAL COMMENT

Section 8.63 provides the machinery for shareholders' action that confers safe harbor protection for a director's conflicting interest transaction, just as section 8.62 provides the machinery for directors' action that confers subchapter F safe harbor protection for such a transaction.

1. Section 8.63(a)

Subsection (a) specifies the procedure required to confer effective safe harbor protection for a director's conflicting interest transaction through a vote of shareholders. In advance of the vote, three steps must be taken: (1) shareholders must be given timely and adequate notice describing the transaction; (2) D must disclose the information called for in subsection (b); and (3) disclosure must be made to the shareholders entitled to vote, as required by section 8.60(7). In the case of smaller closely-held corporations, this disclosure shall be presented by the director directly to the shareholders gathered at the meeting place where the vote is to be held, or provided in writing to the secretary of the corporation for transmittal with the notice of the meeting. In the case of larger publicly held corporations where proxies are being solicited, the disclosure is to be made by the director to those responsible for preparing the proxy materials, for inclusion therein. If the holders of a majority of all qualified shares (as defined in subsection (b)) entitled to vote on the matter vote favorably, the safe harbor provision of section 8.61(b)(2) becomes effective. Action that complies with subsection (a) may be taken at any time, before or after the time when the corporation becomes legally obligated to complete the transaction.

Section 8.63 does not contain a ''limited disclosure'' provision that is comparable to section 8.62(b). Thus, the safe harbor protection of subchapter F is not available through shareholder action under section 8.63 in a case where D either remains silent or makes less than required disclosure because of an extrinsic duty of confidentiality. This omission is intentional. While the section 8.62(b) procedure is workable in the collegial setting of the boardroom, that is far less likely in the case of action by the shareholder body, especially in large corporations where there is heavy reliance upon the proxy mechanic. Unlike the dynamic that would normally occur in the boardroom, in most situations no opportunity exists for shareholders to quiz D about the confidentiality duty and to discuss the implications of acting without the full benefit of D's knowledge about the conflict transaction. In a case of a closely held corporation where section 8.63 procedures are followed, but with D acting in a way that would be permitted by section 8.62(b), a court could attach significance to a favorable shareholder vote in evaluating the fairness of the transaction to the corporation.

2. Section 8.63(b)

In many circumstances, the secretary or other vote tabulator of X Co. will have no way to know which of X Co.'s outstanding shares should be excluded from the tabulation. Subsection (b) (together with subsection (c)) therefore obligates a director who has a conflicting interest respecting the transaction, as a prerequisite to safe harbor protection by shareholder action, to inform the secretary, or other officer or agent authorized to tabulate votes, of the number and holders of shares known to be held by the director or by a related person described in clauses (i) through (v) of section 8.60(5).

If the tabulator of votes knows, or is notified under subsection (b), that particular shares should be excluded but for some reason fails to exclude them from the count and their inclusion in the vote does not affect its outcome, the shareholders' vote will stand. If the improper inclusion determines the outcome, the shareholders' vote fails because it does not comply with subsection (a). But see subsection (e) as to cases where the notification under subsection (b) is defective but not determinative of the outcome of the vote.

3. Section 8.63(c)

Under subsection (a), only ''qualified shares'' may be counted in the vote for purposes of safe harbor action under section 8.61(b)(2). Subsection (b) defines ''qualified shares'' to exclude all shares that, before the vote, the secretary or other tabulator of the vote knows, or is notified under subsection (b), are held by the director who has the conflicting interest, or by any specified related person of that director.

The definition of ''qualified shares'' excludes shares held by D or a ''related person'' as defined in the first five categories of section 8.60(5). That definition does not exclude shares held by entities or persons described in clause (vi) of section 8.60(5), i.e. a person that is, or is an entity that is controlled by, an employer of D. If D is an employee of Y Co., that does not prevent Y Co. from exercising its usual rights to vote any shares it may hold in X Co. D may be unaware of, and would not necessarily monitor, whether his or her employer holds X Co. shares. Moreover, D will typically have no control over his or her employer and how it may vote its X Co. shares.

4. Section 8.63(e)

If D did not provide the information required under subsection (d), on its face the shareholders' action is not in compliance with subsection (a) and D has no safe harbor under subsection (a). In the absence of such safe harbor D can be put to the burden of establishing the fairness of the transaction under section 8.61(b)(3).

That result is the proper one where D's failure to inform was determinative of the vote results or, worse, was part of a deliberate effort on D's part to influence the outcome. But if D's omission was essentially an act of negligence, if the number of unreported shares if voted would not have been determinative of the outcome of the vote, and if the omission was not motivated by D's effort to influence the integrity of the voting process, then the court should be free to fashion an appropriate response to the situation in light of all the considerations at the time of its decision. The court should not, in the circumstances, be automatically forced by the mechanics of subchapter F to a lengthy and retrospective trial on ''fairness.'' Subsection (e) grants the court that discretion in those circumstances and permits it to accord such effect, if any, to the shareholders' vote, or to grant such relief respecting the transaction or D, as the court may find appropriate.

Despite the presumption of regularity customarily accorded the secretary's record, a plaintiff may go behind the secretary's record for purposes of subsection (e).

5. Section 8.63(f)

This subsection underscores that the shareholders' voting procedures and requirements set forth in subsections (a) through (e) treat only the director's conflicting interest. A transaction that receives a shareholders' vote that complies with subchapter F may well fail to achieve a different vote or quorum that may be required for substantive approval of the transaction under other applicable statutory provisions or provisions contained in X Co.'s articles of incorporation or bylaws, and vice versa. Thus, in any case where the quorum and/or voting requirements for substantive approval of a transaction differ from the quorum and/or voting requirements for ''safe harbor'' protection under section 8.63, the corporation may find it necessary to conduct (and record in the minutes of the proceedings) two separate shareholder votes—one for section 8.63 purposes and the other for substantive approval purposes (or, if appropriate, conduct two separate tabulations of one vote).

CHAPTER 9. DOMESTICATION AND CONVERSION

Introductory Comment

This chapter provides a series of procedures by which a domestic business corporation may become a different form of entity or, conversely, an entity that is not a domestic business corporation may become a domestic business corporation. These various types of procedures are as follows:

- *Domestication*. The procedures in subchapter 9B permit a corporation to change its state of incorporation, thus allowing a domestic business corporation to become a foreign business corporation or a foreign business corporation to become a domestic business corporation.

- *Nonprofit Conversion*. The procedures in subchapter 9C permit a domestic business corporation to become either a domestic nonprofit corporation or a foreign nonprofit corporation.

- *Foreign Nonprofit Domestication and Conversion*. The procedures in subchapter 9D permit a foreign nonprofit corporation to become a domestic business corporation.

- *Entity Conversion*. The procedures in subchapter 9E permit a domestic business corporation to become a domestic or foreign other entity, and also permit a domestic or foreign other entity to become a domestic business corporation.

Each of the foregoing transactions could previously be accomplished by a merger under chapter 11 with a wholly owned subsidiary of the appropriate type. An important purpose of this chapter is to permit the transactions to be accomplished directly.

The provisions of this chapter apply only if a domestic business corporation is present either immediately before or immediately after a transaction. Some states may wish to generalize the provisions of this chapter so that they are not limited to transactions involving a domestic business corporation, for example, to permit a domestic limited partnership to become a domestic limited liability company. The Model Entity Transactions Act prepared by the Ad Hoc Committee on Entity Rationalization of the Section of Business Law is such a generalized statute.

The procedures of this chapter do not permit the combination of two or more entities into a single entity. Transactions of that type must continue to be conducted under chapters 11 and 12.

SUBCHAPTER A. PRELIMINARY PROVISIONS

§ 9.01 Excluded Transactions

This chapter may not be used to effect a transaction that:

(1) [converts an insurance company organized on the mutual principle to one organized on a stock-share basis];

(2) * * *

(3) * * *

§ 9.02 Required Approvals [Optional]

(a) If a domestic or foreign business corporation or eligible entity may not be a party to a merger without the approval of the [attorney general], the [department of banking], the [department of insurance] or the [public utility commission], the corporation or eligible entity shall not be a party to a transaction under this chapter without the prior approval of that agency.

(b) Property held in trust or for charitable purposes under the laws of this state by a domestic or foreign eligible entity shall not, by any transaction under this chapter, be diverted from the objects for which it was donated, granted or devised, unless and until the eligible entity obtains an order of [court] [the attorney general] specifying the disposition of the property to the extent required by and pursuant to [cite state statutory cy pres or other nondiversion statute].

SUBCHAPTER B. DOMESTICATION

§ 9.20 Domestication

(a) A foreign business corporation may become a domestic business corporation only if the domestication is permitted by the organic law of the foreign corporation.

(b) A domestic business corporation may become a foreign business corporation if the domestication is permitted by the laws of the foreign jurisdiction. Regardless of whether the laws of the foreign jurisdiction require the adoption of a plan of domestication, the domestication shall be approved by the adoption by the corporation of a plan of domestication in the manner provided in this subchapter.

(c) The plan of domestication must include:

(1) a statement of the jurisdiction in which the corporation is to be domesticated;

(2) the terms and conditions of the domestication;

(3) the manner and basis of reclassifying the shares of the corporation following its domestication into shares or other securities, obligations, rights to acquire shares or other securities, cash, other property, or any combination of the foregoing; and

(4) any desired amendments to the articles of incorporation of the corporation following its domestication.

(d) The plan of domestication may also include a provision that the plan may be amended prior to filing the document required by the laws of this state or the other jurisdiction to consummate the domestication, except that subsequent to approval of the plan by the shareholders the plan may not be amended to change:

(1) the amount or kind of shares or other securities, obligations, rights to acquire shares or other securities, cash, or other property to be received by the shareholders under the plan;

(2) the articles of incorporation as they will be in effect immediately following the domestication, except for changes permitted by section 10.05 or by comparable provisions of the laws of the other jurisdiction; or

(3) any of the other terms or conditions of the plan if the change would adversely affect any of the shareholders in any material respect.

(e) Terms of a plan of domestication may be made dependent upon facts objectively ascertainable outside the plan in accordance with section 1.20(k).

(f) If any debt security, note or similar evidence of indebtedness for money borrowed, whether secured or unsecured, or a contract of any kind, issued, incurred or executed by a domestic business corporation before [the effective date of this subchapter] contains a provision applying to a merger of the corporation and the document does not refer to a domestication of the corporation, the provision shall be deemed to apply to a domestication of the corporation until such time as the provision is amended subsequent to that date.

OFFICIAL COMMENT

1. Applicability

This subchapter authorizes a foreign business corporation to become a domestic business corporation. It also authorizes a domestic business corporation to become a foreign business corporation. In each case, the domestication is authorized only if the laws of the foreign jurisdiction permit the domestication. Whether and on what terms a foreign business corporation is authorized to domesticate in this state are issues governed by the laws of the foreign jurisdiction, not by this subchapter.

A foreign corporation is not required to have in effect a valid certificate of authority under chapter 15 in order to domesticate in this state.

2. Terms and Conditions of Domestication

This subchapter imposes virtually no restrictions or limitations on the terms and conditions of a domestication, except for those set forth in section 9.20(d) concerning provisions in a plan of domestication for amendment of the plan after it has been approved by the shareholders. Shares of a domestic business corporation that domesticates in another jurisdiction may be reclassified into shares or other securities, obligations, rights to acquire shares or other securities, cash or other property. The capitalization of the corporation may be restructured in the domestication, and its articles of incorporation may be amended by the articles of domestication in any way deemed appropriate. When a foreign business corporation domesticates in this state, the laws of the foreign jurisdiction determine which of the foregoing actions may be taken.

Although this subchapter imposes virtually no restrictions or limitations on the terms and conditions of a domestication, section 9.20(c) requires that the terms and conditions be set forth in the plan of domestication. The plan of domestication is not required to be publicly filed, and the articles of domestication that are filed with the secretary of state by a foreign corporation domesticating in this state are not required to include a plan of domestication. See section 9.22. Similarly, articles of charter surrender that are filed with the secretary of state by a domestic business corporation domesticating in another jurisdiction are not required to include a plan of domestication. See section 9.23.

The list in section 9.20(c) of required provisions in a plan of domestication is not exhaustive and the plan may include any other provisions that may be desired.

3. Amendments of Articles of Incorporation

A corporation's articles of incorporation may be amended in a domestication. Under section 9.20(c)(4), a plan of domestication of a domestic business corporation proposing to domesticate in a foreign jurisdiction may include amendments to the articles of incorporation and should include, at a minimum, any amendments required to conform the articles of incorporation to the requirements for articles of incorporation of a corporation incorporated in the foreign jurisdiction. It is assumed that the foreign jurisdiction will give effect to the articles of incorporation as amended to the same extent that it would if the articles had been independently amended before the domestication.

The laws of the foreign jurisdiction determine whether and to what extent a foreign corporation may amend its articles of incorporation when domesticating in this state. Following the domestication of a foreign corporation in this state, of course, its articles of incorporation may be amended under chapter 10.

4. Adoption and Approval; Abandonment

The domestication of a domestic business corporation in a foreign jurisdiction must be adopted and approved as provided in section 9.21. Under section 9.25, the board of directors of a domestic business corporation may abandon a domestication before its effective date even if the plan of domestication has already been approved by the corporation's shareholders.

5. Appraisal Rights

A shareholder of a domestic business corporation that adopts and approves a plan of domestication has appraisal rights if the shareholder does not receive shares in the foreign corporation resulting from the domestication that have terms as favorable to the shareholder in all material respects, and represent at least the same percentage interest of the total voting rights of the outstanding shares of the corporation, as the shares held by the shareholder before the domestication. See sections 9.24(b) and 13.02(a)(6).

6. Transitional Rule

Because the concept of domestication is new, a person contracting with a corporation or loaning it money who drafted and negotiated special rights relating to the transaction before the enactment of this subchapter should not be charged with the consequences of not having dealt with the concept of domestication in the context of those special rights. Section 9.20(e) accordingly provides a transitional rule that is intended to protect such special rights. If, for example, a corporation is a party to a contract that provides that the corporation cannot participate in a merger without the consent of the other party to the contract, the requirement to obtain the consent of the other party will also apply to the domestication of the corporation in another jurisdiction. If the corporation fails to obtain the consent, the result will be that the other party will have the same rights it would have if the corporation were to participate in a merger without the required consent.

The purpose of section 9.20(e) is to protect the third party to a contract with the corporation, and section 9.20(e) should not be applied in such a way as to impair unconstitutionally the third party's contract. As applied to the corporation, section 9.20(e) is an exercise of the reserved power of the state legislature set forth in section 1.02.

The transitional rule in section 9.20(e) ceases to apply at such time as the provision of the agreement or debt instrument giving rise to the special rights is first amended after the effective date of this subchapter because at that time the provision may be amended to address expressly a domestication of the corporation.

A similar transitional rule governing the application to a domestication of special voting rights of directors and shareholders and other internal corporate procedures is found in section 9.21(7).

§ 9.21 Action on a Plan of Domestication

In the case of a domestication of a domestic business corporation in a foreign jurisdiction:

(1) The plan of domestication must be adopted by the board of directors.

(2) After adopting the plan of domestication the board of directors must submit the plan to the shareholders for their approval. The board of directors must also transmit to the shareholders a recommendation that the shareholders approve the plan, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, in which case the board of directors must transmit to the shareholders the basis for that determination.

(3) The board of directors may condition its submission of the plan of domestication to the shareholders on any basis.

(4) If the approval of the shareholders is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the plan of domestication is to be submitted for approval. The notice must state that the purpose, or one of the purposes, of the meeting is to consider the plan and must contain or be accompanied by a copy or summary of the plan. The notice shall include or be accompanied by a copy of the articles of incorporation as they will be in effect immediately after the domestication.

(5) Unless the articles of incorporation, or the board of directors acting pursuant to paragraph (3), requires a greater vote or a greater number of votes to be present, approval of the plan of domestication requires the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the plan exists, and, if any class or series of shares is entitled to vote as a separate group on the plan, the approval of each such separate voting group at a meeting at which a quorum of the voting group consisting of at least a majority of the votes entitled to be cast on the domestication by that voting group exists.

(6) Separate voting by voting groups is required by each class or series of shares that:

(i) are to be reclassified under the plan of domestication into other securities, obligations, rights to acquire shares or other securities, cash, other property, or any combination of the foregoing;

(ii) would be entitled to vote as a separate group on a provision of the plan that, if contained in a proposed amendment to articles of incorporation, would require action by separate voting groups under section 10.04; or

(iii) is entitled under the articles of incorporation to vote as a voting group to approve an amendment of the articles.

(7) If any provision of the articles of incorporation, bylaws or an agreement to which any of the directors or shareholders are parties, adopted or entered into before [the effective date of this subchapter], applies to a merger of the corporation and that document does not refer to a domestication of the corporation, the provision shall be deemed to apply to a domestication of the corporation until such time as the provision is amended subsequent to that date.

OFFICIAL COMMENT

1. In General

This section sets forth the rules for adoption and approval of a plan of domestication of a domestic business corporation in a foreign jurisdiction. The manner in which the domestication of a foreign business corporation in this state must be adopted and approved will be controlled by the laws of the foreign jurisdiction. The provisions of this section follow generally the rules in chapter 11 for adoption and approval of a plan of merger or share exchange.

A plan of domestication must be adopted by the board of directors. Although section 9.21(2) permits the board to refrain from making a recommendation to the shareholders that they approve the plan, that does not change the underlying requirement that the board first adopt the plan before it is submitted to the shareholders. Approval by the shareholders of a plan of domestication is always required.

2. Voting by Separate Groups

Section 9.21(6) provides that a class or series has a right to vote on a plan of domestication as a separate voting group if, as part of the domestication, the class or series would be reclassified into other securities, interests, obligations, rights to acquire shares or other securities, cash or other property. A class or series also is entitled to vote as a separate voting group if the class or series would be entitled to vote as a separate group on a provision in the plan that, if contained in an amendment to the articles of incorporation, would require approval by that class or series under section 10.04. In this latter case, a class or series will be entitled to vote as a separate voting group if the terms of that class or series are being changed, or if the shares of that class or series are being reclassified into shares of any other class or series. It is not intended that immaterial changes in the language of the articles of incorporation made to conform to the usage of the laws of the foreign jurisdiction will alone create an entitlement to vote as a separate group.

Under section 10.04, and therefore under section 9.21(6), if a change that requires voting by separate voting groups affects two or more classes or two or more series in the same or a substantially similar way, the relevant classes or series will vote together, rather than separately, on the change. For the mechanics of voting where voting by voting groups is required under section 9.21(6), see sections 7.25 and 7.26.

If a domestication would amend the articles of incorporation to change the voting requirements on future amendments of the articles, the transaction must also be approved by the vote required by section 7.27.

3. Quorum and Voting

Section 9.21(5) provides that approval of a plan of domestication requires approval of the shareholders at a meeting at which there exists a quorum consisting of a majority of the votes entitled to be cast on the plan. Section 9.21(5) also provides that if any class or series of shares are entitled to vote as a separate group on the plan, the approval of each such separate group must be given at a meeting at which there exists a quorum consisting of at least a majority of the votes entitled to be cast on the plan by that class or series. If a quorum is present, then under sections 7.25 and 7.26 the plan will be approved if more votes are cast in favor of the plan than against it by each voting group entitled to vote on the plan.

In lieu of approval at a shareholders' meeting, approval can be given by the consent of all the shareholders entitled to vote on the domestication, under the procedures set forth in section 7.04.

4. Transitional Rule

Because the concept of domestication is new, persons who drafted and negotiated special rights for directors or shareholders before the enactment of this subchapter should not be charged with the consequences of not having dealt with the concept of domestication in the context of those special rights. Section 9.21(7) accordingly provides a transitional rule that is intended to protect such special rights. Other documents, in addition to the articles of incorporation and bylaws, that may contain such special rights include shareholders agreements, voting trust agreements, vote pooling agreements or other similar arrangements. If, for example, the articles of incorporation provide that the corporation cannot participate in a merger without a supermajority vote of the shareholders, that supermajority requirement will also apply to the domestication of the corporation in another jurisdiction.

The purpose of section 9.21(7) is to protect persons who negotiated special rights for directors or shareholders whether in a contract with the corporation or in the articles of incorporation or bylaws, and section 9.21(7) should not be applied in such a way as to impair unconstitutionally the rights of any party to a contract with the corporation. As applied to the corporation, section 9.21(7) is an exercise of the reserved power of the state legislature set forth in section 1.02.

The transitional rule in section 9.21(7) ceases to apply at such time as the provision of the articles of incorporation, bylaws or agreement giving rise to the special rights is first amended after the effective date of this subchapter because at that time the provision may be amended to address expressly a domestication of the corporation.

A similar transitional rule with regard to the application to a domestication of special contractual rights of third parties is found in section 9.20(e).

§ 9.22 Articles of Domestication

(a) After the domestication of a foreign business corporation has been authorized as required by the laws of the foreign jurisdiction, articles of domestication shall be executed by any officer or other duly authorized representative. The articles shall set forth:

(1) the name of the corporation immediately before the filing of the articles of domestication and, if that name is unavailable for use in this state or the corporation desires to change its name in connection with the domestication, a name that satisfies the requirements of section 4.01;

(2) the jurisdiction of incorporation of the corporation immediately before the filing of the articles of domestication and the date the corporation was incorporated in that jurisdiction; and

(3) a statement that the domestication of the corporation in this state was duly authorized as required by the laws of the jurisdiction in which the corporation was incorporated immediately before its domestication in this state.

(b) The articles of domestication shall either contain all of the provisions that section 2.02(a) requires to be set forth in articles of incorporation and any other desired provisions that section 2.02(b) permits to be included in articles of incorporation, or shall have attached articles of incorporation. In either case, provisions that would not be required to be included in restated articles of incorporation may be omitted.

(c) The articles of domestication shall be delivered to the secretary of state for filing, and shall take effect at the effective time provided in section 1.23.

(d) If the foreign corporation is authorized to transact business in this state under chapter 15, its certificate of authority shall be cancelled automatically on the effective date of its domestication.

§ 9.23 Surrender of Charter Upon Domestication

(a) Whenever a domestic business corporation has adopted and approved, in the manner required by this subchapter, a plan of domestication providing for the corporation to be domesticated in a foreign jurisdiction, articles of charter surrender shall be executed on behalf of the corporation by any officer or other duly authorized representative. The articles of charter surrender shall set forth:

(1) the name of the corporation;

(2) a statement that the articles of charter surrender are being filed in connection with the domestication of the corporation in a foreign jurisdiction;

(3) a statement that the domestication was duly approved by the shareholders and, if voting by any separate voting group was required, by each such separate voting group, in the manner required by this Act and the articles of incorporation;

(4) the corporation's new jurisdiction of incorporation.

(b) The articles of charter surrender shall be delivered by the corporation to the secretary of state for filing. The articles of charter surrender shall take effect on the effective time provided in section 1.23.

OFFICIAL COMMENT

The filing of articles of charter surrender makes the domestication of the corporation in its new jurisdiction of incorporation a matter of public record in this state. It also terminates the status of the corporation as a corporation incorporated under the laws of this state. Once the articles of charter surrender have become effective, the corporation will no longer be in good standing in this state. The corporation may, however, apply for a certificate of authority as a foreign corporation under subchapter 15A.

Where a foreign corporation domesticates in this state, the filing required to terminate its status as a corporation incorporated under the laws of the foreign jurisdiction is determined by the laws of that jurisdiction.

The filing requirements for articles of charter surrender are set forth in sections 1.20 and 1.23. Under section 1.23, a document may specify a delayed effective time and date, and if it does so the document becomes effective at the time and date specified, except that a delayed effective date may not be later than the 90**th** day after the date the document is filed. To avoid any question about a gap in the continuity of its existence, it is recommended that a corporation use a delayed effective date provision in its domestication filings in both this state and the foreign jurisdiction, or otherwise coordinate those filings, so that the filings become effective at the same time.

§ 9.24 Effect of Domestication

(a) When a domestication becomes effective:

(1) the title to all real and personal property, both tangible and intangible, of the corporation remains in the corporation without reversion or impairment;

(2) the liabilities of the corporation remain the liabilities of the corporation;

(3) an action or proceeding pending against the corporation continues against the corporation as if the domestication had not occurred;

(4) the articles of domestication, or the articles of incorporation attached to the articles of domestication, constitute the articles of incorporation of a foreign corporation domesticating in this state;

(5) the shares of the corporation are reclassified into shares, other securities, obligations, rights to acquire shares or other securities, or into cash or other property in accordance with the terms of the domestication, and the shareholders are entitled only to the rights provided by those terms and to any appraisal rights they may have under the organic law of the domesticating corporation; and

(6) the corporation is deemed to:

(i) be incorporated under and subject to the organic law of the domesticated corporation for all purposes;

(ii) be the same corporation without interruption as the domesticating corporation; and

(iii) have been incorporated on the date the domesticating corporation was originally incorporated.

(b) When a domestication of a domestic business corporation in a foreign jurisdiction becomes effective, the foreign business corporation is deemed to:

(1) appoint the secretary of state as its agent for service of process in a proceeding to enforce the rights of shareholders who exercise appraisal rights in connection with the domestication; and

(2) agree that it will promptly pay the amount, if any, to which such shareholders are entitled under chapter 13.

(c) The owner liability of a shareholder in a foreign corporation that is domesticated in this state shall be as follows:

(1) The domestication does not discharge any owner liability under the laws of the foreign jurisdiction to the extent any such owner liability arose before the effective time of the articles of domestication.

(2) The shareholder shall not have owner liability under the laws of the foreign jurisdiction for any debt, obligation or liability of the corporation that arises after the effective time of the articles of domestication.

(3) The provisions of the laws of the foreign jurisdiction shall continue to apply to the collection or discharge of any owner liability preserved by paragraph (1), as if the domestication had not occurred.

(4) The shareholder shall have whatever rights of contribution from other shareholders are provided by the laws of the foreign jurisdiction with respect to any owner liability preserved by paragraph (1), as if the domestication had not occurred.

[(d) A shareholder who becomes subject to owner liability for some or all of the debts, obligations or liabilities of the corporation as a result of its domestication in this state shall have owner liability only for those debts, obligations or liabilities of the corporation that arise after the effective time of the articles of domestication.]

OFFICIAL COMMENT

When a corporation is domesticated in this state under this subchapter, the corporation becomes a domestic business corporation with the same status as if it had been originally incorporated under this Act. Thus, the domesticated corporation will have all of the powers, privileges, and rights granted to corporations originally incorporated in this state and will be subject to all of the duties, liabilities and limitations imposed on domestic business corporations. Except as provided in section 9.24(b), the effect of domesticating a corporation of this state in a foreign jurisdiction is governed by the laws of the foreign jurisdiction. See section 9.20(b).

A domestication is not a conveyance, transfer or assignment. It does not give rise to claims of reverter or impairment of title based on a prohibited conveyance, transfer or assignment. Nor does it give rise to a claim that a contract with the corporation is no longer in effect on the ground of nonassignability, unless the contract specifically provides that it does not survive a domestication.

Section 9.24(a)(1)-(3) and (b) are similar to section 11.07(a)(3)-(5) and (c) with respect to the effects of a merger. Although section 9.24(a)(1)-(3) would be implied by the general rule stated in section 9.24(a)(6) even if not stated expressly, those rules have been included to avoid any question as to whether a different result was intended.

The rule in section 9.24(a)(6)(iii) that the date of incorporation of the foreign corporation remains its date of incorporation after the corporation has been domesticated in this state is a specific application of the general rule in section 9.24(a)(6)(ii). The date of incorporation is required by section 9.22(a)(2) to be set forth in the articles of domestication.

One of the continuing liabilities of the corporation following its domestication in a foreign jurisdiction is the obligation to its shareholders who exercise appraisal rights to pay them the amount, if any, to which they are entitled under chapter 13.

Section 9.24(c) preserves liability only for owner liabilities to the extent they arise before the domestication. Owner liability is not preserved for subsequent changes in an underlying liability, regardless of whether a change is voluntary or involuntary.

Section 9.24(d) is an optional provision that will not be needed in most states. It should be included only when the statutory laws of a state impose personal liability on the shareholders of a corporation, for example, for unpaid wages owed to employees of the corporation.

§ 9.25 Abandonment of a Domestication

(a) Unless otherwise provided in a plan of domestication of a domestic business corporation, after the plan has been adopted and approved as required by this subchapter, and at any time before the domestication has become effective, it may be abandoned by the board of directors without action by the shareholders.

(b) If a domestication is abandoned under subsection (a) after articles of charter surrender have been filed with the secretary of state but before the domestication has become effective, a statement that the domestication has been abandoned in accordance with this section, executed by an officer or other duly authorized representative, shall be delivered to the secretary of state for filing prior to the effective date of the domestication. The statement shall take effect upon filing and the domestication shall be deemed abandoned and shall not become effective.

(c) If the domestication of a foreign business corporation in this state is abandoned in accordance with the laws of the foreign jurisdiction after articles of domestication have been filed with the secretary of state, a statement that the domestication has been abandoned, executed by an officer or other duly authorized representative, shall be delivered to the secretary of state for filing. The statement shall take effect upon filing and the domestication shall be deemed abandoned and shall not become effective.

SUBCHAPTER C. NONPROFIT CONVERSION [OMITTED]

SUBCHAPTER D. FOREIGN NONPROFIT DOMESTICATION AND CONVERSION [OMITTED]

SUBCHAPTER E. ENTITY CONVERSION

§ 9.50 Entity Conversion Authorized; Definitions

(a) A domestic business corporation may become a domestic unincorporated entity pursuant to a plan of entity conversion.

(b) A domestic business corporation may become a foreign unincorporated entity if the entity conversion is permitted by the laws of the foreign jurisdiction.

(c) A domestic unincorporated entity may become a domestic business corporation. If the organic law of a domestic unincorporated entity does not provide procedures for the approval of an entity conversion, the conversion shall be adopted and approved, and the entity conversion effectuated, in the same manner as a merger of the unincorporated entity. If the organic law of a domestic unincorporated entity does not provide procedures for the approval of either an entity conversion or a merger, a plan of entity conversion shall be adopted and approved, the entity conversion effectuated, and appraisal rights exercised, in accordance with the procedures in this subchapter and chapter 13. Without limiting the provisions of this subsection, a domestic unincorporated entity whose organic law does not provide procedures for the approval of an entity conversion shall be subject to subsection (e) and section 9.52(7). For purposes of applying this subchapter and chapter 13:

(1) the unincorporated entity, its interest holders, interests and organic documents taken together, shall be deemed to be a domestic business corporation, shareholders, shares and articles of incorporation, respectively and vice versa, as the context may require; and

(2) if the business and affairs of the unincorporated entity are managed by a group of persons that is not identical to the interest holders, that group shall be deemed to be the board of directors.

(d) A foreign unincorporated entity may become a domestic business corporation if the organic law of the foreign unincorporated entity authorizes it to become a corporation in another jurisdiction.

(e) If any debt security, note or similar evidence of indebtedness for money borrowed, whether secured or unsecured, or a contract of any kind, issued, incurred or executed by a domestic business corporation before [the effective date of this subchapter], applies to a merger of the corporation and the document does not refer to an entity conversion of the corporation, the provision shall be deemed to apply to an entity conversion of the corporation until such time as the provision is amended subsequent to that date.

(f) As used in this subchapter:

(1) ''Converting entity'' means the domestic business corporation or domestic unincorporated entity that adopts a plan of entity conversion or the foreign unincorporated entity converting to a domestic business corporation.

(2) ''Surviving entity'' means the corporation or unincorporated entity that is in existence immediately after consummation of an entity conversion pursuant to this subchapter.

OFFICIAL COMMENT

1. Scope of Subchapter

Subject to certain restrictions which are discussed below, this subchapter authorizes the following types of conversion:

1. a domestic business corporation to a domestic other entity,
2. a domestic business corporation to a foreign other entity,
3. a domestic other entity to a domestic business corporation,
4. a foreign other entity to a domestic business corporation.

This subchapter provides for the conversion of a domestic unincorporated entity only to a domestic business corporation because the conversion of a domestic unincorporated entity to another form of unincorporated entity or to a foreign business corporation would be outside of the scope of this Act. This subchapter similarly does not provide for the conversion of a foreign corporation or unincorporated entity to a domestic unincorporated entity. States may nonetheless wish to consider generalizing the provisions of this subchapter to authorize those types of conversions.

2. Procedural Requirements

The concept of entity conversion as authorized by this subchapter is not found in many laws governing the incorporation or organization of corporations and unincorporated entities. In recognition of that fact, the rules in this section vary depending on whether the corporation or other entity desiring to convert pursuant to this subchapter is incorporated or organized under the laws of this state or of some other jurisdiction.

If the organic law of a domestic unincorporated entity does not expressly authorize it to convert to a domestic business corporation, it is intended that the first sentence of subsection (c) will provide the necessary authority. Until such time as the various organic laws of each form of unincorporated entity have been amended to provide procedures for adopting and approving a plan of entity conversion, subsection (c) provides those procedures by reference to the procedures for mergers under the organic law of the unincorporated entity or, if there are no such merger provisions, by reference to the provisions of this subchapter applicable to domestic business corporations.

Subsection (d) provides that a foreign unincorporated entity may convert to a domestic business corporation pursuant to this subchapter only if the law under which the foreign unincorporated entity is organized permits the conversion. This rule avoids issues that could arise if this state authorized a foreign unincorporated entity to participate in a transaction in this state that its home jurisdiction did not authorize. This subchapter does not specify the procedures that a foreign unincorporated entity must follow to authorize a conversion under this subchapter on the assumption that if the law under which the foreign unincorporated is organized authorizes the conversion that law will also provide the applicable procedures and any safeguards considered necessary to protect the interest holders of the unincorporated entity.

3. Transitional Rule

Because the concept of entity conversion is new, a person contracting with a corporation or loaning it money who drafted and negotiated special rights relating to the transaction before the enactment of this subchapter should not be charged with the consequences of not having dealt with the concept of entity conversion in the context of those special rights. Section 9.50(e) accordingly provides a transitional rule that is intended to protect such special rights. If, for example, a corporation is a party to a contract that provides that the corporation cannot participate in a merger without the consent of the other party to the contract, the requirement to obtain the consent of the other party will also apply to the conversion of the corporation to a domestic or foreign other entity. If the corporation fails to obtain the consent, the result will be that the other party will have the same rights it would have if the corporation were to participate in a merger without the required consent.

The purpose of section 9.50(e) is to protect the third party to a contract with the corporation, and section 9.50(e) should not be applied in such a way as to impair unconstitutionally the third party's contract. As applied to the corporation, section 9.50(e) is an exercise of the reserved power of the state legislature set forth in section 1.02.

The transitional rule in section 9.50(e) ceases to apply at such time as the provision of the agreement or debt instrument giving rise to the special rights is first amended after the effective date of this subchapter because at that time the provision may be amended to address expressly an entity conversion of the corporation.

Section 9.50(e) will also apply in the case of an unincorporated entity whose organic law does not provide procedures for the approval of an entity conversion because section 9.50(c) treats such an unincorporated entity as a business corporation for purposes of section 9.50(e).

A similar transitional rule governing the application to an entity conversion of special voting rights of directors and shareholders and other internal corporate procedures is found in section 9.52(6).

§ 9.51 Plan of Entity Conversion

(a) A plan of entity conversion must include:

(1) a statement of the type of other entity the surviving entity will be and, if it will be a foreign other entity, its jurisdiction of organization;

(2) the terms and conditions of the conversion;

(3) the manner and basis of converting the shares of the domestic business corporation following its conversion into interests or other securities, obligations, rights to acquire interests or other securities, cash, other property, or any combination of the foregoing; and

(4) the full text, as they will be in effect immediately after consummation of the conversion, of the organic documents of the surviving entity.

(b) The plan of entity conversion may also include a provision that the plan may be amended prior to filing articles of entity conversion, except that subsequent to approval of the plan by the shareholders the plan may not be amended to change:

(1) the amount or kind of shares or other securities, interests, obligations, rights to acquire shares, other securities or interests, cash, or other property to be received under the plan by the shareholders;

(2) the organic documents that will be in effect immediately following the conversion, except for changes permitted by a provision of the organic law of the surviving entity comparable to section 10.05; or

(3) any of the other terms or conditions of the plan if the change would adversely affect any of the shareholders in any material respect.

(c) Terms of a plan of entity conversion may be made dependent upon facts objectively ascertainable outside the plan in accordance with section 1.20(k).

OFFICIAL COMMENT

1. Terms and Conditions of Entity Conversion

This subchapter imposes virtually no restrictions or limitations on the terms and conditions of an entity conversion, except for those set forth in section 9.51(b) concerning provisions in a plan of entity conversion for amendment of the plan after it has been approved by the shareholders. Shares of a domestic business corporation that converts to an unincorporated entity may be reclassified into interests or other securities, obligations, rights to acquire interests or other securities, cash or other property. The capitalization of the entity will need to be restructured in the conversion and its organic documents or articles of incorporation may be amended by the articles of entity conversion in any way deemed appropriate. When a foreign unincorporated entity converts to a domestic business corporation, the laws of the foreign jurisdiction determine which of the foregoing actions may be taken.

Although this subchapter imposes virtually no restrictions or limitations on the terms and conditions of an entity conversion, section 9.51(a) requires that the terms and conditions be set forth in the plan of entity conversion. The plan of entity conversion is not required to be publicly filed, and the articles of entity conversion that are filed with the secretary of state are not required to include a plan of entity conversion. See section 9.53. Similarly, articles of charter surrender that are filed with the secretary of state by a domestic business corporation converting to a foreign unincorporated entity are not required to include the plan of entity conversion. See section 9.54.

The list in section 9.51(a) of required provisions in a plan of entity conversion is not exhaustive and the plan may include any other provisions that may be desired.

2. Adoption and Approval; Abandonment

The conversion of a domestic business corporation to a foreign unincorporated entity must be adopted and approved as provided in section 9.52. Shareholders of a domestic business corporation that adopts and approves a plan of entity conversion have appraisal rights. See chapter 13. Under section 9.55, the board of directors of a domestic business corporation may abandon an entity conversion before its effective date even if the plan of entity conversion has already been approved by the corporation's shareholders.

§ 9.52 Action on a Plan of Entity Conversion

In the case of an entity conversion of a domestic business corporation to a domestic or foreign unincorporated entity:

(1) The plan of entity conversion must be adopted by the board of directors.

(2) After adopting the plan of entity conversion, the board of directors must submit the plan to the shareholders for their approv-

al. The board of directors must also transmit to the shareholders a recommendation that the shareholders approve the plan, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, in which case the board of directors must transmit to the shareholders the basis for that determination.

(3) The board of directors may condition its submission of the plan of entity conversion to the shareholders on any basis.

(4) If the approval of the shareholders is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the plan of entity conversion is to be submitted for approval. The notice must state that the purpose, or one of the purposes, of the meeting is to consider the plan and must contain or be accompanied by a copy or summary of the plan. The notice shall include or be accompanied by a copy of the organic documents as they will be in effect immediately after the entity conversion.

(5) Unless the articles of incorporation, or the board of directors acting pursuant to paragraph (3), requires a greater vote or a greater number of votes to be present, approval of the plan of entity conversion requires the approval of each class or series of shares of the corporation voting as a separate voting group at a meeting at which a quorum of the voting group consisting of at least a majority of the votes entitled to be cast on the conversion by that voting group exists.

(6) If any provision of the articles of incorporation, bylaws or an agreement to which any of the directors or shareholders are parties, adopted or entered into before [the effective date of this subchapter], applies to a merger of the corporation and the document does not refer to an entity conversion of the corporation, the provision shall be deemed to apply to an entity conversion of the corporation until such time as the provision is subsequently amended.

(7) If as a result of the conversion one or more shareholders of the corporation would become subject to owner liability for the debts, obligations or liabilities of any other person or entity, approval of the plan of conversion shall require the execution, by each such shareholder, of a separate written consent to become subject to such owner liability.

OFFICIAL COMMENT

1. In General

This section sets forth the rules for adoption and approval of a plan of entity conversion by a domestic business corporation. The manner in which the conversion of a foreign unincorporated entity to a domestic business corporation must be adopted and approved will be controlled by the laws of the foreign jurisdiction. The provisions of this section follow generally the rules in chapter 11 for adoption and approval of a plan of merger or share exchange.

A plan of entity conversion must be adopted by the board of directors. Although section 9.52(2) permits the board to refrain from making a recommendation to the shareholders that they approve the plan, that does not change the underlying requirement that the board adopt the plan before it is submitted to the shareholders. Approval by the shareholders of a plan of entity conversion is always required.

2. Quorum and Voting

Section 9.52(5) provides that if the corporation has more than one class or series of shares, approval of an entity conversion requires the approval of each class or series voting as a separate voting group at a meeting at which there exists a quorum consisting of at least a majority of the votes entitled to be cast on the plan by that class or series. If a quorum is present, then under sections 7.25 and 7.26 the plan will be approved if more votes are cast in favor of the plan than against it by each voting group entitled to vote on the plan. If the shares of a corporation are not divided into two or more classes or series, all of the shares together will constitute a single class for purposes of section 9.52(5).

In lieu of approval at a shareholders' meeting, approval can be given by the consent of all the shareholders entitled to vote on the domestication, under the procedures set forth in section 7.04.

3. Transitional Rule

Because the concept of entity conversion is new, persons who drafted and negotiated special rights for directors or shareholders before the enactment of this subchapter should not be charged with the consequences of not having dealt with the concept of entity conversion in the context of those special rights. Section 9.52(7) accordingly provides a transitional rule that is intended to protect such special rights. Other documents, in addition to the articles of incorporation and bylaws, that may contain such special rights include shareholders agreements, voting trust agreements, vote pooling agreements or other similar arrangements. If, for example, the articles of incorporation provide that the corporation cannot participate in a merger without a supermajority vote of the shareholders, that supermajority requirement will also apply to the conversion of the corporation to a domestic or foreign unincorporated entity.

The purpose of section 9.52(6) is to protect persons who negotiated special rights for directors or shareholders whether in a contract with the corporation or in the articles of incorporation or bylaws, and section 9.52(6) should not be applied in such a way as to impair unconstitutionally the rights of any party to a contract with the corporation. As applied to the corporation, section 9.52(6) is an exercise of the reserved power of the state legislature set forth in section 1.02.

The transitional rule in section 9.52(6) ceases to apply at such time as the provision of the articles of incorporation, bylaws or agreement giving rise to the special rights is first amended after the effective date of this subchapter because at that time the provision may be amended to address expressly an entity conversion of the corporation.

Section 9.52(6) will also apply in the case of an unincorporated entity whose organic law does not provide procedures for the approval of an entity conversion because section 9.50(c) treats such an unincorporated entity as a business corporation for purposes of section 9.52(6).

A similar transitional rule with regard to the application to an entity conversion of special contractual rights of third parties is found in section 9.50(e).

§ 9.53 Articles of Entity Conversion

(a) After the conversion of a domestic business corporation to a domestic unincorporated entity has been adopted and approved as required by this Act, articles of entity conversion shall be executed on behalf of the corporation by any officer or other duly authorized representative. The articles shall:

(1) set forth the name of the corporation immediately before the filing of the articles of entity conversion and the name to which the name of the corporation is to be changed, which shall be a name that satisfies the organic law of the surviving entity;

(2) state the type of unincorporated entity that the surviving entity will be;

(3) set forth a statement that the plan of entity conversion was duly approved by the shareholders in the manner required by this Act and the articles of incorporation;

(4) if the surviving entity is a filing entity, either contain all of the provisions required to be set forth in its public organic document and any other desired provisions that are permitted, or have attached a public organic document; except that, in either case, provisions that would not be required to be included in a restated public organic document may be omitted.

(b) After the conversion of a domestic unincorporated entity to a domestic business corporation has been adopted and approved as required by the organic law of the unincorporated entity, articles of entity conversion shall be executed on behalf of the unincorporated entity by any officer or other duly authorized representative. The articles shall:

(1) set forth the name of the unincorporated entity immediately before the filing of the articles of entity conversion and the name to which the name of the unincorporated entity is to be changed, which shall be a name that satisfies the requirements of section 4.01;

(2) set forth a statement that the plan of entity conversion was duly approved in accordance with the organic law of the unincorporated entity;

(3) either contain all of the provisions that section 2.02(a) requires to be set forth in articles of incorporation and any other desired provisions that section 2.02(b) permits to be included in articles of incorporation, or have attached articles of incorporation; except that, in either case, provisions that would not be required to

be included in restated articles of incorporation of a domestic business corporation may be omitted.

(c) After the conversion of a foreign unincorporated entity to a domestic business corporation has been authorized as required by the laws of the foreign jurisdiction, articles of entity conversion shall be executed on behalf of the foreign unincorporated entity by any officer or other duly authorized representative. The articles shall:

(1) set forth the name of the unincorporated entity immediately before the filing of the articles of entity conversion and the name to which the name of the unincorporated entity is to be changed, which shall be a name that satisfies the requirements of section 4.01;

(2) set forth the jurisdiction under the laws of which the unincorporated entity was organized immediately before the filing of the articles of entity conversion and the date on which the unincorporated entity was organized in that jurisdiction;

(3) set forth a statement that the conversion of the unincorporated entity was duly approved in the manner required by its organic law; and

(4) either contain all of the provisions that section 2.02(a) requires to be set forth in articles of incorporation and any other desired provisions that section 2.02(b) permits to be included in articles of incorporation, or have attached articles of incorporation; except that, in either case, provisions that would not be required to be included in restated articles of incorporation of a domestic business corporation may be omitted.

(d) The articles of entity conversion shall be delivered to the secretary of state for filing, and shall take effect at the effective time provided in section 1.23. Articles of entity conversion filed under section 9.53(a) or (b) may be combined with any required conversion filing under the organic law of the domestic unincorporated entity if the combined filing satisfies the requirements of both this section and the other organic law.

(e) If the converting entity is a foreign unincorporated entity that is authorized to transact business in this state under a provision of law similar to chapter 15, its certificate of authority or other type of foreign qualification shall be cancelled automatically on the effective date of its conversion.

§ 9.54 Surrender of Charter Upon Conversion

(a) Whenever a domestic business corporation has adopted and approved, in the manner required by this subchapter, a plan of entity conversion providing for the corporation to be converted to a foreign unincorporated entity, articles of charter surrender shall be executed on behalf of the corporation by any officer or other duly authorized representative. The articles of charter surrender shall set forth:

(1) the name of the corporation;

(2) a statement that the articles of charter surrender are being filed in connection with the conversion of the corporation to a foreign unincorporated entity;

(3) a statement that the conversion was duly approved by the shareholders in the manner required by this Act and the articles of incorporation;

(4) the jurisdiction under the laws of which the surviving entity will be organized;

(5) if the surviving entity will be a nonfiling entity, the address of its executive office immediately after the conversion.

(b) The articles of charter surrender shall be delivered by the corporation to the secretary of state for filing. The articles of charter surrender shall take effect on the effective time provided in section 1.23.

§ 9.55 Effect of Entity Conversion

(a) When a conversion under this subchapter becomes effective:

(1) the title to all real and personal property, both tangible and intangible, of the converting entity remains in the surviving entity without reversion or impairment;

(2) the liabilities of the converting entity remain the liabilities of the surviving entity;

(3) an action or proceeding pending against the converting entity continues against the surviving entity as if the conversion had not occurred;

(4) in the case of a surviving entity that is a filing entity, its articles of incorporation or public organic document and its private organic document become effective;

(5) in the case of a surviving entity that is a nonfiling entity, its private organic document becomes effective;

(6) the shares or interests of the converting entity are reclassified into shares, interests, other securities, obligations, rights to acquire shares, interests or other securities, or into cash or other property in accordance with the plan of conversion; and the shareholders or interest holders of the converting entity are entitled only to the rights provided to them under the terms of the conversion and to any appraisal rights they may have under the organic law of the converting entity; and

(7) the surviving entity is deemed to:

(i) be incorporated or organized under and subject to the organic law of the converting entity for all purposes;

(ii) be the same corporation or unincorporated entity without interruption as the converting entity; and

(iii) have been incorporated or otherwise organized on the date that the converting entity was originally incorporated or organized.

(b) When a conversion of a domestic business corporation to a foreign other entity becomes effective, the surviving entity is deemed to:

(1) appoint the secretary of state as its agent for service of process in a proceeding to enforce the rights of shareholders who exercise appraisal rights in connection with the conversion; and

(2) agree that it will promptly pay the amount, if any, to which such shareholders are entitled under chapter 13.

(c) A shareholder who becomes subject to owner liability for some or all of the debts, obligations or liabilities of the surviving entity shall be personally liable only for those debts, obligations or liabilities of the surviving entity that arise after the effective time of the articles of entity conversion.

(d) The owner liability of an interest holder in an unincorporated entity that converts to a domestic business corporation shall be as follows:

(1) The conversion does not discharge any owner liability under the organic law of the unincorporated entity to the extent any such owner liability arose before the effective time of the articles of entity conversion.

(2) The interest holder shall not have owner liability under the organic law of the unincorporated entity for any debt, obligation or liability of the corporation that arises after the effective time of the articles of entity conversion.

(3) The provisions of the organic law of the unincorporated entity shall continue to apply to the collection or discharge of any owner liability preserved by paragraph (1), as if the conversion had not occurred.

(4) The interest holder shall have whatever rights of contribution from other interest holders are provided by the organic law of the unincorporated entity with respect to any owner liability preserved by paragraph (1), as if the conversion had not occurred.

§ 9.56 Abandonment of an Entity Conversion

(a) Unless otherwise provided in a plan of entity conversion of a domestic business corporation, after the plan has been adopted and approved as required by this subchapter, and at any time before the entity conversion has become effective, it may be abandoned by the board of directors without action by the shareholders.

(b) If an entity conversion is abandoned after articles of entity conversion or articles of charter surrender have been filed with the secretary of state but before the entity conversion has become effective, a statement that the entity conversion has been abandoned in accordance with this section, executed by an officer or other duly authorized representative, shall be delivered to the secretary of state for filing prior to the effective date of the entity conversion. Upon filing, the statement shall take effect and the entity conversion shall be deemed abandoned and shall not become effective.

CHAPTER 10. AMENDMENT OF ARTICLES OF INCORPORATION AND BYLAWS

SUBCHAPTER A. AMENDMENT OF ARTICLES OF INCORPORATION

§ 10.01 Authority to Amend

(a) A corporation may amend its articles of incorporation at any time to add or change a provision that is required or permitted in the articles of incorporation as of the effective date of the amendment or to delete a provision that is not required to be contained in the articles of incorporation.

(b) A shareholder of the corporation does not have a vested property right resulting from any provision in the articles of incorporation, including provisions relating to management, control, capital structure, dividend entitlement, or purpose or duration of the corporation.

OFFICIAL COMMENT

Section 10.01(a) authorizes a corporation to amend its articles of incorporation by adding a new provision to its articles of incorporation, modifying an existing provision, or deleting a provision in its entirety. The sole test for the validity of an amendment is whether the provision could lawfully have been included in (or in the case of a deletion, omitted from) the articles of incorporation as of the effective date of the amendment.

The power of amendment must be exercised pursuant to the procedures set forth in chapter 10. Section 10.03 requires most amendments to be approved by a majority of the votes cast on the proposed amendment at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast is present. This requirement is supplemented by section 10.04, which governs voting by voting groups on amendments that directly affect a single class or series of shares, and by section 7.27, which governs amendments that change the voting requirements for future amendments.

Section 10.01(b) restates the policy embodied in earlier versions of the Act and in all modern state corporation statutes, that a shareholder "does not have a vested property right" in any provision of the articles of incorporation. Under section 1.02, corporations and their shareholders are also subject to amendments of the governing statute.

Section 10.01 should be construed liberally to achieve the fundamental purpose of this chapter of permitting corporate adjustment and change by majority vote. Section 10.01(b) rejects decisions by a few courts that have applied a vested right or property right doctrine to restrict or invalidate amendments to articles of incorporation because they modified particular rights conferred on shareholders by the original articles of incorporation.

Under general corporation law and under the Act, a provision in the articles of incorporation is subject to amendment under section 10.01 even though the provision is described, referred to, or stated in a share certificate, information statement, or other document issued by the corporation that reflects provisions of the articles of incorporation. The only exception to this unlimited power of amendment is section 6.27, which provides that without the consent of the holder, amendments cannot impose share transfer restrictions on previously issued shares.

However, section 10.01 does not concern obligations of a corporation to its shareholders based upon contracts independent of the articles of incorporation. An amendment permitted by this section may constitute a breach of such a contract or of a contract between the shareholders themselves. A shareholder with contractual rights (or who otherwise is concerned about possible onerous amendments) may obtain complete protection against these amendments by establishing procedures in the articles of incorporation or bylaws that limit the power of amendment without the shareholder's consent. In appropriate cases, a shareholder may be able to enjoin an amendment that constitutes a breach of a contract.

Minority shareholders are protected from the power of the majority to impose onerous or objectionable amendments in several ways. First, such shareholders may have the right to vote on amendments by separate voting groups (section 10.04). Second, a decision by a majority shareholder or a control group to exercise the powers granted by this section in a way that may breach a duty to minority or noncontrolling interests may be reviewable by a court under its inherent equity power to review transactions for good faith and fair dealing to the minority shareholders. McNulty v. W. & J. Sloane, 184 Misc. 835, 54 N.Y.S.2d 253 (Sup. Ct. 1945); Kamena v. Janssen Dairy Corp., 133 N.J. Eq. 214, 31 A.2d 200, 202 (Ch. 1943), aff'd, 134 N.J. Eq. 359, 35 A.2d 894 (1944) (where the court stated that it "is more a question of fair dealing between the strong and the weak than it is a question of percentages or proportions of the votes favoring the plan"). See also Teschner v. Chicago Title & Trust Co., 59 Ill. 2d 452, 322 N.E.2d 54, 57 (1974), where the court, in upholding a transaction that had a reasonable business purpose, relied partially on the fact that there was "no claim of fraud or deceptive conduct . . . [or] that the exchange offer was unfair or that the price later offered for the shares was inadequate."

Because of the broad power of amendment contained in this section, it is unnecessary to make any reference to, or reserve, an express power to amend in the articles of incorporation.

§ 10.02 Amendment Before Issuance of Shares

If a corporation has not yet issued shares, its board of directors, or its incorporators if it has no board of directors, may adopt one or more amendments to the corporation's articles of incorporation.

OFFICIAL COMMENT

Section 10.02 provides that, before any shares are issued, amendments may be made by the persons empowered to complete the organization of the corporation. Under section 2.04 the organizers may be either the incorporators or the initial directors named in the articles of incorporation.

§ 10.03 Amendment by Board of Directors and Shareholders

If a corporation has issued shares, an amendment to the articles of incorporation shall be adopted in the following manner:

(a) The proposed amendment must be adopted by the board of directors.

(b) Except as provided in sections 10.05, 10.07, and 10.08, after adopting the proposed amendment the board of directors must submit the amendment to the shareholders for their approval. The board of directors must also transmit to the shareholders a recommendation that the shareholders approve the amendment, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, in which case the board of directors must transmit to the shareholders the basis for that determination.

(c) The board of directors may condition its submission of the amendment to the shareholders on any basis.

(d) If the amendment is required to be approved by the shareholders, and the approval is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the amendment is to be submitted for approval. The notice must state that the purpose, or one of the purposes, of the meeting is to consider the amendment and must contain or be accompanied by a copy of the amendment.

(e) Unless the articles of incorporation, or the board of directors acting pursuant to subsection (c), requires a greater vote or a greater number of shares to be present, approval of the amendment requires the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the amendment exists, and, if any class or series of shares is entitled to vote as a separate group on the amendment, except as provided in section 10.04(c), the approval of each such separate voting group at a meeting at which a quorum of the voting group consisting of at least a majority of the votes entitled to be cast on the amendment by that voting group exists.

OFFICIAL COMMENT

1. In General

Under section 10.03, if a corporation has issued shares, a proposed amendment to the articles of incorporation must be adopted by the board. Thereafter, the board must submit the amendment to the shareholders for their approval, except as provided in sections 10.05, 10.07, and 10.08.

2. Submission to the Shareholders

Section 10.03 requires the board of directors, after having adopted an amendment, to submit the amendment to the shareholders for approval except as otherwise provided by sections 10.05, 10.07, and 10.08. When submitting the amendment, the board of directors must make a recommendation to the shareholders that the amendment be approved, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should make no recommendation. For example, the board of directors may make such a determination where there is not a sufficient number of directors free of a conflicting interest to approve the amendment or because the board of directors is evenly divided as to the merits of an amendment but is able to agree that shareholders should be permitted to consider the amendment. If the board of directors makes such a determination, it must describe the conflict of interest or special circumstances, and communicate the basis for the determination, when submitting the amendment to the shareholders. The exception for conflicts of interest or other special circumstances is intended to be sparingly available. Generally, shareholders should not be asked to act on an amendment in the absence of a recommendation by the board of directors. The exception is not intended to relieve the board of directors of its duty to consider carefully the amendment and the interests of shareholders.

Section 10.03(c) permits the board of directors to condition its submission of an amendment on any basis. Among the conditions that a board might impose are that the amendment will not be deemed approved (i) unless it is approved by a specified vote of the shareholders, or by one or more specified classes or series of shares, voting as a separate voting group, or by a specified percentage of disinterested shareholders, or (ii) if shareholders holding more than a specified fraction of outstanding shares assert appraisal rights. The board of directors is not limited to conditions of these types.

3. Quorum and Voting

Section 10.03(e) provides that approval of an amendment requires approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the amendment exists, including, if any class or series of shares is entitled to vote as a separate group on the amendment, the approval of each such separate group, at a meeting at which a similar quorum of the voting group exists. If a quorum exists, then under sections 7.25 and 7.26 the amendment will be approved if more votes are cast in favor of the amendment than against it by the voting group or separate voting groups entitled to vote on the plan. This represents a change from the Act's previous voting rule for amendments, which required approval by a majority of votes cast, with no minimum quorum, for some amendments, and approval by a majority of the votes entitled to be cast by a voting group, for others.

If an amendment would affect the voting requirements on future amendments, it must also be approved by the vote required by section 7.27.

§ 10.04 Voting on Amendments by Voting Groups

(a) If a corporation has more than one class of shares outstanding, the holders of the outstanding shares of a class are entitled to vote as a separate voting group (if shareholder voting is otherwise required by this Act) on a proposed amendment to the articles of incorporation if the amendment would:

(1) effect an exchange or reclassification of all or part of the shares of the class into shares of another class;

(2) effect an exchange or reclassification, or create the right of exchange, of all or part of the shares of another class into shares of the class;

(3) change the rights, preferences, or limitations of all or part of the shares of the class;

(4) change the shares of all or part of the class into a different number of shares of the same class;

(5) create a new class of shares having rights or preferences with respect to distributions or to dissolution that are prior or superior to the shares of the class;

(6) increase the rights, preferences, or number of authorized shares of any class that, after giving effect to the amendment, have rights or preferences with respect to distributions or to dissolution that are prior or superior to the shares of the class;

(7) limit or deny an existing preemptive right of all or part of the shares of the class; or

(8) cancel or otherwise affect rights to distributions that have accumulated but not yet been authorized on all or part of the shares of the class.

(b) If a proposed amendment would affect a series of a class of shares in one or more of the ways described in subsection (a), the holders of shares of that series are entitled to vote as a separate voting group on the proposed amendment.

(c) If a proposed amendment that entitles the holders of two or more classes or series of shares to vote as separate voting groups under this section would affect those two or more classes or series in the same or a substantially similar way, the holders of shares of all the classes or series so affected must vote together as a single voting group on the proposed amendment, unless otherwise provided in the articles of incorporation or required by the board of directors.

(d) A class or series of shares is entitled to the voting rights granted by this section although the articles of incorporation provide that the shares are nonvoting shares.

OFFICIAL COMMENT

Section 10.04(a) requires separate approval by voting groups for certain types of amendments to the articles of incorporation where the corporation has more than one class of shares outstanding. In general, section 10.04 carries forward provisions of the prior Act, but certain changes have been made. Under the prior Act, approval by a class, voting as a separate voting group, was required for an amendment that would increase or decrease the aggregate number of shares of the class. That provision does not appear in the present Act. Also, in the prior Act approval by a class, voting as a separate voting group, was required for an amendment that would create a new class of shares having rights or preferences with respect to dissolution that would be prior, superior, or substantially equal to the class, and for an amendment that would increase the rights, preferences, or number of authorized shares of any class that, after giving effect to the amendment, would have rights or preferences with respect to distributions or dissolution that would be prior, superior, or substantially equal to the shares of the class. Under the present Act, approval by a class, voting as a separate voting group, is required in these cases only when the new or other class would have rights with respect to distributions or dissolution that would be prior or superior to the class, not when the rights would be substantially equal.

Shares are entitled to vote as separate voting groups under this section even though they are designated as nonvoting shares in the articles of incorporation, or the articles of incorporation purport to deny them entirely the right to vote on the proposal in question, or purport to allow other classes or series of shares to vote as part of the same voting group. However, an amendment that does not require shareholder approval does not trigger the right to vote by voting groups under this section. This would include a determination by the board of directors, pursuant to authority granted in the articles of incorporation, of the preferences, limitations and relative rights of any class prior to the issuance of any shares of that class, or of one or more series within a class before the issuance of any shares of that series (see section 6.02(a)).

The right to vote as a separate voting group provides a major protection for classes or series of shares with preferential rights, or classes or series of limited or nonvoting shares, against amendments that are especially burdensome to that class or series. This section, however, does not make the right to vote by separate voting group dependent on an evaluation of whether the amendment is detrimental to the class or series; if the amendment is one of those described in section 10.04(a), the class or series is automatically entitled to vote as a separate voting group on the amendment. The question whether an amendment is detrimental is often a question of judgment, and approval by the affected class or series is required irrespective of whether the board or other shareholders believe it is beneficial or detrimental to the affected class or series.

Under subsection (a)(4), a class is entitled to vote as a separate voting group on an amendment that would change the shares of all or part of the class into a different number of shares of the same class. An amendment that changes the number of shares owned by one of more shareholders of a class into a fraction of a share, through a "reverse split," falls within subsection (a)(4) and therefore requires approval by the class, voting as a separate voting group, whether or not the fractional share is to be acquired for cash under section 6.04.

Sections 7.25 and 7.26 set forth the mechanics of voting by multiple voting groups.

Subsection (b) extends the privilege of voting by separate voting group to a series of a class of shares if the series has financial or voting provisions unique to the series that are affected in one or more of the ways described in subsection (a). Any significant distinguishing feature of a series, which an amendment affects or alters, should trigger the right of voting by separate voting group for that series. However, under subsection (c) if a proposed amendment that entitles two or more classes or series of shares to vote as separate voting groups would affect those classes or series in the same or a substantially similar way, the shares of all the class or series so affected must vote together, as a single voting group, unless otherwise provided in the articles of incorporation or required by the board of directors.

The application of subsections (b) and (c) may best be illustrated by examples.

First, assume there is a class of shares, with preferential rights, comprised of three series, each with different preferential dividend rights. A proposed amendment would reduce the rate of dividend applicable to the "Series A" shares and would change the dividend right of the "Series B" shares from a cumulative to a noncumulative right. The amendment would not affect the preferential dividend right of the "Series C" shares. Both Series A and B would be entitled to vote as separate voting groups on the proposed amendment; the holders of the Series C shares, not directly affected by the amendment, would not be entitled to vote at all, unless otherwise provided, or unless the shares are voting shares under the articles of incorporation, in which case they would not vote as a separate voting group but in the voting group consisting of all shares with general voting rights under the articles of incorporation.

Second, if the proposed amendment would reduce the dividend right of Series A and change the dividend right of both Series B and C from a cumulative to a noncumulative right, the holders of Series A would be entitled to vote as a single voting group, and the holders of Series B and C would be required to vote together as a single, separate voting group.

Third, assume that a corporation has common stock and two classes of preferred stock. A proposed amendment would create a new class of senior preferred that would have priority in distribution rights over both the common stock and the existing classes of preferred stock. Because the creation of the new senior preferred would affect all three classes of stock in the same or a substantially similar way, all three classes would vote together as a single voting group on the proposed amendment.

Under the prior version of section 10.04(c), series that were affected by an amendment in the same or a substantially similar manner were required to vote together, but classes that were affected by an amendment in the same or a substantially similar manner voted separately. Thus under the prior version of section 10.04(c) if, in the second example, the A, B, and C stock had been denominated as classes rather than series, then the A, B, and C holders would have been required to vote separately rather than together. Similarly, in the third example, under the prior version of section 10.04(c) the Common and existing Preferred would have been required to vote separately rather than together, because each was a separate class. The distinction between classes and series for this purpose seems artificial, and therefore has been eliminated in the current version of section 10.04(c).

Section 10.04(d) makes clear that the right to vote by separate voting groups provided by section 10.04 may not be narrowed or eliminated by the articles of incorporation. Even if a class or series of shares is described as ''nonvoting'' and the articles purport to make that class or series nonvoting ''for all purposes,'' that class or series nevertheless has the voting right provided by this section. No inference should be drawn from section 10.04(d) as to whether other, unrelated sections of the Act may be modified by provisions in the articles of incorporation.

§ 10.05 Amendment by Board of Directors

Unless the articles of incorporation provide otherwise, a corporation's board of directors may adopt amendments to the corporation's articles of incorporation without shareholder approval:

(1) to extend the duration of the corporation if it was incorporated at a time when limited duration was required by law;

(2) to delete the names and addresses of the initial directors;

(3) to delete the name and address of the initial registered agent or registered office, if a statement of change is on file with the secretary of state;

(4) if the corporation has only one class of shares outstanding:

(a) to change each issued and unissued authorized share of the class into a greater number of whole shares of that class; or

(b) to increase the number of authorized shares of the class to the extent necessary to permit the issuance of shares as a share dividend;

(5) to change the corporate name by substituting the word ''corporation,'' ''incorporated,'' ''company,'' ''limited,'' or the abbreviation ''corp.,'' ''inc.,'' ''co.,'' or ''ltd.,'' for a similar word or abbreviation in the name, or by adding, deleting, or changing a geographical attribution for the name;

(6) to reflect a reduction in authorized shares, as a result of the operation of section 6.31(b), when the corporation has acquired its own shares and the articles of incorporation prohibit the reissue of the acquired shares;

(7) to delete a class of shares from the articles of incorporation, as a result of the operation of section 6.31(b), when there are no remaining shares of the class because the corporation has acquired all shares of the class and the articles of incorporation prohibit the reissue of the acquired shares; or

(8) to make any change expressly permitted by section 6.02(a) or (b) to be made without shareholder approval.

OFFICIAL COMMENT

The amendments described in clauses (1) through (8) are so routine and ''housekeeping'' in nature as not to require approval by shareholders. None affects substantive rights in any meaningful way.

Section 10.05(4)(a) authorizes the board of directors to change each issued and unissued share of an outstanding class of shares into a greater number of whole shares if the corporation has only that class of shares outstanding. All shares of the class being changed must be treated identically under this clause. Section 10.05(4)(b) authorizes the board of directors to increase the number of shares of the class to the extent necessary to permit the issuance of shares as a share dividend, if the corporation has only that one class of stock outstanding.

Amendments provided for in this section may be included in restated articles of incorporation under section 10.07 or in articles of merger under chapter 11.

§ 10.06 Articles of Amendment

After an amendment to the articles of incorporation has been adopted and approved in the manner required by this Act and by the articles of incorporation, the corporation shall deliver to the secretary of state, for filing, articles of amendment, which shall set forth:

(1) the name of the corporation;

(2) the text of each amendment adopted, or the information required by section 1.20(k)(5);

(3) if an amendment provides for an exchange, reclassification, or cancellation of issued shares, provisions for implementing the amendment if not contained in the amendment itself, (which may be made dependent upon facts objectively ascertainable outside the articles of amendment in accordance with section 1.20(k)(5));

(4) the date of each amendment's adoption; and

(5) if an amendment:

(a) was adopted by the incorporators or board of directors without shareholder approval, a statement that the amendment was duly approved by the incorporators or by the board of directors, as the case may be, and that shareholder approval was not required;

(b) required approval by the shareholders, a statement that the amendment was duly approved by the shareholders in the manner required by this Act and by the articles of incorporation; or

(c) is being filed pursuant to section 1.20(k)(5), a statement to that effect.

OFFICIAL COMMENT

Section 10.06(3) requires the articles of amendment to contain a statement of the manner in which an exchange, reclassification, or cancellation of issued shares is to be put into effect if not set forth in the amendment itself. This requirement avoids any possible confusion that may arise as to how the amendment is to be put into effect and also permits the amendment itself to be limited to provisions of permanent applicability, with transitional provisions having no long-range effect appearing only in the articles of amendment.

§ 10.07 Restated Articles of Incorporation

(a) A corporation's board of directors may restate its articles of incorporation at any time, with or without shareholder approval, to consolidate all amendments into a single document.

(b) If the restated articles include one or more new amendments that require shareholder approval, the amendments must be adopted and approved as provided in section 10.03.

(c) A corporation that restates its articles of incorporation shall deliver to the secretary of state for filing articles of restatement setting forth the name of the corporation and the text of the restated articles of incorporation together with a certificate which states that the restated articles consolidate all amendments into a single document and, if a new amendment is included in the restated articles, which also includes the statements required under section 10.06.

(d) Duly adopted restated articles of incorporation supersede the original articles of incorporation and all amendments thereto.

(e) The secretary of state may certify restated articles of incorporation as the articles of incorporation currently in effect, without including the certificate information required by subsection (c).

OFFICIAL COMMENT

Restated articles of incorporation serve the useful purpose of permitting articles of incorporation that have been amended from time to time, or are being concurrently amended, to be consolidated into a single document.

A restatement of a corporation's articles of incorporation is not an amendment of the articles of incorporation, but only a consolidation of amendments into a single document. A corporation that is restating its articles may concurrently amend the articles, and include the new amendments in the restated articles. In such a case, the provisions of this chapter that govern amendments of the articles of incorporation would apply to the new amendments. In case of doubt whether a provision of a restatement of the articles of incorporation might be deemed to be an amendment, rather than a consolidation, the prudent course for the corporation is to treat that provision as an amendment, and follow the procedures that apply to amendments under this chapter.

Where the articles of incorporation are amended at the same time they are restated, a combined articles of amendment and restatement may be filed.

§ 10.08 Amendment Pursuant to Reorganization

(a) A corporation's articles of incorporation may be amended without action by the board of directors or shareholders to carry out a plan of reorganization ordered or decreed by a court of competent jurisdiction under the authority of a law of the United States.

(b) The individual or individuals designated by the court shall deliver to the secretary of state for filing articles of amendment setting forth:

(1) the name of the corporation;

(2) the text of each amendment approved by the court;

(3) the date of the court's order or decree approving the articles of amendment;

(4) the title of the reorganization proceeding in which the order or decree was entered; and

(5) a statement that the court had jurisdiction of the proceeding under federal statute.

(c) This section does not apply after entry of a final decree in the reorganization proceeding even though the court retains jurisdiction of the proceeding for limited purposes unrelated to consummation of the reorganization plan.

OFFICIAL COMMENT

Section 10.08 provides a simplified method of conforming corporate documents filed under state law with the federal statutes relating to corporate reorganization. If a federal court confirms a plan of reorganization that requires articles of amendment to be filed, those amendments may be prepared and filed by the persons designated by the court and the approval of neither the shareholders nor the board of directors is required.

This section applies only to amendments in articles of incorporation approved before the entry of a final decree in the reorganization.

§ 10.09 Effect of Amendment

An amendment to the articles of incorporation does not affect a cause of action existing against or in favor of the corporation, a proceeding to which the corporation is a party, or the existing rights of persons other than shareholders of the corporation. An amendment changing a corporation's name does not abate a proceeding brought by or against the corporation in its former name.

OFFICIAL COMMENT

Under section 10.09, amendments to articles of incorporation do not interrupt the corporate existence and do not abate a proceeding by or against the corporation even though the amendment changes the name of the corporation.

Amendments are effective when filed unless a delayed effective date is elected. See section 1.23.

SUBCHAPTER B. AMENDMENT OF BYLAWS

§ 10.20 Amendment by Board of Directors or Shareholders

(a) A corporation's shareholders may amend or repeal the corporation's bylaws.

(b) A corporation's board of directors may amend or repeal the corporation's bylaws, unless:

(1) the articles of incorporation, section 10.21 or, if applicable, section 10.22 reserve that power exclusively to the shareholders in whole or in part; or

(2) the shareholders in amending, repealing, or adopting a bylaw expressly provide that the board of directors may not amend, repeal, or reinstate that bylaw.

OFFICIAL COMMENT

The power to amend or repeal bylaws is shared by the board of directors and the shareholders, unless that power is reserved exclusively to the shareholders by an appropriate provision in the articles of incorporation. Section 10.20(b)(1) provides that the power to amend or repeal the bylaws may be reserved to the shareholders ''in whole or part.'' This language permits the reservation of power to be limited to specific articles or sections of the bylaws or to specific subjects or topics addressed in the bylaws.

Section 10.20(b)(2) permits the shareholders to amend, repeal, or adopt a bylaw and reserve exclusively to themselves the power to amend, repeal, or reinstate that bylaw if the reservation is express.

Section 10.21 limits the power of directors to adopt or amend supermajority provisions in bylaws. See section 10.21 and the Official Comment thereto.

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.

§ 10.21 Bylaw Increasing Quorum or Voting Requirement for Directors

(a) A bylaw that increases a quorum or voting requirement for the board of directors may be amended or repealed:

(1) if adopted by the shareholders, only by the shareholders, unless the bylaw otherwise provides;

(2) if adopted by the board of directors, either by the shareholders or by the board of directors.

(b) A bylaw adopted or amended by the shareholders that increases a quorum or voting requirement for the board of directors may provide that it can be amended or repealed only by a specified vote of either the shareholders or the board of directors.

(c) Action by the board of directors under subsection (a) to amend or repeal a bylaw that changes the quorum or voting requirement for the board of directors must meet the same quorum requirement and be adopted by the same vote required to take action under the quorum and voting requirement then in effect or proposed to be adopted, whichever is greater.

OFFICIAL COMMENT

Provisions that increase a quorum or voting requirement for the board over the requirement that would otherwise apply under this Act or that was previously set forth in the bylaws (''supermajority requirements'') may be placed in the bylaws of the corporation without specific authorization in the articles of incorporation. See section 8.24(a) and (c). Like other bylaw provisions, they may be adopted either by the shareholders or by the board of directors. See section 10.20. Such provisions may be amended or repealed by the board of directors or shareholders as provided in this section.

Section 10.21(a)(1) provides that if a supermajority requirement is imposed by a bylaw adopted by the shareholders, only the shareholders may amend or repeal it. Under section 10.21(b), such a bylaw may impose restrictions on the manner in which it may be thereafter amended or repealed by the shareholders. If a supermajority requirement is imposed in a bylaw adopted by the board of directors, the bylaw may be amended either by the shareholders or the board of directors (see section 10.21(a)(2)). However, if such an amendment is amended by the board of directors, section 10.21(c) requires approval by the supermajority requirement then in effect or proposed to be adopted, whichever is greater. Compare section 7.27.

§ 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(c), 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 in the usual case in which section 10.22(a) would apply when the candidates for director equal the number of directorships up for election. In that case, and by way of example, the holder of a 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(a) 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 renoticing 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.

CHAPTER 11. MERGER AND SHARE EXCHANGES

§ 11.01 Definitions

As used in this chapter:

(a) ''Merger'' means a business combination pursuant to section 11.02.

(b) ''Party to a merger'' or ''party to a share exchange'' means any domestic or foreign corporation or eligible entity that will:

(1) merge under a plan of merger;

(2) acquire shares or eligible interests of another corporation or an eligible entity in a share exchange; or

(3) have all of its shares or eligible interests or all of one or more classes or series of its shares or eligible interests acquired in a share exchange.

(c) ''Share exchange'' means a business combination pursuant to section 11.03.

(d) ''Survivor'' in a merger means the corporation or eligible entity into which one or more other corporations or eligible entities are merged. A survivor of a merger may preexist the merger or be created by the merger.

OFFICIAL COMMENT

1. In General

The definition of what constitutes an ''eligible entity'' in section 1.40(7B) determines the kinds of entities, other than corporations, with which a corporation may merge. The definition of ''voting power'' in section 1.40 also has important substantive implications, because whether shareholder approval is required for a transaction under chapter 11 depends in part on the proportion of voting power that is carried by shares that would be issued and issuable as a result of the transaction.

2. Interests

The term ''interests'' in section 1.40(13B) includes such interests as general and limited partnership interests in limited partnerships, equity interests in limited liability companies, and any other form of equity or ownership interests in an unincorporated entity, as defined in section 1.40(24A), however denominated. For purposes of this chapter, the definition of ''eligible interests'' in section 1.40(7C) adds to those types of interests any form of membership in a domestic or foreign nonprofit corporation.

3. Organic Documents

The definition of the term ''organic documents'' which was previously found in section 11.01(c) is now set forth in section 1.40(15A).

4. Other Entity

For purposes of this chapter, the term ''other entity'' is defined more broadly in this section than it is in section 1.40 (15C).

5. Survivor

The term ''survivor'' is used in chapter 11 as a defined technical term and therefore is not always used in a manner that is equivalent to the ordinary meaning of the term. For example, a corporation may be the ''survivor'' of a merger within the meaning of section 11.01(d) even if it is created by the merger, and therefore had no existence before the merger.

§ 11.02 Merger

(a) One or more domestic business corporations may merge with one or more domestic or foreign business corporations or eligible entities pursuant to a plan of merger, or two or more foreign business corporations or domestic or foreign eligible entities may merge into a new domestic business corporation to be created in the merger in the manner provided in this chapter.

(b) A foreign business corporation, or a foreign eligible entity, may be a party to a merger with a domestic business corporation, or may be created by the terms of the plan of merger, only if the merger is permitted by the foreign business corporation or eligible entity.

(b.1) If the organic law of a domestic eligible entity does not provide procedures for the approval of a merger, a plan of merger may be adopted and approved, the merger effectuated, and appraisal rights exercised in accordance with the procedures in this chapter and chapter 13. For the purposes of applying this chapter and chapter 13:

(1) the eligible entity, its members or interest holders, eligible interests and organic documents taken together shall be deemed to be a domestic business corporation, shareholders, shares and articles of incorporation, respectively and vice versa as the context may require; and

(2) if the business and affairs of the eligible entity are managed by a group of persons that is not identical to the members or interest holders, that group shall be deemed to be the board of directors.

(c) The plan of merger must include:

(1) the name of each domestic or foreign business corporation or eligible entity that will merge and the name of the domestic or foreign business corporation or eligible entity that will be the survivor of the merger;

(2) the terms and conditions of the merger;

(3) the manner and basis of converting the shares of each merging domestic or foreign business corporation and eligible interests of each merging domestic or foreign eligible entity into shares or other securities, eligible interests, obligations, rights to acquire shares, other securities or eligible interests, cash, other property, or any combination of the foregoing;

(4) the articles of incorporation of any domestic or foreign business or nonprofit corporation, or the organic documents of any domestic or foreign unincorporated entity, to be created by the merger, or if a new domestic or foreign business or nonprofit corporation or unincorporated entity is not to be created by the merger, any amendments to the survivor's articles of incorporation or organic documents; and

(5) any other provisions required by the laws under which any party to the merger is organized or by which it is governed, or by the articles of incorporation or organic document of any such party.

(d) Terms of a plan of merger may be made dependent on facts objectively ascertainable outside the plan in accordance with section 1.20(k).

(e) The plan of merger may also include a provision that the plan may be amended prior to filing articles of merger, but if the shareholders of a domestic corporation that is a party to the merger are required or permitted to vote on the plan, the plan must provide that subsequent to approval of the plan by such shareholders the plan may not be amended to change:

(1) the amount or kind of shares or other securities, eligible interests, obligations, rights to acquire shares, other securities or eligible interests, cash, or other property to be received under the plan by the shareholders of or owners of eligible interests in any party to the merger;

(2) the articles of incorporation of any corporation, or the organic documents of any unincorporated entity, that will survive or be created as a result of the merger, except for changes permitted by section 10.05 or by comparable provisions of the organic laws of any such foreign corporation or domestic or foreign unincorporated entity; or

(3) any of the other terms or conditions of the plan if the change would adversely affect such shareholders in any material respect.

[(f) Property held in trust or for charitable purposes under the laws of this state by a domestic or foreign eligible entity shall not be diverted by a merger from the objects for which it was donated, granted or devised, unless and until the eligible entity obtains an order of [court] [the attorney general] specifying the disposition of the property to the extent required by and pursuant to [cite state statutory cy pres or other nondiversion statute].]

OFFICIAL COMMENT

1. In General

Section 11.02 authorizes mergers between one or more domestic corporations, or between one or more domestic corporations and one or more foreign corporations or domestic or foreign eligible entities. Upon the effective date of the merger the survivor becomes vested with all the assets of the corporations or eligible entities that merge into the survivor and becomes subject to their liabilities, as provided in section 11.07.

2. Applicability

A merger of a domestic corporation with a foreign corporation or a foreign other entity is authorized by chapter 11 only if the merger is permitted by the laws under which the foreign corporation or other entity is organized, and in effecting the merger the foreign business corporation or other entity complies with such laws. Whether and on what terms a foreign corporation or a foreign other entity is authorized to merge with a domestic corporation is a matter that is governed by the laws under which that corporation or other entity is organized or by which it is governed, not by chapter 11.

Nevertheless, certain provisions of chapter 11 have an indirect effect on a foreign corporation or foreign other entity that proposes to or does merge with a domestic corporation, because they set conditions concerning the effectiveness and effect of the merger. For example, section 11.02(c) sets forth certain requirements for the contents of a plan of merger. This section is directly applicable only to domestic corporations, but has an indirect effect on a foreign corporation or other entity that is a party to a proposed merger with a domestic corporation.

In some cases, the impact of chapter 11 on a foreign corporation or foreign other entity is more direct. For example, section 11.07(d) provides that upon a merger becoming effective, a foreign corporation or foreign other entity that is the survivor of the merger is deemed to appoint the secretary of state as its agent for service of process in a proceeding to enforce the rights of shareholders of each domestic corporation that is a party to the merger to exercise appraisal rights and to agree that it will promptly pay to such shareholders the amount, if any, to which they are entitled under chapter 13.

If the law under which a domestic other entity is organized does not expressly authorize it to merge with a domestic business corporation, it is intended that section 11.02(a) will provide the necessary authority. Until such time as the various laws governing the organization of each form of eligible entity have been amended to provide procedures for adopting and approving a plan of merger, subsection (b.1) provides those procedures by reference to the provisions of this subchapter applicable to domestic business corporations.

3. Terms and Conditions of Merger

Chapter 11 imposes virtually no restrictions or limitations on the terms and conditions of a merger, except for those set forth in section 11.02(e) concerning provisions in a plan of merger for amendment of the plan after it has been approved by shareholders. Owners of shares or eligible interests in a party to the merger that merges into the survivor may receive shares or other securities of the survivor, shares or other securities of a party other than the survivor, interests, obligations, rights to acquire shares, or other securities, cash, or other property. The capitalization of the survivor may be restructured in the merger, and its articles or organizational documents may be amended by the articles of merger, in any way deemed appropriate.

Although chapter 11 imposes virtually no restrictions or limitations on the terms or conditions of a merger, section 11.02(c) requires that the terms and conditions be set forth in the plan of merger. The present Act clarifies that the plan of merger need not be set forth in the articles of merger that are to be delivered to the secretary of state for filing after the merger has been adopted and approved. See section 11.06.

Section 11.02(c)(4) provides that a plan of merger must set forth the articles of incorporation of any corporation, and the organizational documents of any other entity, to be created by the merger, or if a new corporation or other entity is not to be created by the merger, any amendments to the survivor's articles of incorporation or organizational documents. If a domestic corporation is merged into an existing domestic or foreign corporation or other entity, section 11.02(c) does not require that the survivor's articles of incorporation or organizational documents be included in the plan of merger. However, if approval of the plan of merger by the shareholders of a domestic corporation to be merged into another party to the merger is required under section 11.04, section 11.04(d) requires that the shareholders be furnished with a copy or summary of those articles of incorporation or organizational documents in connection with voting on approval of the merger.

The list in section 11.02(c) of required provisions in a plan of merger is not exhaustive and the plan may include any other provisions that may be desired.

4. Amendments of Articles of Incorporation

Under section 11.02, a corporation's articles of incorporation may be amended by a merger. Under section 11.02(c)(4), a plan of merger must include any amendments to the survivor's articles of incorporation or organizational documents. If the plan of merger is approved, the amendments will be effective.

5. Adoption and Approval; Abandonment

A merger must be adopted and approved as set forth in sections 11.04 and 11.05. Under section 11.08, the board of directors may abandon a merger before its effective date even if the plan of merger has already been approved by the corporation's shareholders.

6. Effective Date of Merger

A merger takes effect on the date the articles of merger are filed, unless a later date, not more than 90 days after filing, is specified in the articles. See section 11.06 and the Official Comment thereto.

7. Appraisal Rights

Shareholders of a domestic corporation that is a party to a merger may have appraisal rights. See chapter 13.

8. Protection of Restricted Property

This section permits a nonprofit corporation or unincorporated nonprofit association to merge into a for-profit corporation or unincorporated entity. The laws of some states governing the nondiversion of charitable and trust property to other uses may not be worded in a fashion that will cover a merger under section 11.02. To prevent a merger from being used to avoid restrictions on the use of property held by nonprofit entities, optional section 11.02(f) may be used to require approval of mergers by the appropriate arm of government having supervision of nonprofit entities.

§ 11.03 Share Exchange

(a) Through a share exchange:

(1) a domestic corporation may acquire all of the shares of one or more classes or series of shares of another domestic or foreign corporation, or all of the interests of one or more classes or series of interests of a domestic or foreign other entity, in exchange for shares or other securities, interests, obligations, rights to acquire shares or other securities, cash, other property, or any combination of the foregoing, pursuant to a plan of share exchange, or

(2) all of the shares of one or more classes or series of shares of a domestic corporation may be acquired by another domestic or foreign corporation or other entity, in exchange for shares or other securities, interests, obligations, rights to acquire shares or other securities, cash, other property, or any combination of the foregoing, pursuant to a plan of share exchange.

(b) A foreign corporation or eligible entity may be a party to a share exchange only if the share exchange is permitted by the organic law of the corporation or other entity.

(b.1) If the organic law of a domestic other entity does not provide procedures for the approval of a share exchange, a plan of share exchange may be adopted and approved, and the share exchange effectuated, in accordance with the procedures, if any, for a merger. If the organic law of a domestic other entity does not provide procedures for the approval of either a share exchange or a merger, a plan of share exchange may be adopted and approved, the share exchange effectuated, and appraisal rights exercised, in accordance with the procedures in this chapter and chapter 13. For the purposes of applying this chapter and chapter 13:

(1) the other entity, its interest holders, interests and organic documents taken together shall be deemed to be a domestic business corporation, shareholders, shares and articles of incorporation, respectively and vice versa as the context may require; and

(2) if the business and affairs of the other entity are managed by a group of persons that is not identical to the interest holders, that group shall be deemed to be the board of directors.

(c) The plan of share exchange must include:

(1) the name of each corporation or other entity whose shares or interests will be acquired and the name of the corporation or other entity that will acquire those shares or interests;

(2) the terms and conditions of the share exchange;

(3) the manner and basis of exchanging shares of a corporation or interests in an other entity whose shares or interests will be acquired under the share exchange into shares or other securities, interests, obligations, rights to acquire shares, other securities, or interests, cash, other property, or any combination of the foregoing; and

(4) any other provisions required by the laws under which any party to the share exchange is organized or by the articles of incorporation or organic document of any such party.

(d) Terms of a plan of share exchange may be made dependent on facts objectively ascertainable outside the plan in accordance with section 1.20(k).

(e) The plan of share exchange may also include a provision that the plan may be amended prior to filing articles of share exchange, but if the shareholders of a domestic corporation that is a party to the share exchange are required or permitted to vote on the plan, the plan must provide that subsequent to approval of the plan by such shareholders the plan may not be amended to change:

(1) the amount or kind of shares or other securities, interests, obligations, rights to acquire shares, other securities or interests, cash, or other property to be issued by the corporation or to be received under the plan by the shareholders of or owners of interests in any party to the share exchange; or

(2) any of the other terms or conditions of the plan if the change would adversely affect such shareholders in any material respect.

(f) Section 11.03 does not limit the power of a domestic corporation to acquire shares of another corporation or interests in another entity in a transaction other than a share exchange.

OFFICIAL COMMENT

1. In General

It is often desirable to structure a corporate combination so that the separate existence of one or more parties to the combination does not cease although another corporation or eligible entity obtains ownership of the shares or eligible interests of those parties. This objective is often particularly important in the formation of insurance and bank holding companies, but is not limited to those contexts. In the absence of the procedure authorized in section 11.03, this kind of result often can be accomplished only by a triangular merger, which involves the formation by a corporation, A, of a new subsidiary, followed by a merger of that subsidiary into another party to the merger, B, effected through the exchange of A's securities for securities of B. Section 11.03 authorizes a more straightforward procedure to accomplish the same result.

Under section 11.03, the acquiring corporation in a share exchange must acquire all of the shares or interests of the class or series of shares or interests that is being acquired. The shares or interests of one or more other classes or series of the acquired corporation or other entity may be excluded from the share exchange or may be included on different bases. After the plan of share exchange is adopted and approved as required by section 11.04, it is binding on all holders of the class or series to be acquired. Accordingly, a share exchange may operate in a mandatory fashion on some holders of the class or series of shares or interests acquired.

Section 11.03(f) makes clear that the authorization of share exchange combinations under section 11.03 does not limit the power of corporations to acquire shares or interests without using the share-exchange procedure, either as part of a corporate combination or otherwise.

In contrast to mergers, the articles of incorporation of a party to a share exchange may not be amended by a plan of share exchange. Such an amendment may, however, be effected under chapter 10 as a separate element of a corporate combination that involves a share exchange.

2. Applicability

Whether and on what terms a foreign corporation or a foreign other entity is authorized to enter into a share exchange with a domestic corporation is a matter that is governed by the laws under which that corporation or other entity is organized or by which it is governed, not by chapter 11. Therefore, for example, section 11.04, which governs the manner in which a plan of share exchange must be adopted, applies only to adoption of a plan of share exchange by a domestic corporation.

Nevertheless, certain provisions of chapter 11 have an indirect effect on a foreign corporation or foreign other entity that proposes to or does engage in a share exchange with a domestic corporation, because they set conditions concerning the effectiveness and effect of the share exchange. For example, section 11.03(c) sets forth certain requirements for the contents of a plan of share exchange. This section is directly applicable only to domestic corporations, but has an indirect effect on a foreign corporation or foreign other entity that is a party to a proposed share exchange with a domestic corporation.

If the law under which a domestic other entity is organized does not expressly authorize it to participate in a share (or interest) exchange with a domestic corporation, it is intended that section 11.03(a) will provide the necessary authority. Until such time as the various laws governing the organization of each form of entity have been amended to provide procedures for adopting and approving a plan of share (or interest) exchange, subsection (b.1) provides those procedures by reference to the provisions of this subchapter applicable to domestic business corporations.

3. Terms and Conditions of Share Exchange

Chapter 11 imposes virtually no restrictions or limitations on the terms or conditions of a share exchange, except for those contained in section 11.03(e) concerning provisions in a plan of share exchange for amendment of the plan after it has been approved by shareholders, and the requirement in section 11.03(a) that the acquiring party must acquire all the shares of the acquired class or series of stock or interests. Owners of shares or interests in a party whose shares are acquired under section 11.03(a)(2) may receive securities or interests of the acquiring party, securities or eligible interests of a party other than the acquiring party, or cash or other property.

Although chapter 11 imposes virtually no restrictions or limitations on the terms or conditions of a share exchange, section 11.03(c) requires that the terms and conditions be set forth in the plan of share exchange. The present Act clarifies that the plan of share exchange need not be set forth in the articles of share exchange that are to be delivered to the secretary of state for filing after the share exchange has been adopted and approved. See section 11.06.

The list in section 11.03(c) of required provisions in a plan of share exchange is not exhaustive and the plan may include any other provisions that may be desired.

4. Adoption and Approval; Abandonment

A share exchange must be adopted and approved as set forth in section 11.04. Under section 11.08, the board of directors may abandon a share exchange before its effective date even if the plan of share exchange has already been approved by the corporation's shareholders.

5. Effective Date of Share Exchange

A share exchange takes effect on the date the articles of share exchange are filed, unless a later date, not more than 90 days after filing, is specified in the articles. See section 11.06 and the Official Comment thereto.

6. Appraisal Rights

Holders of a class or series of shares of a domestic corporation that is acquired in a share exchange may have appraisal rights. See chapter 13.

§ 11.04 Action on a Plan of Merger or Share Exchange

In the case of a domestic corporation that is a party to a merger or share exchange:

(a) The plan of merger or share exchange must be adopted by the board of directors.

(b) Except as provided in subsection (g) and in section 11.05, after adopting the plan of merger or share exchange the board of directors must submit the plan to the shareholders for their approval. The board of directors must also transmit to the shareholders a recommendation that the shareholders approve the plan, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, in which case the board of directors must transmit to the shareholders the basis for that determination.

(c) The board of directors may condition its submission of the plan of merger or share exchange to the shareholders on any basis.

(d) If the plan of merger or share exchange is required to be approved by the shareholders, and if the approval is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the plan is to be submitted for approval. The notice must state that the purpose, or one of the purposes, of the meeting is to consider the plan and must contain or be accompanied by a copy or summary of the plan. If the corporation is to be merged into an existing corporation or other entity, the notice shall also include or be accompanied by a copy or summary of the articles of incorporation or organizational documents of that corporation or other entity. If the corporation is to be merged into a corporation or other entity that is to be created pursuant to the merger, the notice shall include or be accompanied by a copy or a summary of the articles of incorporation or organizational documents of the new corporation or other entity.

(e) Unless the articles of incorporation, or the board of directors acting pursuant to subsection (c), requires a greater vote or a greater number of votes to be present, approval of the plan of merger or share exchange requires the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the plan exists, and, if any class or series of shares is entitled to vote as a separate group on the plan of merger or share exchange, the approval of each such separate voting group at a meeting at which a quorum of the voting group consisting of at least a majority of the votes entitled to be cast on the merger or share exchange by that voting group is present.

(f) Separate voting by voting groups is required:

(1) on a plan of merger, by each class or series of shares that:

(i) are to be converted under the plan of merger into other securities, interests, obligations, rights to acquire shares, other securities or interests, cash, other property, or any combination of the foregoing; or

(ii) would be entitled to vote as a separate group on a provision in the plan that, if contained in a proposed amendment to articles of incorporation, would require action by separate voting groups under section 10.04;

(2) on a plan of share exchange, by each class or series of shares included in the exchange, with each class or series constituting a separate voting group; and

(3) on a plan of merger or share exchange, if the voting group is entitled under the articles of incorporation to vote as a voting group to approve a plan of merger or share exchange.

(g) Unless the articles of incorporation otherwise provide, approval by the corporation's shareholders of a plan of merger or share exchange is not required if:

(1) the corporation will survive the merger or is the acquiring corporation in a share exchange;

(2) except for amendments permitted by section 10.05, its articles of incorporation will not be changed;

(3) each shareholder of the corporation whose shares were outstanding immediately before the effective date of the merger or share exchange will hold the same number of shares, with identical preferences, limitations, and relative rights, immediately after the effective date of change; and

(4) the issuance in the merger or share exchange of shares or other securities convertible into or rights exercisable for shares does not require a vote under section 6.21(f).

(h) If as a result of a merger or share exchange one or more shareholders of a domestic corporation would become subject to owner liability for the debts, obligations or liabilities of any other person or entity, approval of the plan of merger or share exchange shall require the execution, by each such shareholder, of a separate written consent to become subject to such owner liability.

OFFICIAL COMMENT

1. In General

Under section 11.04, a plan of merger or share exchange must be adopted by the board. Thereafter, the board must submit the plan to the shareholders for their approval, unless the conditions stated in section 11.04(g) or section 11.05 are satisfied. A plan of share exchange must always be approved by the shareholders of the class or series that is being acquired in a share exchange. Similarly, a plan of merger must always be approved by the shareholders of a corporation that is merged into another party in a merger, unless the corporation is a subsidiary and the merger falls within section 11.05. However, under section 11.04(g) approval of a plan of merger or share exchange by the shareholders of a surviving corporation in a merger or of an acquiring corporation in a share exchange is not required if the conditions stated in that section, including the fundamental rule of section 6.21(f), are satisfied.

Section 11.04(f) provides that a class or series has a right to vote on a plan of merger as a separate voting group if, pursuant to the merger, the class or series would be converted into other securities, eligible interests, obligations, rights to acquire shares, other securities or eligible interests, cash, or other property. A class or series also is entitled to vote as a separate voting group if the class or series would be entitled to vote as a separate group on a provision in the plan that, if contained in an amendment to the articles of incorporation, would require approval by that class or series, voting as a separate voting group, under section 10.04. Under this latter requirement, a class or series will be entitled to vote as a separate voting group if the terms of that class or series are being changed or the shares of that class or series are being converted into shares of any other class or series. Where the surviving entity is a foreign business corporation, it is not intended that immaterial changes in the terms of a class or series that conform to the usage of the laws of the foreign jurisdiction will alone create an entitlement to vote as a separate group.

Under section 10.04, and therefore under section 11.04(f), if a change that requires voting by separate voting groups affects two or more classes or two or more series in the same or a substantially similar way, the relevant classes or series vote together rather than separately, on the change. If separate voting by voting groups is required for a merger or a share exchange under section 11.04(f), it will not be excused by section 11.04(g). For the mechanics of voting where voting by voting groups is required under section 11.04(f), see sections 7.25 and 7.26 and the Official Comments thereto.

If a merger would amend the articles of incorporation in such a way as to affect the voting requirements on future amendments, the transaction must also be approved by the vote required by section 7.27.

2. Submission to the Shareholders

Section 11.04(b) requires the board of directors, after having adopted the plan of merger or share exchange, to submit the plan of merger or share exchange to the shareholders for approval, except as provided in subsection (g) and section 11.05. When submitting the plan of merger or share exchange the board of directors must make a recommendation to the shareholders that the plan be approved, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should make no recommendation. For example, the board or directors may make such a determination where there is not a sufficient number of directors free of a conflicting interest to approve the transaction or because the board of directors is evenly divided as to the merits of a transaction but is able to agree that shareholders should be permitted to consider the transaction. If the board of directors makes such a determination, it must describe the conflict of interest or special circumstances, and communicate the basis for the determination, when submitting the plan of merger or share exchange to the shareholders. The exception for conflicts of interest or other special circumstances is intended to be sparingly available. Generally, shareholders should not be asked to act on a merger or share exchange in the absence of a recommendation by the board of directors. The exception is not intended to relieve the board of directors of its duty to consider carefully the proposed transaction and the interests of shareholders.

Section 11.04(c) permits the board of directors to condition its submission of a plan of merger or share exchange on any basis. Among the conditions that a board might impose are that the plan will not be deemed approved (i) unless it is approved by a specified vote of the shareholders, or by one or more specified classes or series of shares, voting as a separate voting group, or by a specified percentage of disinterested shareholders or (ii) if shareholders holding more than a specified fraction of the outstanding shares assert appraisal rights. The board of directors is not limited to conditions of these types.

Section 11.04(d) provides that if the plan of merger or share exchange is required to be approved by the shareholders, and if the approval is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the plan is to be submitted. Requirements concerning the timing and content of a notice of meeting are set out in section 7.05. Section 11.04(d) does not itself require that notice be given to nonvoting shareholders where the merger is approved, without a meeting, by unanimous consent. However, that requirement is imposed by section 7.04(d).

3. Quorum and Voting

Section 11.04(e) provides that approval of a plan of merger or share exchange requires approval of the shareholders at a meeting at which a quorum consisting of a majority of the votes entitled to be cast on the plan exists and, if any class or series of shares are entitled to vote as a separate group on the plan, the approval of each such separate group at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the plan by that class or series exists. If a quorum is present, then under sections 7.25 and 7.26 the plan will be approved if more votes are cast in favor of the plan than against it by the voting group or separate voting groups entitled to vote on the plan. This represents a change from the Act's previous voting rule for mergers and share exchanges, which required approval by a majority of outstanding shares.

In lieu of approval at a shareholders' meeting, approval can be given by the consent of all the shareholders entitled to vote on the merger or share exchange, under the procedures set forth in section 7.04.

4. Abandonment of Merger or Share Exchange

Under section 11.08, the board of directors may abandon a merger or share exchange before its effective date even if the plan of merger or share exchange has already been approved by the corporation's shareholders.

5. Personal Liability of Shareholders

Section 11.04(h) applies only in situations where a shareholder is becoming subject to ''owner liability'' as defined in section 1.40(15C), for example, where a corporation is merging into a general partnership. Where an other entity whose interest holders have owner liability, such as a general partnership, is merging into a corporation, the effect of the transaction on the owner liability of the interest holders in the unincorporated entity will be determined by section 11.07(e).

§ 11.05 Merger Between Parent and Subsidiary or Between Subsidiaries

(a) A domestic parent corporation that owns shares of a domestic or foreign subsidiary corporation that carry at least 90 percent of the voting power of each class and series of the outstanding shares of the subsidiary that have voting power may merge the subsidiary into itself or into another such subsidiary, or merge itself into the subsidiary, without the approval of the board of directors or shareholders of the subsidiary, unless the articles of incorporation of any of the corporations otherwise provide, and unless, in the case of a foreign subsidiary, approval by the subsidiary's board of directors or shareholders is required by the laws under which the subsidiary is organized.

(b) If under subsection (a) approval of a merger by the subsidiary's shareholders is not required, the parent corporation shall, within ten days after the effective date of the merger, notify each of the subsidiary's shareholders that the merger has become effective.

(c) Except as provided in subsections (a) and (b), a merger between a parent and a subsidiary shall be governed by the provisions of chapter 11 applicable to mergers generally.

OFFICIAL COMMENT

Under section 11.05, if a parent owns 90 percent of the voting power of each class and series of the outstanding shares of a subsidiary that have voting power, the subsidiary may be merged into the parent or another such subsidiary, or the parent may be merged into the subsidiary, without the approval of the subsidiary's shareholders or board of directors, subject to certain informational and notice requirements. Approval by the subsidiary's shareholders is not required partly because if a parent already owns 90 percent or more of the voting power of each class and series of a subsidiary's shares, approval of a merger by the subsidiary's shareholders would be a foregone conclusion, and partly to facilitate the simplification of corporate structure where only a very small fraction of stock is held by outside shareholders. Approval by the subsidiary's board of directors is not required because if the parent owns 90 percent or more of the voting power of each class and series of the subsidiary's outstanding shares, the subsidiary's directors cannot be expected to be independent of the parent, so that the approval by the subsidiary's board of directors would also be a foregone conclusion. In other respects, mergers between parents and 90 percent owned subsidiaries are governed by the provisions of chapter 11.

Section 11.05 dispenses with approval by the board of directors or the shareholders of a subsidiary that is merged into the parent or another subsidiary if the conditions of the section are met. Section 11.05 does not in itself dispense with approval by the shareholders of the parent. Under section 11.04(g), a merger of the kind described in section 11.05 in which the subsidiary is merged upstream into the parent would usually not require approval of the parent's shareholders, because in such cases the parent's articles of incorporation are usually not affected by the merger and the parent usually does not issue stock carrying more than 20 percent of its voting power. If, however, a parent is merged downstream into the subsidiary, approval by the parent's shareholders would be required under section 11.04.

§ 11.06 Articles of Merger or Share Exchange

(a) After a plan of merger or share exchange has been adopted and approved as required by this Act, articles of merger or share exchange shall be executed on behalf of each party to the merger or share exchange by any officer or other duly authorized representative. The articles shall set forth:

(1) the names of the parties to the merger or share exchange;

(2) if the articles of incorporation of the survivor of a merger are amended, or if a new corporation is created as a result of a merger, the amendments to the survivor's articles of incorporation or the articles of incorporation of the new corporation;

(3) if the plan of merger or share exchange required approval by the shareholders of a domestic corporation that was a party to the merger or share exchange, a statement that the plan was duly approved by the shareholders and, if voting by any separate voting group was required, by each such separate voting group, in the manner required by this Act and the articles of incorporation;

(4) if the plan of merger or share exchange did not require approval by the shareholders of a domestic corporation that was a party to the merger or share exchange, a statement to that effect; and

(5) as to each foreign corporation or eligible entity that was a party to the merger or share exchange, a statement that the participation of the foreign corporation or eligible entity was duly authorized as required by the organic law of the corporation or eligible entity.

(b) Articles of merger or share exchange shall be delivered to the secretary of state for filing by the survivor of the merger or the acquiring corporation in a share exchange, and shall take effect on the effective date provided in section 1.23. Articles of merger or share exchange filed under this section may be combined with any filing required under the organic law of any domestic eligible entity involved in the transaction if the combined filing satisfies the requirements of both this section and the other organic law.

OFFICIAL COMMENT

The filing of articles of merger or share exchange makes the transaction a matter of public record. The requirements of filing are set forth in section 1.20. The effective date of the articles is the effective date of their filing, unless otherwise specified. Under section 1.23, a document may specify a delayed effective time and date, and if it does so the document becomes effective at the time and date specified, except that a delayed effective date may not be later than the 90th day after the date the document is filed.

If a merger or share exchange involves a domestic eligible entity whose organic law also requires a filing to effectuate the transaction, section 11.06(b) permits the filings under that organic law and this section to be combined so that only one document need be filed with the secretary of state.

§ 11.07 Effect of Merger or Share Exchange

(a) When a merger becomes effective:

(1) the corporation or eligible entity that is designated in the plan of merger as the survivor continues or comes into existence, as the case may be;

(2) the separate existence of every corporation or eligible entity that is merged into the survivor ceases;

(3) all property owned by, and every contract right possessed by, each corporation or eligible entity that merges into the survivor is vested in the survivor without reversion or impairment;

(4) all liabilities of each corporation or eligible entity that is merged into the survivor are vested in the survivor;

(5) the name of the survivor may, but need not be, substituted in any pending proceeding for the name of any party to the merger whose separate existence ceased in the merger;

(6) the articles of incorporation or organic documents of the survivor are amended to the extent provided in the plan of merger;

(7) the articles of incorporation or organic documents of a survivor that is created by the merger become effective; and

(8) the shares of each corporation that is a party to the merger, and the interests in an eligible entity that is a party to a merger, that are to be converted under the plan of merger into shares, eligible interests, obligations, rights to acquire securities, other securities, or eligible interests, cash, other property, or any combina-

tion of the foregoing, are converted, and the former holders of such shares or eligible interests are entitled only to the rights provided to them in the plan of merger or to any rights they may have under chapter 13 or the organic law of the eligible entity.

(b) When a share exchange becomes effective, the shares of each domestic corporation that are to be exchanged for shares, other securities, interests, obligations, rights to acquire shares or other securities, cash, other property, or any combination of the foregoing, are entitled only to the rights provided to them in the plan of share exchange or to any rights they may have under chapter 13.

(c) A person who becomes subject to owner liability for some or all of the debts, obligations or liabilities of any entity as a result of a merger or share exchange shall have owner liability only to the extent provided in the organic law of the entity and only for those debts, obligations and liabilities that arise after the effective time of the articles of merger or share exchange.

(d) Upon a merger becoming effective, a foreign corporation, or a foreign eligible entity, that is the survivor of the merger is deemed to:

(1) appoint the secretary of state as its agent for service of process in a proceeding to enforce the rights of shareholders of each domestic corporation that is a party to the merger who exercise appraisal rights, and

(2) agree that it will promptly pay the amount, if any, to which such shareholders are entitled under chapter 13.

(e) The effect of a merger or share exchange on the owner liability of a person who had owner liability for some or all of the debts, obligations or liabilities of a party to the merger or share exchange shall be as follows:

(1) The merger or share exchange does not discharge any owner liability under the organic law of the entity in which the person was a shareholder or interest holder to the extent any such owner liability arose before the effective time of the articles of merger or share exchange.

(2) The person shall not have owner liability under the organic law of the entity in which the person was a shareholder, member or interest holder prior to the merger or share exchange for any debt, obligation or liability that arises after the effective time of the articles of merger or share exchange.

(3) The provisions of the organic law of any entity for which the person had owner liability before the merger or share exchange shall continue to apply to the collection or discharge of any owner liability preserved by paragraph (1), as if the merger or share exchange had not occurred.

(4) The person shall have whatever rights of contribution from other persons are provided by the organic law of the entity for which the person had owner liability with respect to any owner liability preserved by paragraph (1), as if the merger or share exchange had not occurred.

OFFICIAL COMMENT

Under section 11.07(a), in the case of a merger the survivor and the parties that merge into the survivor become one. The survivor automatically becomes the owner of all real and personal property and becomes subject to all the liabilities, actual or contingent, of each party that is merged into it. A merger is not a conveyance, transfer, or assignment. It does not give rise to claims of reverter or impairment of title based on a prohibited conveyance, transfer or assignment. It does not give rise to a claim that a contract with a party to the merger is no longer in effect on the ground of nonassignability, unless the contract specifically provides that it does not survive a merger. All pending proceedings involving either the survivor or a party whose separate existence ceased as a result of the merger are continued. Under section 11.07(a)(5), the name of the survivor may be, but need not be, substituted in any pending proceeding for the name of a party to the merger whose separate existence ceased as a result of the merger. The substitution may be made whether the survivor is a complainant or a respondent, and may be made at the instance of either the survivor or an opposing party. Such a substitution has no substantive effect, because whether or not the survivor's name is substituted it succeeds to the claims of, and is subject to the liabilities of, any party to the merger whose separate existence ceased as a result of the merger.

In contrast to a merger, a share exchange does not in and of itself affect the separate existence of the parties, vest in the acquiring party the assets of the party whose stock or eligible interests are to be acquired, or render the acquiring party liable for the liabilities of the party whose stock or eligible interests the acquiring party acquires.

Under section 11.07(a)(8), on the effective date of a merger the former shareholders of a corporation that is merged into the survivor are entitled only to the rights provided in the plan of merger (which would include any rights they have as holders of the consideration they acquire) or to any rights they may have under chapter 13. Similarly, under section 11.07(b), on the effective date of a share exchange the former shareholders of a corporation whose shares are acquired are entitled only to the rights provided in the plan of share exchange (which would include any rights they have as holders of the consideration they acquire) or to any rights they may have under chapter 13. These provisions are not intended to preclude an otherwise proper question concerning the merger's validity, or to override or otherwise affect any provisions of chapter 13 concerning the exclusiveness of rights under that chapter.

Under section 11.07(d), when a merger becomes effective a foreign corporation or a foreign other entity that is the survivor of the merger is deemed to appoint the secretary of state as its agent for service of process in a proceeding to enforce the rights of any shareholders of each domestic corporation that is a party to the merger who exercise appraisal rights, and to agree that is will promptly pay the amount, if any, to which such shareholders are entitled under chapter 13. This result is based on the implied consent of such a foreign corporation or foreign other entity to the terms of chapter 11 by virtue of entering into an agreement that is governed by this chapter.

Section 11.07(e) preserves liability only for owner liabilities to the extent they arise before the merger or share exchange. Owner liability is not preserved for subsequent changes in an underlying liability, regardless of whether a change is voluntary or involuntary.

Under section 11.04(h), a merger cannot have the effect of making any shareholder of a domestic corporation subject to owner liability for the debts, obligations or liabilities of any other person or entity unless each such shareholder has executed a separate written consent to become subject to such owner liability.

This section does not address the issue that could arise in a merger where a person who had authority to bind a party to the merger loses that authority because of the merger and yet purports to act to bind the survivor of the merger. For example, in a merger of a general partnership into a corporation, a person who is a general partner but does not become an officer of the corporation will lose the authority of a general partner to bind the business to obligations incurred in the ordinary course, but might purport to commit the corporation to such an obligation in dealing with a person who does not have knowledge of the merger. Instances in which this occurs are rare and, in the limited instances in which it does occur, general principles of agency law are sufficient to resolve the problems created.

§ 11.08 Abandonment of a Merger or Share Exchange

(a) Unless otherwise provided in a plan of merger or share exchange or in the laws under which a foreign business corporation or a domestic or foreign eligible entity that is a party to a merger or a share exchange is organized or by which it is governed, after the plan has been adopted and approved as required by this chapter, and at any time before the merger or share exchange has become effective, it may be abandoned by a domestic business corporation that is a party thereto without action by its shareholders, in accordance with any procedures set forth in the plan of merger or share exchange or, if no such procedures are set forth in the plan, in the manner determined by the board of directors, subject to any contractual rights of other parties to the merger or share exchange.

(b) If a merger or share exchange is abandoned under subsection (a) after articles of merger or share exchange have been filed with the secretary of state but before the merger or share exchange has become effective, a statement that the merger or share exchange has been abandoned in accordance with this section, executed on behalf of a party to the merger or share exchange by an officer or other duly authorized representative, shall be delivered to the secretary of state for filing prior to the effective date of the merger or share exchange. Upon filing, the statement shall take effect and the merger or share exchange shall be deemed abandoned and shall not become effective.

OFFICIAL COMMENT

Under section 11.08, unless otherwise provided in the plan of merger or share exchange, a domestic business corporation that is a party to a merger or share exchange may abandon the transaction without shareholder approval, even though the transaction has been previously approved by the shareholders. The power under section 11.08 to abandon a transaction without shareholder approval does not affect any contract rights that other parties may have. The power of a foreign business corporation or a domestic or foreign eligible entity to abandon a transaction will be determined by the organic law of the corporation or eligible entity, except as provided in sections 11.02(b.1) and 11.03(b.1).

CHAPTER 12. DISPOSITION OF ASSETS

§ 12.01 Disposition of Assets Not Requiring Shareholder Approval

No approval of the shareholders of a corporation is required, unless the articles of incorporation otherwise provide:

(1) to sell, lease, exchange, or otherwise dispose of any or all of the corporation's assets in the usual and regular course of business;

(2) to mortgage, pledge, dedicate to the repayment of indebtedness (whether with or without recourse), or otherwise encumber any or all of the corporation's assets, whether or not in the usual and regular course of business;

(3) to transfer any or all of the corporation's assets to one or more corporations or other entities all of the shares or interests of which are owned by the corporation; or

(4) to distribute assets pro rata to the holders of one or more classes or series of the corporation's shares.

OFFICIAL COMMENT

Section 12.01 provides that no approval of the shareholders is required for dispositions of assets of the types described therein, unless the articles of incorporation otherwise provide. Dispositions other than those described in section 12.01 require shareholder approval if they fall within section 12.02.

Under subsection (1), shareholder approval is not required for a disposition of the corporation's assets in the usual and regular course of business, regardless of the size of the transaction. Examples of such dispositions would include the sale of a building that was the corporation's only major asset where the corporation was formed for the purpose of constructing and selling that building, or the sale by a corporation of its only major business where the corporation was formed to buy and sell businesses and the proceeds of the sale are to be reinvested in the purchase of a new business, or an open or closed end investment company whose portfolio turns over many times in short periods.

Subsection (3) provides that no approval of shareholders is required to transfer any or all of the corporation's assets to a wholly owned subsidiary or other entity. This provision may not be used as a device to avoid a vote of shareholders by a multi-step transaction.

Subsection (4) provides that no approval of the shareholders is required to distribute assets pro rata to the holders of one or more classes of the corporation's shares. A traditional spin-off—that is, a pro rata distribution of the shares of a subsidiary to the holders of one or more classes of shares—falls within this subsection. A split-off that is, a non pro rata distribution of shares of a subsidiary to some or all shareholders in exchange for some of their shares would require shareholder approval if the disposition left the parent without a significant continuing business activity under subsection 12.02(a). A split-up—that is, a distribution of the shares of two or more subsidiaries in complete liquidation to shareholders—would be governed by section 14.02 (dissolution), not by chapter 12. In each of the foregoing situations, the subsidiary or subsidiaries could be historical or newly created.

§ 12.02 Shareholder Approval of Certain Dispositions

(a) A sale, lease, exchange, or other disposition of assets, other than a disposition described in section 12.01, requires approval of the corporation's shareholders if the disposition would leave the corporation without a significant continuing business activity. If a corporation retains a business activity that represented at least 25 percent of total assets at the end of the most recently completed fiscal year, and 25 percent of either income from continuing operations before taxes or revenues from continuing operations for that fiscal year, in each case of the corporation and its subsidiaries on a consolidated basis, the corporation will conclusively be deemed to have retained a significant continuing business activity.

(b) A disposition that requires approval of the shareholders under subsection (a) shall be initiated by a resolution by the board of directors authorizing the disposition. After adoption of such a resolution, the board of directors shall submit the proposed disposition to the shareholders for their approval. The board of directors shall also transmit to the shareholders a recommendation that the shareholders approve the proposed disposition, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, in which case the board of directors shall transmit to the shareholders the basis for that determination.

(c) The board of directors may condition its submission of a disposition to the shareholders under subsection (b) on any basis.

(d) If a disposition is required to be approved by the shareholders under subsection (a), and if the approval is to be given at a meeting, the corporation shall notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the disposition is to be submitted for approval. The notice shall state that the purpose, or one of the purposes, of the meeting is to consider the disposition and shall contain a description of the disposition, including the terms and conditions thereof and the consideration to be received by the corporation.

(e) Unless the articles of incorporation or the board of directors acting pursuant to subsection (c) requires a greater vote, or a greater number of votes to be present, the approval of a disposition by the shareholders shall require the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the disposition exists.

(f) After a disposition has been approved by the shareholders under subsection (b), and at any time before the disposition has been consummated, it may be abandoned by the corporation without action by the shareholders, subject to any contractual rights of other parties to the disposition.

(g) A disposition of assets in the course of dissolution under chapter 14 is not governed by this section.

(h) The assets of a direct or indirect consolidated subsidiary shall be deemed the assets of the parent corporation for the purposes of this section.

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1. In General

Section 12.02(a) requires shareholder approval for a sale, lease, exchange or other disposition by a corporation that would leave the corporation without a significant continuing business activity. The test employed in section 12.02(a) for whether a disposition of assets requires shareholder approval differs verbally from the test employed in past versions of the Model Act, which centered on whether a sale involves ''all or substantially all'' of a corporation's assets. The ''all or substantially all'' test has also been used in most corporate statutes. In practice, however, courts interpreting these statutes have commonly employed a test comparable to that embodied in 12.02(a). For example, in Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch.), aff'd, 316 A.2d 619 (Del. 1974), the court stated that ''While it is true that [the all or substantially all] test does not lend itself to a strict mathematical standard to be applied in every case, the qualitative factor can be defined to some degree.... If the sale is of assets quantitatively vital to the operation of the corporation and is out of the ordinary [course] and substantially affects the existence and purpose of the corporation then it is beyond the power of the Board of Directors.'' In Thorpe v. Cerbco, Inc., 676 A.2d 436 (Del. 1996), a major issue was whether the sale by a corporation, CERBCO, of one of its subsidiaries, East, would have been a sale of all or substantially all of the corporation's assets, and therefore would have required shareholder approval under the Delaware statute. The court, quoting Oberly v. Kirby, 592 A.2d 445 (Del. 1991), stated:

> ''[T]he rule announced in Gimbel v. Signal Cos., Del. Ch., 316 A.2d 599, aff'd, Del. Supr., 316 A.2d 619 (1974), makes it clear that the need for shareholder ... approval is to be measured not by the size of a sale alone, but also by its qualitative effect upon the corporation. Thus, it is relevant to

> ask whether a transaction 'is out of the ordinary and substantially affects the existence and purpose of the corporation.' [Gimbel, 316 A.2d] at 606.''
>
> In the opinion below, the Chancellor determined that the sale of East would constitute a radical transformation of CERBCO. In addition, CERBCO's East stock accounted for 68 [percent] of CERBCO's assets in 1990 and this stock was its primary income generating asset. We therefore affirm the decision that East stock constituted ''substantially all'' of CERBCO's assets as consistent with Delaware law.

See also Katz v. Bregman, 431 A.2d 1274 (Del. Ch.), appeal refused sub nom. Plant Industries, Inc. v. Katz, 435 A.2d 1044 (Del. 1981); Stiles v. Aluminum Products Co., 338 Ill. App. 48, 86 N.E.2d 887 (1949); Campbell v. Vose, 515 F.2d 256 (10th Cir. 1975); South End Improvement Group, Inc. v. Mulliken, 602 So. 2d 1327 (Fla. App. 1992); Schwadel v. Uchitel, 455 So. 2d 401 (Fla. App. 1984).

Whether a disposition leaves a corporation with a significant continuing business activity, within the meaning of section 12.02(a), depends primarily on whether the corporation will have a remaining business activity that is significant when compared to the corporation's business prior to the disposition. The addition of a safe harbor, embodied in the second sentence of section 12.02(a), under which a significant business activity exists if the continuing business activity represented at least 25 percent of the total assets and 25 percent of either income from continuing operations before income taxes or revenues from continuing operations, in each case of the company and its subsidiaries on a consolidated basis for the most recent full fiscal year, the corporation will conclusively be deemed to have retained a significant continuing business activity, represents a policy judgment that a greater measure of certainty than is provided by interpretations of the current case law is highly desirable. The application of this brightline safe harbor test should, in most cases, produce a reasonably clear result substantially in conformity with the approaches taken in the better case law developing the ''quantitative'' and ''qualitative'' analyses. The test is to be applied to assets, revenue, and income for the most recent fiscal year ended immediately before the decision to make the disposition in question.

If a corporation disposes of assets for the purpose of reinvesting the proceeds of the disposition in substantially the same business in a somewhat different form (for example, by selling the corporation's only plant for the purpose of buying or building a replacement plant), the disposition and reinvestment should be treated together, so that the transaction should not be deemed to leave the corporation without a significant continuing business activity.

In determining whether a disposition would leave a corporation without a significant continuing business activity, the term ''the corporation'' includes subsidiaries that are or should be consolidated with the parent under generally accepted accounting principles. Accordingly, if, for example, a corporation's only significant business is owned by a wholly or almost wholly owned subsidiary, a sale of that business requires approval of the parent's shareholders under section 12.02. See Schwadel v. Uchitel, 455 So. 2d 401 (Fla. App. 1984). Correspondingly, if a corporation owns one significant business directly, and several other significant businesses through one or more wholly or almost wholly owned subsidiaries, a sale by the corporation of the single business it owns directly does not require shareholder approval under section 12.02.

If all or a large part of a corporation's assets are held for investment, the corporation actively manages those assets, and it has no other significant business, for purposes of the statute the corporation should be considered to be in the business of investing in such assets, so that a sale of most of those assets without a reinvestment should be considered a sale that would leave the corporation without a significant continuing business activity. In applying the 25 percent tests of section 12.02(a), an issue could arise if a corporation had more than one business activity, one or more of which might be traditional operating activities such as manufacturing or distribution, and another of which might be considered managing investments in other securities or enterprises. If the activity constituting the management of investments is to be a continuing business activity as a result of the active engagement of the management of the corporation in that process, and the 25 percent tests were met upon the disposition of the other businesses, shareholder approval would not be required.

As under section 6.40(d) (determination of whether a dividend is permissible), and for the same reasons, the board of directors may base a determination that a retained continuing business falls within the 25 percent brightline tests of the safe harbor embodied in the second sentence of section 12.02(a) either on accounting principles and practices that are reasonable in the circumstances or (in applying the asset test) on a fair valuation or other method that is reasonable in the circumstances. See section 6.40(d) and Comment 4 thereto.

The utilization of the term ''significant,'' and the specific 25 percent safe harbor test for purposes of this section, should not be read as implying a standard for the test of significance or materiality for any other purposes under the Act or otherwise.

2. Submission to Shareholders

Section 12.02(b) requires the board of directors, after having adopted a resolution authorizing a disposition that requires shareholder approval, to submit the disposition to the shareholders for approval. When submitting the disposition to the shareholders, the board of directors must make a recommendation to the shareholders that the disposition be approved, unless the board makes a determination that because of conflicts of interests or other special circumstances it should make no recommendation. For example, the board of directors may make such a determination where there is not a sufficient number of directors free of a conflicting interest to approve the transaction or because the board of directors is evenly divided as to the merits of a transaction but is able to agree that shareholders should be permitted to consider the transaction. If the board of directors makes such a determination, it must describe the conflicts of interests or special circumstances, and communicate the basis for the determination, when submitting the disposition to the shareholders. The exception for conflicts of interest or other special circumstances is intended to be sparingly available. Generally, shareholders should not be asked to act on a disposition in the absence of a recommendation by the board of directors. The exception is not intended to relieve the board of directors of its duty to consider carefully the proposed transaction and the interests of shareholders.

Section 12.02(c) permits the board of directors to condition its submission of a proposed disposition to the shareholders. Among the conditions that board might impose are that the disposition will not be deemed approved: (i) unless it is approved by a specified percentage of the shareholders, or by one or more specified classes or series of shares, voting as a separate voting group, or by a specified percentage of disinterested shareholders, or (ii) if shareholders holding more than a specified fraction of the outstanding shares assert appraisal rights. The board of directors is not limited to conditions of these types.

3. Quorum and Voting

Section 12.02(e) provides that approval of a plan of merger or share exchange requires approval of the shareholders at a meeting at which at least a majority of the votes entitled to be cast on the plan is present, including, if any class or series of shares are entitled to vote as a separate group on the plan, the approval of each such separate group at a meeting at which a similar quorum of the voting group exists. If a quorum is present, then under sections 7.25 and 7.26 the plan will be approved if more votes are cast in favor of the plan than against it by the voting group or separate voting groups entitled to vote on the plan. This represents a change from the Act's previous voting rule, which required approval by a majority of outstanding shares.

In lieu of approval at a shareholders' meeting, approval can be given by the consent of all the shareholders entitled to vote on the merger or share exchange, under the procedures set forth in section 7.04.

4. Appraisal Rights

Shareholders of a domestic corporation that engages in a disposition that requires shareholder approval under section 12.02 may have appraisal rights. See chapter 13.

5. Subsidiaries

The term ''subsidiary'' or ''subsidiaries,'' as used in section 12.02, includes both corporate and noncorporate subsidiaries. Accordingly, for example, a limited liability company or a partnership may be a subsidiary for purposes of section 12.02.

CHAPTER 13. APPRAISAL RIGHTS

SUBCHAPTER A. RIGHT TO APPRAISAL AND PAYMENT FOR SHARES

§ 13.01 Definitions

In this chapter:

(1) ''Affiliate'' means a person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with another person or is a senior executive thereof For purposes of section 13.02(b)(4), a person is deemed to be an affiliate of its senior executives.

(2) ''Beneficial shareholder'' means a person who is the beneficial owner of shares held in a voting trust or by a nominee on the beneficial owner's behalf

(3) ''Corporation'' means the issuer of the shares held by a shareholder demanding appraisal and, for matters covered in sections 13.22–13.31, includes the surviving entity in a merger.

(4) ''Fair value'' means the value of the corporation's shares determined:

(i) immediately before the effectuation of the corporate action to which the shareholder objects;

(ii) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal; and

(iii) without discounting for lack of marketability or minority status except, if appropriate, for amendments to the articles pursuant to section 13.02(a)(5).

(5) ''Interest'' means interest from the effective date of the corporate action until the date of payment, at the rate of interest on judgments in this state on the effective date of the corporate action.

(5.1) ''Interested transaction'' means a corporate action described in section 13.02(a), other than a merger pursuant to section 11.05, involving an interested person in which any of the shares or assets of the corporation are being acquired or converted. As used in this definition:

(i) ''Interested person'' means a person, or an affiliate of a person, who at any time during the one-year period immediately preceding approval by the board of directors of the corporate action:

(A) was the beneficial owner of 20 percent or more of the voting power of the corporation, excluding any shares acquired pursuant to an offer for all shares having voting power if the offer was made within one year prior to the corporate action for consideration of the same kind and of a value equal to or less than that paid in connection with the corporate action;

(B) had the power, contractually or otherwise, to cause the appointment or election of 25 percent or more of the directors to the board of directors of the corporation; or

(C) was a senior executive or director of the corporation or a senior executive of any affiliate thereof, and that senior executive or director will receive, as a result of the corporate action, a financial benefit not generally available to other shareholders as such, other than:

(I) employment, consulting, retirement, or similar benefits established separately and not as part of or in contemplation of the corporate action; or

(II) employment, consulting, retirement, or similar benefits established in contemplation of, or as part of, the corporate action that are not more favorable than those existing before the corporate action or, if more favorable, that have been approved on behalf of the corporation in the same manner as is provided in section 8.62; or

(III) in the case of a director of the corporation who will, in the corporate action, become a director of the acquiring entity in the corporate action or one of its affiliates, rights and benefits as a director that are provided on the same basis as those afforded by the acquiring entity generally to other directors of such entity or such affiliate.

(ii) ''Beneficial owner'' means any person who, directly or indirectly, through any contract, arrangement, or understanding, other than a revocable proxy, has or shares the power to vote, or to direct the voting of, shares; except that a member of a national securities exchange is not deemed to be a beneficial owner of securities held directly or indirectly by it on behalf of another person solely because the member is the record holder of the securities if the member is precluded by the rules of the exchange from voting without instruction on contested matters or matters that may affect substantially the rights or privileges of the holders of the securities to be voted. When two or more persons agree to act together for the purpose of voting their shares of the corporation, each member of the group formed thereby is deemed to have acquired beneficial ownership, as of the date of the agreement, of all voting shares of the corporation beneficially owned by any member of the group.

(6) ''Preferred shares'' means a class or series of shares whose holders have preference over any other class or series with respect to distributions.

(7) ''Record shareholder'' means the person in whose name shares are registered in the records of the corporation or the beneficial owner of shares to the extent of the rights granted by a nominee certificate on file with the corporation.

(8) ''Senior executive'' means the chief executive officer, chief operating officer; chief financial officer; and anyone in charge of a principal business unit or function.

(9) ''Shareholder'' means both a record shareholder and a beneficial shareholder.

OFFICIAL COMMENT

1. Overview

Chapter 13 deals with the tension between the desire of the corporate leadership to be able to enter new fields, acquire new enterprises, and rearrange investor rights, and the desire of investors to adhere to the rights and the risks on the basis of which they invested. Contemporary corporation statutes in the United States attempt to resolve this tension through a combination of two devices, On the one hand, through their approval of an amendment to the articles of incorporation, a merger; share exchange or disposition of assets, the majority may change the nature and shape of the enterprise and the rights of all its shareholders. On the other hand, shareholders who object to these changes may withdraw the fair value of their investment in cash through their exercise of appraisal rights.

The traditional accommodation has been sharply criticized from two directions. From the viewpoint of investors who object to the transaction, the appraisal process is criticized for providing little help to the ordinary investor because its technicalities make its use difficult, expensive, and risky From the viewpoint of the corporate leadership, the appraisal process is criticized because it fails to protect the corporation from demands that are motivated by the hope of a nuisance settlement or by fanciful conceptions of value. See generally Bayless Manning, ''The Shareholders' Appraisal Remedy: An Essay for Frank Coker,'' 72 YALE L.J. 223 (1962).

Chapter 13 is a compromise between these opposing points of view. It is designed to increase the frequency with which assertion of appraisal rights leads to economical and satisfying solutions, and to decrease the frequency with which such assertion leads to delay, expense, and dissatisfaction. It seeks to achieve these goals primarily by simplifying and clarifying the appraisal process, as well as by motivating the parties to settle their differences in private negotiations without resort to judicial appraisal proceedings.

Chapter 13 proceeds from the premise that judicial appraisal should be provided by statute only when two conditions co-exist. First, the proposed corporate action as approved by the majority will result in a fundamental change in the shares to be affected by the action. Second, uncertainty concerning the fair value of the affected shares may cause reasonable persons to differ about the fairness of the terms of the corporate action. Uncertainty is greatly reduced, however; in the case of publicly-traded shares. This explains both the market exception described below and the limits provided to the exception.

Appraisal rights in connection with mergers and share exchanges under chapter 11 and dispositions of assets requiring shareholder approval under chapter 12 are provided when these two conditions co-exist. Each of these actions will result in a fundamental change in the shares that a disapproving shareholder may feel was not adequately compensated by the terms approved by the majority. Except for shareholders of a subsidiary corporation that is merged under section 11.05 (the ''short-form'' merger), only those shareholders who are entitled to vote on a transaction are entitled to appraisal rights. The linkage between voting and appraisal rights is justified because the right to a shareholder vote is a good proxy for assessing the seriousness of the change contemplated by the corporate action. This is especially true where the action triggers group-voting provisions.

Notwithstanding this linkage, amended chapter 13 eliminates appraisal for voting shareholders in several instances where it would have been available under the 1984 Act. Shareholders who are entitled to vote on a corporate action, whether because such shareholders have general voting rights or because group voting provisions are triggered, are not entitled to appraisal if the change will not alter the terms of the class or series of securities that they hold. Thus, statutory appraisal rights are not available for shares of any class of the surviving corporation in a merger or any class of shares that is not included in a share exchange. Appraisal is also not triggered by a voluntary dissolution under chapter 14 because that action does not affect liquidation rights—the only rights that are relevant following a shareholder vote to dissolve.

With the exception of reverse stock splits that result in cashing out some of the shares of a class or series, amended chapter 13 also eliminates appraisal in connection with all amendments to the articles of incorporation. This change in amended chapter 13 does not reflect a judgment that an amendment changing the terms of a particular class or series may not have significant economic effects. Rather; it reflects a judgment that distinguishing among different types of amendments for the purposes of statutory appraisal is necessarily arbitrary and thus may not accurately reflect the actual demand of shareholders for appraisal in specific instances. Instead, amended chapter 13 permits a high degree of private-ordering by delineating a list of transactions for which the corporation may voluntarily choose to provide appraisal and by permitting a provision in the articles of incorporation that eliminates, in whole or in part, statutory appraisal tights for preferred shares.

Chapter 13 also is unique in its approach to appraisal rights for publicly-traded shares; Approximately half of the general corporation statutes in the United States provide exceptions to appraisal for publicly-traded shares, on the theory that it is not productive to expose the corporation to the time, expense and cash drain imposed by appraisal demands when shareholders who are dissatisfied with the consideration offered in an appraisal-triggering transaction could sell their shares and obtain cash from the market. This exception to appraisal is generally known as the ''market-out'' and is referred to here as the ''market exception.'' Opponents of the market exception argue that it results in unfairness where neither the consideration offered in connection with the transaction nor the market price reflects the fair value of the shares, particularly if the corporate decision-makers have a conflict of interest.

Chapter 13 seeks to accommodate both views by providing a market exception that is limited to those situations where shareholders are likely to receive fair value when they sell their shares in the market after the announcement of an appraisal-triggering transaction. For the market exception to apply under chapter 13, there must first be a liquid market. Second, unique to chapter 13, the market exception does not apply in specified circumstances where the appraisal-triggering action is deemed to be a conflict-of-interest transaction.

2. Definitions

Section 13.01 contains specialized definitions applicable only to chapter 13.

Beneficial shareholder

The definition of ''beneficial shareholder'' means a person who owns the beneficial interest in shares; ''shares'' is defined in section 1.40(22) to include, without limitation, a holder of a depository receipt for shares. Similar definitions are found in section 7.40(2) (derivative proceedings) and section 16.02(1) (inspection of records by a shareholder). In the context of chapter 13, beneficial shareholder means a person having a direct economic interest in the shares. The definition is not intended to adopt the broad definition of beneficial ownership in SEC Rule 13d–2, which includes persons with a right to vote or dispose of the shares even though they have no economic interest in them. However; section 13.02(b)(5) includes the concept of the right to vote in determining whether the event represents a conflict transaction that renders the market exception unavailable.

Corporation

The definition of ''corporation'' in section 13.01(3) includes, for purposes of the post-transaction matters covered in section 13.22 through 13.31, a successor entity in a merger where the corporation is not the surviving entity. The definition does not include a domestic acquiring corporation in a share exchange or disposition of assets because the corporation whose shares or assets were acquired continues in existence in both of these instances and remains responsible for the appraisal obligations. Whether a foreign corporation or other form of domestic or foreign entity is subject to appraisal rights in connection with any of these transactions depends upon the corporation or other applicable law of the relevant jurisdiction.

Fair value

Subsection (i) of the definition of ''fair value'' in section 13.0 1(4) makes clear that fair value is to be determined immediately before the effectuation of the corporate action, rather than, as is the case under most state.statutes that address the issue, the date of the shareholders' vote. This comports with the purpose of this chapter to preserve the shareholder's prior rights as a shareholder until the effective date of the corporate action, rather than leaving the shareholder in an ambiguous state with neither rights as a shareholder nor perfected appraisal rights. The corporation and, as relevant, its shares are valued as they exist immediately before the effectuation of the corporate action requiring appraisal. Accordingly, section 13.01(4) permits consideration of changes in the market price of the corporation's shares in anticipation of the transaction, to the extent such changes are relevant. Similarly, in a two-step transaction culminating in a merger; the corporation is valued immediately before the second step merger; taking into account any interim changes in value. *Cf Cede* & *Co. v. Technicolor, Inc.,* 684 A.2d 289 (Del. 1996).

The definition of ''fair value'' in section 13.01(4) makes several changes from the prior version. The 1984 Model Act's definition of ''fair value'' was silent on how fair value was to be determined, except for a concluding clause that excluded from the valuation ''any appreciation or depreciation in anticipation of the corporate action, unless exclusion would be inequitable.'' The Official Comment provided that the section left to the courts ''the details by which 'fair value' is to be determined within the broad outlines of the definition.'' While the logic of the prior Official Comment continues to apply, the exclusionary clause in the prior Model Act definition, including the qualification for cases where the exclusion would be inequitable, has been deleted. Those provisions have not been susceptible to meaningful judicial interpretation and have been set aside in favor of the broader concept in subsection (ii).

The new formulation in paragraph (ii), which is patterned on section 7.22 of the Principles of Corporate Governance promulgated by the American Law Institute, directs courts to keep the methodology chosen in appraisal proceedings consistent with evolving economic concepts and adopts that part of section 7.22 which provides that fair value should be determined using ''customary valuation concepts and techniques generally employed . . . , for similar businesses in the context of the transaction requiring appraisal.'' Subsection (ii) adopts the accepted view that different transactions and different contexts may warrant different valuation methodologies. Customary valuation concepts and techniques will typically take into account numerous relevant factors, including assigning a higher valuation to corporate assets that would be more productive if acquired in a comparable transaction but excluding any element of value attributable to the unique synergies of the actual purchaser of the corporation or its assets. For example, if the corporation's assets include undeveloped real estate that is located in a prime commercial area, the court should consider the value that would be attributed to the real estate as commercial development property in a comparable transaction. The court should not, however; assign any additional value based upon the specific plans or special use of the actual purchaser.

Modern valuation methods will normally result in a range of values, not a particular single value. When a transaction falls within that range, ''fair value'' has been established. Absent unusual circumstances, it is expected that the consideration in an arm's-length transaction will fall within the range of ''fair value'' for purposes of section 13.01(4). Section 7.22 of the ALI Principles of Corporate Governance also provides that in situations that do not involve certain types of specified conflicts of interest, ''the aggregate price accepted by the board of directors of the subject corporation should be presumed to represent the fair value of the corporation, or of the assets sold in the case of an asset sale, unless the plaintiff can prove otherwise by clear and convincing evidence.'' That presumption has not been included in the definition of ''fair value m section 13.01(4) because the framework of defined types of conflict transactions which is a predicate for the ALI's presumption is not contained in the Model Act. Nonetheless, under section 13.01(4), a court determining fair value should give great deference to the aggregate consideration accepted or approved by a disinterested board of directors for an appraisal-triggering transaction.

Subsection (iii) of the definition of ''fair value'' establishes that valuation discounts for lack of marketability or minority status are inappropriate in most appraisal actions, both because most transactions that trigger appraisal rights affect the corporation as a whole and because such discounts give the majority the opportunity to take advantage of minority shareholders who have been forced against their will to accept the appraisal-triggering transaction. Subsection (iii), in conjunction with the lead-in language to the definition, is also designed to adopt the more modern view that appraisal should generally award a shareholder his or her proportional interest in the corporation after valuing the corporation as a whole, rather than the value of the shareholder's shares when valued alone. If, however; the corporation voluntarily grants appraisal tights for transactions that do not affect the entire corporation—such as certain amendments to the articles of incorporation—the court should use its discretion in applying discounts if appropriate. As the introductory clause of section 13.01 notes, the definition of ''fair value'' applies only to chapter 13. See the Official Comment to section 14.34 which recognizes that a minority discount may be appropriate under that section.

Interest

The definition of ''interest'' in section 13.01(5) is included to apprise the parties of their respective rights and obligations. The right to receive interest is based on the elementary consideration that the corporation, rather than the shareholder demanding appraisal, has the use of the shareholder's money from the effective date of the corporate action (when those shareholders who do not demand appraisal rights have the right to receive their consideration from the transaction) until the date of payment. Section 13.01(5) thus requires interest to be paid at the rate of interest on judgments from the effective date of the corporate action until the date of payment. The specification of the rate of interest on judgments, rather than a more subjective rate, eliminates a possible issue of contention and should facilitate voluntary settlements. Each state determines whether interest is compound or simple.

Interested Transaction

The term ''interested transaction'' addresses two groups of conflict transactions: those in section 13.01(5.1)(i)(A) and (B), which involve controlling shareholders; and those in section 13.01(5.1)(i)(C), which involve senior executives and directors. Regardless of which type of interested transaction may be involved, when a transaction fits within the definition of an interested transaction there are two consequences: the market out will not be applicable in situations where it would otherwise apply, and the exclusion of other remedies under section 13.40 will not be applicable unless certain disinterested approvals have been obtained.

Section 13.01(5.1)(i)(A) covers the acquisition or exchange of shares or assets of the corporation by a shareholder or an affiliate of the shareholder that could be considered controlling by virtue of ownership of a substantial amount of voting stock (20 percent). Section 13.01(5.1)(i)(B) covers the acquisition or exchange of shares or assets of the corporation by an individual or group, or by an affiliate of such individual or group, that has the ability to exercise control, through contract, stock ownership, or some other means, over at least one fourth of the board's membership. The definition of ''beneficial owner'' in section 13.01(5.1)(ii) serves to identify possible conflict situations by deeming each member of a group that agrees to vote in tandem to be a beneficial owner of all the voting shares owned by the group. In contract, the term ''beneficial shareholder,'' as defined in section 13.01(2), is used to identify those persons entitled to appraisal rights. The last portion of subsection (5.1)(i)(A) recognizes that an acquisition effected in two steps (a tender offer followed by a merger) within one year, where the two steps are either on the same terms or the second step is on terms that are more favorable to target shareholders, is properly considered a single transaction for purposes of identifying conflict transactions, regardless of whether the second-step merger is governed by sections 11.04 or 11.05.

A reverse split in which small shareholders are cashed out will constitute an interested transaction if there is a shareholder who satisfies the test in section 13.01(5.1)(i)(A) or (B). In that case, the corporation itself will be an affiliate of the large shareholder and thus within the concept of an ''interested person,'' such that when the corporation acquires the shares of the small shareholders being cashed out the acquisition will be an interested transaction.

Section 13.01(5.1)(i)(C) covers the acquisition or exchange of shares or assets of the corporation by a person, or an affiliate of a person, who is, or in the year leading up to the transaction was, a senior executive or director of the corporation. It applies to management buyouts because participation in the buyout group is itself ''a financial benefit not available to other shareholders as such.'' It also applies to transactions involving other types of economic benefits (in addition to benefits afforded to shareholders generally, as such) afforded to senior executives (as defined in section 13.01(8)) and directors in specified conflict situations, unless specific objective or procedural standards are met. Finally, it will apply to less common situations, such as where the vote of a director is manipulated by providing the director with special consideration to secure his or her vote in favor of the transaction. Section 13.01(1) specifically defines the term ''affiliate'' to include an entity of which a person is a senior executive. Due to this specialized definition, if a senior executive of the corporation is to continue and is to receive enumerated employment and other financial benefits after the transaction, exempting the transaction from the category of ''interested transactions'' will depend on meeting one of the three conditions specified in clauses (I), (II) and (III) of section 13.01(5.1)(i)(C):

- First, under section 13.01(5.1)(i)(C)(I), a transaction will not be considered an interested transaction if financial benefits that result from the transaction consist of employment, consulting, retirement or similar benefits established separately and not in contemplation of the transaction. For example, if an individual has an arrangement under which benefits will be triggered on a ''change of control,'' such as accelerated vesting of options, retirement benefits, deferred compensation and similar items, or is afforded the opportunity to retire or leave the employ of the enterprise with more favorable economic results than would be the case absent a change of control, the existence of these arrangements would not mean that the transaction is an interested transaction if the arrangements had been established as a general condition of the individual's employment or continued employment, rather than in contemplation of the particular transaction.

- Second, under section 13.01(5.1)(i)(C)(II), if such arrangements are established as part of, or as a condition of, the transaction, the transaction will still not be considered an interested transaction if the arrangements are either not more favorable than those already in existence or, if more favorable, are approved by ''qualified'' directors (i.e., meeting the standard of disinterestedness specified in section 1.43), in the same manner as provided for conflicting interest transactions generally with the corporation under section 8.62. This category would include arrangements with the corporation that have been negotiated as part of, or as a condition of, the transaction or arrangements with the acquiring company or one or more of its other subsidiaries.

- The third situation, delineated in section 13.01(5.1)(i)(C)(III), addresses a person who is a director of the issuer and, in connection with the transaction, is to become a director of the acquiring entity or its parent, or to continue as a director of the corporation when it becomes a subsidiary of the acquiring entity. In this situation, the transaction will not be considered an interested transaction as long as that person will not be treated more favorably as a director than are other persons who are serving in the same director positions.

Senior executive

The definition of ''senior executive'' in section 13.01(8) encompasses the group of individuals in control of corporate information and the day-to-day operations. An employee of a subsidiary organization is a ''senior executive'' of the parent if the employee is ''in charge of a principal business unit or function'' of the parent and its subsidiaries on a combined or consolidated basis.

Shareholder

The definition of ''shareholder'' in section 13.01(9) for purposes of chapter 13 differs from the definition of that term used elsewhere in the Model Act. Section 1.40(21) defines ''shareholder'' as used generally in the Act to mean only a ''record shareholder''; that term is specifically defined in section 13.01(7). Section 13.01(9), on the other hand, defines ''shareholder'' to include not only a ''record shareholder'' but also a ''beneficial shareholder;'' a term that is itself defined in section 13.01(2). The specially defined terms ''record shareholder'' and ''beneficial shareholder'' appear primarily in section 13.03, which establishes the manner in which beneficial shareholders, and record shareholders who are acting on behalf of beneficial shareholders, perfect appraisal rights. The word ''shareholder'' is used generally throughout chapter 13 in order to permit both record and beneficial shareholders to take advantage of the provisions of this chapter; subject to their fulfilling the applicable requirements of this chapter.

§ 13.02 Right to Appraisal

(a) A shareholder is entitled to appraisal rights, and to obtain payment of the fair value of that shareholder's shares, in the event of any of the following corporate actions:

(1) consummation of a merger to which the corporation is a party (i) if shareholder approval is required for the merger by section 11.04 and the shareholder is entitled to vote on the merger; except that appraisal rights shall not be available to any shareholder of the corporation with respect to shares of any class or series that remain outstanding after consummation of the merger; or (ii) if the corporation is a subsidiary and the merger is governed by section 11.05;

(2) consummation of a share exchange to which the corporation is a party as the corporation whose shares will be acquired if the shareholder is entitled to vote on the exchange, except that appraisal rights shall not be available to any shareholder of the corporation with respect to any class or series of shares of the corporation that is not exchanged;

(3) consummation of a disposition of assets pursuant to section 12.02 if the shareholder is entitled to vote on the disposition;

(4) an amendment of the articles of incorporation with respect to a class or series of shares that reduces the number of shares of a

class or series owned by the shareholder to a fraction of a share if the corporation has the obligation or right to repurchase the fractional share so created;

(5) any other amendment to the articles of incorporation, merger; share exchange or disposition of assets to the extent provided by the articles of incorporation, bylaws or a resolution of the board of directors;

(6) consummation of a domestication if the shareholder does not receive shares in the foreign corporation resulting from the domestication that have terms as favorable to the shareholder in all material respects, and represent at least the same percentage interest of the total voting rights of the outstanding shares of the corporation, as the shares held by the shareholder before the domestication;

(7) consummation of a conversion of the corporation to nonprofit status pursuant to subchapter 9C; or

(8) consummation of a conversion of the corporation to an unincorporated entity pursuant to subchapter 9E.

(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 the outstanding shares of such class or series has a market value of at least $20 million (exclusive of the value of such shares held by its subsidiaries, senior executives, directors and beneficial shareholders owning more than 10 percent of such shares).

(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.

(2) The applicability of subsection (b)(1) shall be determined as of:

(i) the record date fixed to determine the shareholders entitled to receive notice of and to vote at, the meeting of shareholders to act upon the corporate action requiring appraisal rights; or

(ii) the day before the effective date of such corporate action if there is no meeting of shareholders.

(3) Subsection (b)(1) shall not be applicable and appraisal rights shall be available pursuant to subsection (a) for the holders of any class or series of shares who are required by the terms of the corporate action requiring appraisal rights to accept for such shares anything other than cash. or shares of any class or any series of shares of any corporation, or any other proprietary interest of any other entity, that satisfies the standards set forth in subsection (b)(1) at the time the corporate action becomes effective.

(4) Subsection (b)(1) shall not be applicable and appraisal rights shall be available pursuant to subsection (a) for the holders of any class or series of shares where the corporate action is an interested transaction.

(c) Notwithstanding any other provision of section 13.02, the articles of incorporation as originally filed or any amendment thereto may limit or eliminate appraisal rights for any class or series of preferred shares, but any such limitation or elimination contained in an amendment to the articles of incorporation that limits or eliminates appraisal rights for any of such shares that are outstanding immediately prior to the effective date of such amendment or that the corporation is or may be required to issue or sell thereafter pursuant to any conversion, exchange or other right existing immediately before the effective date of such amendment shall not apply to any corporate action that becomes effective within one year of that date if such action would otherwise afford appraisal rights.

OFFICIAL COMMENT

1. Transactions Requiring Appraisal Rights

Section 13.02(a) establishes the scope of appraisal rights by identifying those transactions which afford this right. In view of the significant degree of private ordering permitted by section 13.02(a)(5), the scope of statutory appraisal provided is somewhat narrower than that provided in the 1984 Model Act. As discussed in the first section of the Official Comment to section 13.01, statutory appraisal is made available only for corporate actions that will result in a fundamental change in the shares to be affected by the action and then only when uncertainty concerning the fair value of the affected shares may cause reasonable differences about the fairness of the terms of the corporate action. The transactions that satisfy both of these criteria are:

(1) A merger pursuant to section 11.04 or a short-form merger pursuant to section 11.05. Holders of any class or series that is to be exchanged or converted in connection with a merger under section 11.04 are entitled both to a vote under section 11.04(f) and to appraisal under section 13.02(a)(1). Although shareholders of a subsidiary that is a party to a merger under section 11.05 are not entitled to a vote, they are entitled to appraisal under 13.02(a)(1) because their interests will be extinguished by the merger. Section 13.02(a)(1)(i) denies appraisal rights to any class or series of shares in the surviving corporation if such class or series remains outstanding.

(2) A share exchange under section 11.03 if the corporation is a party whose shares are being acquired in the exchange. Consistent with the treatment in section 13.02(a)(1) of mergers requiring shareholder approval, subsection (2) provides appraisal only for those shares that will be exchanged.

(3) A disposition of assets requiring shareholder approval under section 12.02. Minimally, shareholders of all classes or series of the corporation that are generally entitled to vote on matters requiring shareholder approval will be entitled to assert appraisal rights. Whether shares of a class or series that do not have general voting rights will be entitled to vote on the asset disposition and thus become entitled to appraisal rights depends on the form of the transaction disposing of the corporation's assets. In the usual form of this transaction, which is governed by chapter 12, the acquirer purchases substantially all of the assets and assumes substantially all of the liabilities of the corporation, which then liquidates pursuant to a plan of dissolution approved by the shareholders as part of the transaction and distributes the consideration received from the acquirer to its shareholders. If the transaction provides a non-voting class of preferred with its liquidation preference, there is no change in the contractual terms of the preferred and it is entitled neither to vote nor to appraisal rights. By the same token, a preferred class cannot be required to accept any consideration different from that called for in its liquidation preference without amending the terms of the class. For example, a plan that called for the preferred to accept securities of the acquirer in lieu of its cash liquidation preference would trigger both group voting and appraisal rights on behalf of the class. In the unusual event that the asset disposition plan contemplated that the corporation would continue in existence, the terms of a non-voting class would not have been changed as a result of the transaction, and appraisal rights would not be available. As provided in section 12.02(g), a disposition of assets by a corporation in the course of dissolution under chapter 14 is governed by that chapter, not chapter 12, and thus does not implicate appraisal rights.

(4) Amendments to the articles of incorporation that effectuate a reverse stock split which reduces the number of shares that a shareholder owns of a class or series to a fractional share if the corporation has the obligation or right to repurchase the fractional share so created. The reasons for granting appraisal rights in this situation are similar to those granting such rights in cases of cash-out mergers, as both transactions could compel affected shareholders to accept cash for their investment in an amount established by the corporation. Appraisal is afforded only for those shareholders of a class or series whose interest is so affected.

(5) Any other merger; share exchange, disposition of assets or amendment to the articles to the extent the articles, bylaws, or a resolution of the board of directors grants appraisal rights to a particular class or series of stock. A corporation may voluntarily wish to grant to the holders of one or more of its classes or series of shares appraisal rights in connection with these important transactions whenever the Act does not provide statutory appraisal rights. The grant of appraisal rights may satisfy shareholders who might, in the absence of appraisal rights, seek other remedies. Moreover, in situations where the existence of appraisal rights may otherwise be disputed, the voluntary offer of those rights under this section may avoid litigation.

Obviously, an express grant of voluntary appraisal tights under section 13.02(a)(5) is intended to override any of the exceptions to the availability of appraisal rights in section 13.02(a). Any voluntary grant of appraisal rights by the corporation to the holders of one or more of its classes or series of shares will thereby automatically make all of the provisions of chapter 13 applicable to the corporation and such holders regarding this corporate action.

(6) A domestication in which the shares held by a shareholder are reclassified in a manner that results in the shareholder holding shares either with terms that are not as favorable in all materials respects or representing a smaller percentage of the total outstanding voting rights in the corporation as those held before the domestication. Appraisal rights are not provided if the shares of a shareholder are otherwise reclassified so long as the forego-ing restrictions are satisfied.

(7) A conversion to nonprofit status pursuant to subchapter 9C. Such a conversion involves such a fundamental change in the nature of the corpora-tion that appraisal rights are provided to all of the shareholders.

(8) A conversion of the corporation to an unincorporated entity pursu-ant to subchapter 9E. As with the previous type of transaction, this form of conversion is so fundamental that appraisal rights are provided to all of the shareholders.

2. Market Out to Appraisal Rights

Chapter 13 provides a limited exception to appraisal rights for those situa-tions where shareholders can either accept the consideration offered in the appraisal-triggering transaction or can obtain the fair value of their shares by selling them in the market. This provision 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. Further-more, after the corporation announces an appraisal-triggering action, the market operates at maximum efficiency with respect to that corporation's shares because interested parties and market professionals evaluate the offer and competing offers may be generated if the original offer is deemed inadequate. Moreover, the market out reflects an evaluation that the uncertainty costs and time commit-ment involved in any appraisal proceeding are not warranted where shareholders can sell their shares in an efficient, fair and liquid market. For these reasons, approximately half of the states have enacted market outs to their appraisal statutes.

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 have 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.

Because section 13.02(b)(3) excludes from the market out those transactions that require shareholders to accept anything other than cash or securities that also meet the liquidity tests of section 13.02(b)(1), shareholders are assured of receiving either appraisal tights, cash from the transaction, or shares or other proprietary interests in the survivor entity that are liquid. Section 13.02(b)(2) provides that the corporation generally must satisfy the requirements of section 13.02(b)(1) on the record date for a shareholder vote on the appraisal-triggering transaction. For purposes of subsection 13.02(a)(1)(ii), the requirements of section 13.02(b)(1) must be met as of the day before the corporate action becomes effective.

3. Appraisal Rights in Conflict Transactions

The premise of the market out is that the market must be liquid and the valuation assigned to the relevant shares must be ''reliable.'' Section 13.02(b)(1) is designed to assure liquidity. For purposes of these provisions, section 13.02(b)(4) is designed to assure reliability by recognizing that the market price of or consideration for; shares of a corporation that proposes to engage in a section 13.02(a) transaction may be subject to influences where a corporation's management, controlling shareholders or directors have conflicting interests that could, if not dealt with appropriately, adversely affect the consideration that otherwise could have been expected. Section 13.02(b)(4) thus provides that the market out will not apply in those instances where the transaction constitutes an interested transaction (as defined in section 13.01(5.1)).

4. Elimination of Appraisal Rights for Preferred Shares

Section 13.02(c) permits the corporation to eliminate or limit appraisal rights for the holders of one or more series or classes of preferred shares. The operative provisions may be set forth in the corporation's articles of incorporation as originally filed or in any amendment thereto, but any such amendment will not become effective for one year with respect to outstanding shares or shares which the corporation is or may be required to issue or sell at some later date pursuant to any rights outstanding prior to such amendment becoming effective. Shareholders who have not yet acquired, or do not have a right to acquire from the corporation, any shares of preferred stock, should have the ability either not to acquire any shares of preferred stock or to have appraisal rights granted or restored for such shares, if such shareholders so desire, before purchasing them. In contrast, because the terms of common shares are rarely negotiated, section 13.02 does not permit the corporation to eliminate or limit the appraisal rights of common shares.

§ 13.03 Assertion of Rights by Nominees and Beneficial Owners

(a) A record shareholder may assert appraisal rights as to fewer than all the shares registered in the record shareholder's name but owned by a beneficial shareholder only if the record shareholder objects with respect to all shares of the class or series owned by the beneficial shareholder and notifies the corporation in writing of the name and address of each beneficial shareholder on whose behalf appraisal rights are being asserted. The rights of a record shareholder who asserts appraisal rights for only part of the shares held of record in the record shareholder's name under this subsection shall be determined as if the shares as to which the record shareholder objects and the record shareholder's other shares were registered in the names of different record shareholders.

(b) A beneficial shareholder may assert appraisal rights as to shares of any class or series held on behalf of the shareholder only if such shareholder:

(1) submits to the corporation the record shareholder's written consent to the assertion of such rights no later than the date referred to in section 13.22(b)(2)(ii); and

(2) does so with respect to all shares of the class or series that are beneficially owned by the beneficial shareholder.

OFFICIAL COMMENT

Section 13.03 addresses the relationship between those who are entitled to assert appraisal rights and the widespread practice of nominee or street name ownership of publicly-held shares. Generally, a shareholder must demand appraisal for all the shares of a class or series which the shareholder owns. If a record shareholder is a nominee for several beneficial shareholders, some of whom wish to demand appraisal and some of whom do not, section 13.03(a) permits the record shareholder to assert appraisal rights with respect to a portion of the shares held of record by the record shareholder but only with respect to all the shares beneficially owned by a single person. This limitation is necessary to prevent abuse by a single beneficial shareholder who is not fundamentally opposed to the proposed corporate action but who may wish to speculate on the appraisal process, as to some of that shareholder's shares, on the possibility of a high payment. On the other hand, a shareholder who owns shares in more than one class or series may assert appraisal rights for only some-but not all classes or series that the shareholder owns. This is permitted because fair treatment of one class or series does not guarantee fair treatment of other classes or series.

Section 13.03(a) also requires a record shareholder who demands appraisal with respect to a portion of the shares held by the record shareholder to notify the corporation of the name and address of the beneficial owner on whose behalf the record shareholder has demanded appraisal rights.

Section 13.03(b) permits a beneficial shareholder to assert appraisal rights directly if the beneficial shareholder submits the record shareholder's written consent. Although generally the record shareholder is treated as the owner of shares, this section recognizes that sometimes the record shareholders are holding shares on behalf of beneficial shareholders. It would be foreign to the premises underlying nominee and street name ownership to require these record shareholders to forward demands and participate in litigation on behalf of their clients. In order to make appraisal rights effective without burdening record shareholders, beneficial shareholders should be allowed to assert their own claims as provided in this subsection. The beneficial shareholder is required to submit, no later than the date specified in section 13.22(b)(2)(ii), a written consent by the record shareholder to the assertion of appraisal rights to verify the beneficial shareholder's entitlement and to permit the protection of any security interest in the shares. In practice, a broker's customer who wishes to assert appraisal rights may request the broker to supply the customer with the name of the record shareholder (which may be a house nominee or a nominee of the Depository Trust Company), and a form of consent signed by the record shareholder. At the same time, the customer may want to obtain certificates for the shares so that they may be deposited pursuant to section 13.23. After the corporation has received the form of consent, the corporation must deal with the beneficial shareholder.

SUBCHAPTER B. PROCEDURE FOR EXERCISE OF APPRAISAL RIGHTS

§ 13.20 Notice of Appraisal Rights

(a) Where any corporate action specified in section 13.02(a) is to be submitted to a vote at a shareholders' meeting, the meeting notice must state that the corporation has concluded that the shareholders are, are not or may be entitled to assert appraisal rights under this chapter. If the corporation concludes that appraisal rights are or may be available, a copy of this chapter must accompany the meeting notice sent to those record shareholders entitled to exercise appraisal rights.

(b) In a merger pursuant to section 11.05, the parent corporation must notify in writing all record shareholders of the subsidiary who are entitled to assert appraisal rights that the corporate action became effective. Such notice must be sent within 10 days after the corporate action became effective and include the materials described in section 13.22.

(c) Where any corporate action specified in section 13.02(a) is to be approved by written consent of the shareholders pursuant to section 7.04:

(1) written notice that appraisal rights are, are not or may be available must be given to each record shareholder from whom a consent is solicited at the time consent of such shareholder is first solicited and, if the corporation has concluded that appraisal rights are or may be available, must be accompanied by a copy of this chapter; and

(2) written notice that appraisal rights are, are not or may be available must be delivered together with the notice to nonconsenting and nonvoting shareholders required by sections 7.04(e) and (f), may include the materials described in section 13.22 and, if the corporation has concluded that appraisal rights are or may be available, must be accompanied by a copy of this chapter.

(d) Where corporate action described in Section 13.02(a) is proposed, or a merger pursuant to Section 11.05 is effected, the notice referred to in subsection (a) or (c), if the corporation concludes that appraisal rights are or may be available, and in subsection (b) of this Section 13.20 shall be accompanied by:

(1) the annual financial statements specified in section 16.20(a) of the corporation that issued the shares that may be subject to appraisal, which shall be as of a date ending not more than 16 months before the date of the notice and shall comply with section 16.20(b); provided that, if such annual financial statements are not reasonably available, the corporation shall provide reasonably equivalent financial information; and

(2) the latest available quarterly financial statements of such corporation, if any.

(e) The right to receive the information described in subsection (d) may be waived in writing by a shareholder before or after the corporate action.

OFFICIAL COMMENT

Before a vote at a meeting is taken on a corporate action, the corporation is required by section 13.20(a) to notify record shareholders that a transaction is proposed and that the corporation has concluded either that appraisal rights are or are not available; alternatively, if the corporation is unsure about the availability of appraisal rights, it may state that appraisal rights may be available. Notice of appraisal rights is needed because many shareholders do not know what appraisal rights they may have or how to assert them.

Section 13.20(b) provides that notice be given by the parent corporation within 10 days after the effective date of a merger of its subsidiary under section 11.05.

Where any corporate action specified in section 13.02(a) is to be approved by written consent pursuant to section 7.04, notice that appraisal rights are, are not or may be available must be given to each shareholder from whom a consent is solicited at the time such shareholder is first solicited. Written notice that appraisal rights are, are not or may be available must also be given to all nonconsenting and nonvoting shareholders together with the notice required by section 7.04. If the corporation has concluded that appraisal rights are or may be available, the notices required by section 13.20(c)(1) and section 13.20(c)(2) must be accompanied by a copy of this chapter. Where notice is given pursuant to section 13.20(c)(2), such notice may be combined with the notice required by section 13.22 if the corporate action became effective within the preceding 10 days.

Section 13.20(d) specifies certain disclosure requirements for corporate actions for which appraisal rights are provided. Because appraisal is an ''opt-in'' remedy, shareholders otherwise entitled to an appraisal of their shares by reason of corporate actions specified in section 13.02 must elect whether to seek that remedy or accept the results of that action. Because an election is needed, the common law duty of disclosure articulated by some states, notably Delaware, has required the corporation to disclose all material facts available to it that would enable affected shareholders to make an informed decision whether or not to demand appraisal. See, e.g., Turner v. Bernstein, 776 A.2d 530 (Del. Ch. 2000). That duty may include the obligation to provide financial information relating to the value of the company, where such information is relevant to the decision. See, e.g., Gilliland v. Motorola, Inc., 859 A.2d 80 (Del. Ch. 2004). The board of directors typically will have relied upon such information before approving the corporate action and before determining that the consideration offered constitutes fair value for the shares being surrendered or exchanged. Such financial information will normally include the company's financial statements, and it may also include financial expert valuation analyses of the company or summaries of such analyses. See, e.g., In re Pure Resources Inc. Shareholders Litig., 808 A.2d 421 (Del. Ch. 2002). Section 13.20(d) specifies certain financial information disclosure requirements. Disclosure of additional information may be necessary depending upon applicable case law. See Official Comment 3, section 8.30(c).

By specifying certain disclosure requirements, section 13.20(d) reduces the risk, in the transactions to which it applies, of an uninformed shareholder decision whether or not to exercise appraisal rights. Section 13.20(e) permits a shareholder to waive the right to receive the information. The objective served by specifying these disclosure requirements is to facilitate a shareholder's decision whether to exercise appraisal rights. Section 13.20(d) does not address remedies, including those, if any, that shareholders might have against persons other than the corporation, as a result of the failure to provide the required information. Section 13.31(b)(1) provides that a corporation may be liable for the fees and expenses of counsel and experts for the respective parties for failure to comply substantially with section 13.20, as well as the related section 13.24.

Although the information requirements of section 13.20 would not apply to transactions for which there are no appraisal rights because of the market exception under section 13.02(b), the corporations to which the market exception applies are public companies which in most cases are subject to federal disclosure requirements.

§ 13.21 Notice of Intent to Demand Payment

(a) If a corporate action specified in section 13.02(a) is submitted to a vote at a shareholders' meeting, a shareholder who wishes to assert appraisal rights with respect to any class or series of shares:

(1) must deliver to the corporation before the vote is taken written notice of the shareholder's intent to demand payment if the proposed action is effectuated; and

(2) must not vote, or cause or permit to be voted, any shares of such class or series in favor of the proposed action.

(b) If a corporate action specified in section 13.02(a) is to be approved by less than unanimous written consent, a shareholder who wishes to assert appraisal rights with respect to any class or series of shares must not execute a consent in favor of the proposed action with respect to that class or series of shares.

(c) A shareholder who fails to satisfy the requirements of subsection (a) or (b) is not entitled to payment under this chapter.

OFFICIAL COMMENT

Section 13.21 applies to all transactions requiring appraisal where the action is approved by shareholder action. In that case, shareholders of the subsidiary do not vote on the transaction but are nevertheless entitled to appraisal.

Section 13.21(a) requires that, where action is to be taken at a shareholders' meeting, a shareholder must give notice of an intent to demand payment before the vote on the corporate action is taken. This notice enables the corporation to determine how much of a cash payment may be required. It also serves to limit the number of persons to whom the corporation must give further notice during the remainder of the appraisal process.

Under sections 13.21(a)(2) and 13.21(b), a shareholder is no longer eligible to assert appraisal rights with respect to a class or series of shares if the shareholder votes such class or series of shares in favor of the corporate action, or executes a consent without identifying the class or series of shares consenting to such action.

§ 13.22 Appraisal Notice and Form

(a) If proposed corporate action requiring appraisal rights under section 13.02(a) becomes effective, the corporation must deliver a written appraisal notice and form required by subsection (b)(1) to all shareholders who satisfied the requirements of section 13.21(a) or section 13..21(b). In the case of a merger under section 11.05, the parent must deliver a written appraisal notice and form to all record shareholders who may be entitled to assert appraisal rights.

(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 ten 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;

(2) state:

(i) where the form must be sent and where certificates for certificated shares must be deposited and the date by which those certificates must be deposited, which date may not be earlier than the date for receiving the required form under subsection (2)(ii);

(ii) a date by which the corporation must receive the form which date may not be fewer than 40 nor more than 60 days after the date the subsection (a) appraisal notice and form are sent, and state that the shareholder shall have waived the right to demand appraisal with respect to the shares unless the form is received by the corporation by such specified date;

(iii) the corporation's estimate of the fair value of the shares;

(iv) that, if requested in writing, the corporation will provide, to the shareholder so requesting, within 10 days after the date specified in subsection (2)(ii) the number of shareholders who return the forms by the specified date and the total number of shares owned by them; and

(v) the date by which the notice to withdraw under section 13.23 must be received, which date must be within 20 days after the date specified in subsection (2)(ii); and

(3) be accompanied by a copy of this chapter.

OFFICIAL COMMENT

The purpose of section 13.22 is to require the corporation to provide shareholders with information and a form for perfecting appraisal rights. The content of this notice and form are spelled out in detail to ensure that they accomplish this purpose.

The appraisal notice must be sent only to those shareholders who satisfy the requirements of section 13.21(a) or section 13.21(b). In a short-form merger under section 11.05, the notice must be sent to all persons who may be eligible for appraisal rights no earlier than the effective date of the merger and no later than 10 days thereafter. In either case, the notice must be accompanied by a copy of this chapter.

The notice must supply a form to be used by the person asserting appraisal tights in order to complete the exercise of those rights. Under section 13.22(b)(2)(ii), the notice must specify the date by which the shareholder's executed form must be received by the corporation, which date must be at least 40 days but not more than 60 days after the appraisal notice is sent.

Under section 13.22(b)(2)(i), the notice must also specify where and when share certificates must be deposited; the time for deposit may not be set at a date earlier than the date for receiving the required form under section 13.22(b)(2)(ii).

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 announcement 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.

Sections 13.22(b)(2)(iii) and (b)(2)(iv) require the corporation to state its estimate of the fair value of the shares and how shareholders may obtain the number of shareholders and number of shares demanding appraisal rights. The information required by sections 13.22(b)(2)(iii) and (b)(2)(iv) is intended to help shareholders assess whether they wish to demand payment or to withdraw their demand for appraisal, but the information under section 13.22(b)(2)(iv) is required to be sent only to those shareholders from whom the corporation has received a written request. If such request is received, the corporation must respond within 10 days after forms are due pursuant to section 13.22(b)(2)(ii). Finally, section l3.22(b)(2)(v) requires the corporation to specify the date by which the shareholder's notice to withdraw under section 13.23 must be received.

§ 13.23 Perfection of Rights; Right to Withdraw

(a) A shareholder who receives notice pursuant to section 13.22 and who wishes to exercise appraisal rights must sign and return the form sent by the corporation and, in the case of certificated shares, deposit the shareholder's certificates in accordance with the terms of the notice by the date referred to in the notice pursuant to section 13.22(b)(2)(ii). In addition, if applicable, the shareholder must certify on the form whether the beneficial owner of such shares acquired beneficial ownership of the shares before the date required to be set forth in the notice pursuant to section 13.22(b)(1). If a shareholder fails to make this certification, the corporation may elect to treat the shareholder's shares as after-acquired shares under section 13.25. In addition, a shareholder who wishes to exercise appraisal rights must execute and return the form and, in the case of certificated shares, deposit the shareholder's certificates in accordance with the terms of the notice by the date referred to in the notice pursuant to section 13.22(b)(2)(ii). Once a shareholder deposits that shareholder's certificates or, in the case of uncertificated shares, returns the signed forms, that shareholder loses all rights as a shareholder, unless the shareholder withdraws pursuant to subsection (b).

(b) A shareholder who has complied with subsection (a) may nevertheless decline to exercise appraisal rights and withdraw from the appraisal process by so notifying the corporation in writing by the date set forth in the appraisal notice pursuant to section 13.22(b)(2)(v). A shareholder who fails to so withdraw from the appraisal process may not thereafter withdraw without the corporation's written consent.

(c) A shareholder who does not sign and return the form and, in the case of certificated shares, deposit that shareholder's share certificates where required, each by the date set forth in the notice described in section 13.22(b), shall not be entitled to payment under this chapter.

OFFICIAL COMMENT

Section 13.23 permits shareholders to perfect their appraisal rights under subsection (a), subject to their right to withdraw under subsection (b). In the case of a transaction involving a vote by shareholders, returning the signed form and, in the case of certificated shares, depositing the shares are the shareholder's confirmation of the shareholder's intention expressed earlier under section 13.21(a) to pursue appraisal rights; in the case of a merger of a subsidiary under section 11.05, it is the shareholder's first statement of this position.

If required, the shareholder should include on the appraisal form a certification as to whether the date on which the beneficial shareholder acquired beneficial ownership of the shares was before (or on or after) the date the transaction was announced. See section 13.22(b)(1). This information permits the corporation to exercise its right under section 13.25 to defer payment of compensation for certain shares. The corporation may elect to proceed under section 13.25 with respect to those shareholders who were required to make the certification but did not do so.

Section 13.23(a) also requires persons with certificated shares who file the required form to deposit their share certificates as directed by the corporation in its appraisal notice. Once a shareholder deposits that shareholder's shares, that shareholder loses all rights as a shareholder unless the shareholder withdraws from the appraisal process pursuant to section 13.23(b).

With respect to certificated shares, this provision differs from many statutes in that the certificates are deposited for retention, rather than "submitted for notation." This difference reflects the requirement in section 13.22(b)(2)(i) for deposit only after the corporate action became effective; in contrast, many state statutes require shareholders to send in their certificates in anticipation of the effectuation of the proposed corporate action.

Alternatively, under section 13.23(b), a shareholder may withdraw from the appraisal process by so notifying the corporation in writing by the deadline set forth in the appraisal notice. After that date, however a shareholder who has complied with the requirements to sign and return the form and, in the case of certificated shares, deposit the share certificates may not withdraw from the process without the corporation's written consent.

Under section 13.23(c), a shareholder who fails to sign and return the form with respect to the shares of a class or series for which the shareholder is demanding appraisal or does not deposit that shareholder's share certificates as required by section 13.23(a) loses all tights to pursue appraisal and obtain payment under this chapter. If a beneficial shareholder wishes to assert appraisal rights in place of the record shareholder, the beneficial shareholder must also comply with section 13.03(b).

§ 13.24 Payment

(a) Except as provided in section 13.25, within 30 days after the form required by section 13.22(b)(2)(ii) is due, the corporation shall pay in cash to those shareholders who complied with section 13.23(a) the amount the corporation estimates to be the fair value of their shares, plus interest.

(b) The payment to each shareholder pursuant to subsection (a) must be accompanied by:

(1)(i) the annual financial statements specified in section 16.20(a) of the corporation that issued the shares to be appraised, which shall be as of a date ending not more than 16 months before the date of payment, and shall comply with section 16.20(b); provided that, if such annual financial statements are not reasonably available, the corporation shall provide reasonably equivalent financial information, and (ii) the latest available quarterly financial statements of such corporation, if any;

(2) a statement of the corporation's estimate of the fair value of the shares, which estimate must equal or exceed the corporation's estimate given pursuant to section 13.22(b)(2)(iii);

(3) a statement that shareholders described in subsection (a) have the right to demand further payment under section 13.26 and that if any such shareholder does not do so within the time period specified therein, such shareholder shall be deemed to have accepted such payment in full satisfaction of the corporation's obligations under this chapter.

OFFICIAL COMMENT

Section 13.24 is applicable both to shareholders who have complied with section 13.23(a), as well as to shareholders who are described in section 13.25(a) if the corporation so chooses. The corporation must, however, elect to treat all shareholders described in section 13.25(a) either under section 13.24 or under section 13.25; it may not elect to treat some shareholders from this group under section 13.24 but treat others under section 13.25. Considerations of simplicity and harmony may prompt the corporation to elect to treat all shareholders under section 13.24.

Section 13.24 changes the relative balance between the corporation and shareholders demanding appraisal by requiring the corporation to pay in cash within 30 days after the required form is due the corporation's estimate of the fair value of the stock plus interest. Section 13.24(b)(2) requires that estimate to at least equal the corporation's estimate of fair value given pursuant to section 13.22(b)(2)(iii). Since under section 13.23(a) all rights as a shareholder are terminated with the deposit of that shareholder's shares, the former shareholder should have immediate use of such money A difference of opinion over the total amount to be paid should not delay payment of the amount that is undisputed. Thus, the corporation must pay its estimate of fair value, plus interest from the effective date of the corporate action, without waiting for the conclusion of the appraisal proceeding.

Since the former shareholder must decide whether or not to accept the payment in full satisfaction, the corporation must at this time furnish the former shareholder with the information specified in section 13.24(b), with a reminder of the former shareholder's further rights and liabilities. Even though the specified information was previously furnished under section 13.20(d) at the time notice of appraisal rights was given, it must still be furnished under section 13.24(b) at the time of payment. Sometimes that information will have to be updated to satisfy the requirements of section 13.24(b), for example, because the annual financial statements are more than 16 months old or there are new quarterly financial statements.

§ 13.25 After-Acquired Shares

(a) A corporation may elect to withhold payment required by section 13.24 from any shareholder who was required to, but did not certify that beneficial ownership of all of the shareholder's shares for which appraisal rights are asserted was acquired before the date set forth in the appraisal notice sent pursuant to section 13.22(b)(1).

(b) If the corporation elected to withhold payment under subsection (a), it must, within 30 days after the form required by section 13.22(b)(2)(ii) is due, notify all shareholders who are described in subsection (a):

(1) of the information required by section 13.24(b)(1);

(2) of the corporation's estimate of fair value pursuant to section 13.24(b)(2);

(3) that they may accept the corporation's estimate of fair value, plus interest, in full satisfaction of their demands or demand appraisal under section 13.26;

(4) that those shareholders who wish to accept such offer must so notify the corporation of their acceptance of the corporation's offer within 30 days after receiving the offer; and

(5) that those shareholders who do not satisfy the requirements for demanding appraisal under section 13.26 shall be deemed to have accepted the corporation's offer.

(c) Within ten days after receiving the shareholder's acceptance pursuant to subsection (b), the corporation must pay in cash the amount it offered under subsection (b)(2) to each shareholder who agreed to accept the corporation's offer in full satisfaction of the shareholder's demand.

(d) Within 40 days after sending the notice described in subsection (b), the corporation must pay in cash the amount it offered to pay under subsection (b)(2) to each shareholder described in subsection (b)(5).

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 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.

The date used as a cut-off for determining the application of this section is when ''the principal terms'' of the transaction are first announced to shareholders or to a newspaper of general circulation that can be expected to reach the financial community or included in a public filing with the Securities and Exchange Commission. The cut-off should not be set at an earlier date, such as when the first public statement that the corporate action was under consideration was made, because the goal of this section is to prevent use of appraisal rights as a speculative device after the terms of the transaction are announced. See the Official Comment to section 13.22.

Section 13.25(b) requires the corporation to furnish specified information to all shareholders described in subsection (a) and offer them the option of accepting the corporation's estimate of fair value plus interest, in full satisfaction of their claims, provided that such shareholders so accept and notify the corporation within ten days of receiving this offer. Within ten days after receiving a shareholder's acceptance, the corporation must pay that shareholder in cash the stated fair value plus interest.

A shareholder may accept the offered payment in full satisfaction of that shareholder's claim; alternatively, a shareholder may reject the corporation's offer and demand a judicial determination under section 13.26 and payment of the amount so determined at the termination of the proceeding. A shareholder who does not satisfy the requirements of section 13.26 shall be deemed to have accepted the corporation's offer.

§ 13.26 Procedure if Shareholder Dissatisfied With Payment or Offer

(a) A shareholder paid pursuant to section 13.24 who is dissatisfied with the amount of the payment must notify the corporation in writing of that shareholder's estimate of the fair value of the shares and demand payment of that estimate plus interest (less any payment under section 13.24). A shareholder offered payment under section 13.25 who is dissatisfied with that offer must reject the offer and demand payment of the shareholder's stated estimate of the fair value of the shares plus interest.

(b) A shareholder who fails to notify the corporation in writing of that shareholder's demand to be paid the shareholder's stated estimate of the fair value plus interest under subsection (a) within 30 days after receiving the corporation's payment or offer of payment under section 13.24 or section 13.25, respectively, waives the right to demand payment under this section and shall be entitled only to the payment made or offered pursuant to those respective sections.

OFFICIAL COMMENT

A shareholder who is not content with the corporation's remittance under section 13.24, or offer of remittance under section 13.25, and wishes to pursue appraisal rights further must state m writing the amount the shareholder is willing to accept. A shareholder whose demand is deemed arbitrary unreasonable or not in good faith, however; runs the risk of being assessed litigation expenses under section 13.31. These provisions are designed to encourage settlement without a judicial proceeding.

A shareholder to whom the corporation has made payment (or who has been offered payment under section 13.25) must make a supplemental demand within 30 days after receipt of the payment or offer of payment in order to permit the corporation to make an early decision on initiating appraisal proceedings. A failure to make such demand causes the shareholder to relinquish under section 13.26(b) anything beyond the amount the corporation paid or offered to pay.

SUBCHAPTER C. JUDICIAL APPRAISAL OF SHARES

§ 13.30 Court Action

(a) If a shareholder makes demand for payment under section 13.26 which remains unsettled, the corporation shall commence a proceeding within 60 days after receiving the payment demand and petition the court to determine the fair value of the shares and accrued interest. If the corporation does not commence the proceeding within the 60–day period, it shall pay in cash to each shareholder the amount the shareholder demanded pursuant to section 13.26 plus interest.

(b) The corporation shall commence the proceeding in the appropriate court of the county where the corporation's principal office (or, if none, its registered office) in this state is located. If the corporation is a foreign corporation without a registered office in this state, it shall commence the proceeding in the county in this state where the principal office or registered office of the domestic corporation merged with the foreign corporation was located at the time of the transaction.

(c) The corporation shall make all shareholders (whether or not residents of this state) whose demands remain unsettled parties to the proceeding as in an action against their shares, and all parties must be served with a copy of the petition. Nonresidents may be served by registered or certified mail or by publication as provided by law

(d) The jurisdiction of the court in which the proceeding is commenced under subsection (b) is plenary and exclusive. The court may appoint one or more persons as appraisers to receive evidence and recommend a decision on the question of fair value. The appraisers shall have the powers described in the order appointing them, or in any amendment to it. The shareholders demanding appraisal rights are entitled to the same discovery rights as parties in other civil proceedings. There shall be no right to a jury trial.

(e) Each shareholder made a party to the proceeding is entitled to judgment (i) for the amount, if any, by which the court finds the fair value of the shareholder's shares, plus interest, exceeds the amount paid by the corporation to the shareholder for such shares or (ii) for the fair value, plus interest, of the shareholder's shares for which the corporation elected to withhold payment under section 13.25.

OFFICIAL COMMENT

Section 13.30 retains the concept of judicial appraisal as the ultimate means of determining fair value. The proceeding is to be commenced by the corporation within 60 days after a timely demand for payment under section 13.26 was received. If the proceeding is not commenced within this period, the corporation must pay the additional amounts demanded by the shareholders under section 13.26. See the Official Comment to section 13.26.

All demands for payment made under section 13.26 are to be resolved in a single proceeding brought in the county in the state where the corporation's principal office is located or, if it is a foreign corporation, where its registered office is located, or if it has no registered office, where the principal office of the corporation which issued the shares to be appraised was located. All shareholders making section 13.26 demands must be made parties, with service by publication authorized if necessary Appraisers may be appointed within the discretion of the court. Since the nature of the proceeding is similar to a proceeding in equity or for an accounting, section 13.30(d) provides that there is no right to a jury trial. The final judgment establishes not only the fair value of the shares in the abstract but also determines how much each shareholder who made a section 13.26 demand should actually receive.

§ 13.31 Court Costs and Expenses

(a) The court in an appraisal proceeding commenced under section 13.30 shall determine all court costs of the proceeding, including the reasonable compensation and expenses of appraisers appointed by the court. The court shall assess the court costs against the corporation, except that the court may assess court costs against all or some of the shareholders demanding appraisal, in amounts the court finds equitable, to the extent the court finds such shareholders acted arbitrarily, vexatiously, or not in good faith with respect to the rights provided by this chapter.

(b) The court in an appraisal proceeding may also assess the expenses of the respective parties, in amounts the court finds equitable:

(1) against the corporation and in favor of any or all shareholders demanding appraisal if the court finds the corporation did not substantially comply with the requirements of sections 13.20, 13.22, 13.24 or 13.25; or

(2) against either the corporation or a shareholder demanding appraisal, in favor of any other party, if the court finds that the party against whom the expenses are assessed acted arbitrarily, vexatiously, or not in good faith with respect to the rights provided by this chapter.

(c) If the court in an appraisal proceeding finds that the expenses incurred by any shareholder were of substantial benefit to other shareholders similarly situated, and that such expenses should not be assessed against the corporation, the court may direct that such expenses be paid out of the amounts awarded the shareholders who were benefitted.

(d) To the extent the corporation fails to make a required payment pursuant to sections 13.24, 13.25, or 13.26, the shareholder may sue directly for the amount owed and, to the extent successful, shall be entitled to recover from the corporation all expenses of the suit.

OFFICIAL COMMENT

Section 13.31(a) provides a general rule that the court costs of the appraisal proceeding should be assessed against the corporation. Nevertheless, the court is authorized to assess these court costs, in whole or in part, against all or some of the shareholders demanding appraisal if it concludes they acted arbitrarily, vexatiously, or not in good faith regarding the rights provided by this chapter. Under section 13.31(b), the court may assess expenses against the corporation or against all or some of the shareholders demanding appraisal for the reasons stated in this subsection. Under section 13.31(c), if the corporation is not required to pay the expenses incurred by any shareholder demanding appraisal, the court may require all shareholders who benefitted to share in the payment of such expenses. The purpose of all these grants of discretion with respect to expenses is to increase the incentives of both sides to proceed in good faith under this chapter to attempt to resolve their disagreement without the need of a formal judicial appraisal of the value of shares.

While subsections (a)-(c) allocate court costs and expenses m an appraisal proceeding, subsection (d) covers the situation where the corporation was obligated to make payment and did not meet this obligation. In that event, the shareholder may sue the corporation directly for the amount owed. In such an action, subsection (d) requires the court, to the extent the shareholder was successful, to impose all court costs and the shareholder's expenses on the corporation.

SUBCHAPTER D. OTHER REMEDIES

§ 13.40 Other Remedies Limited

(a) The legality of a proposed or completed corporate action described in section 13.02(a) may not be contested, nor may the corporate action be enjoined, set aside or rescinded, in a legal or equitable proceeding by a shareholder after the shareholders have approved the corporate action.

(b) Subsection (a) does not apply to a corporate action that:

(1) was not authorized and approved in accordance with the applicable provisions of:

(i) chapter 9, 10, 11 or 12,

(ii) the articles of incorporation or bylaws, or

(iii) the resolution of the board of directors authorizing the corporate action;

(2) was procured as a result of fraud, a material misrepresentation, or an omission of a material fact necessary to make statements made, in light of the circumstances in which they were made, not misleading;

(3) is an interested transaction, unless it has been recommended by the board of directors in the same manner as is provided in section 8.62 and has been approved by the shareholders in the same manner as is provided in section 8.63 as if the interested transaction were a director's conflicting interest transaction; or

(4) is approved by less than unanimous consent of the voting shareholders pursuant to section 7.04 if:

(i) the challenge to the corporate action is brought by a shareholder who did not consent and as to whom notice of the approval of the corporate action was not effective at least ten days before the corporate action was effected; and

(ii) the proceeding challenging the corporate action is commenced within ten days after notice of the approval of the corporate action is effective as to the shareholder bringing the proceeding.

OFFICIAL COMMENT

With four exceptions, section 13.40 provides that a corporate action described in section 13.02(a) may not be contested, nor may the corporate action be enjoined, set aside or rescinded, in a proceeding by a shareholder after the shareholders have approved the action. The theory underlying this section generally is that when a majority of shareholders has approved a corporate change, the corporation should be permitted to proceed even if a minority considers the change unwise or disadvantageous. The existence of the appraisal remedy recognizes that shareholders may disagree about the financial consequences that a corporate action may have and some may hold such strong views that they will want to vindicate them in a judicial proceeding. Since a judicial proceeding is insulated from the dynamics of an actual negotiation, it is not surprising that the two processes could produce different valuations. Accordingly, if such a proceeding results in an award of additional consideration to the shareholders who pursued appraisal, no inference should be drawn that the judgment of the majority was wrong or that compensation is now owed to shareholders who did not seek appraisal. The limitations are not confined to cases where appraisal is available. The liquidity and reliability considerations that justify the market out justify imposing the same limitation on post-shareholder approval remedies that apply when appraisal is available.

Section 13.40 permits proceedings contesting the legality of a transaction, or seeking to enjoin, rescind or set aside the corporate action after the action has been approved by shareholders under found circumstances:

(1) Situations where there are fundamental flaws in the process by which the corporate action was approved. Thus section 13.40(b)(1) permits challenges to procedural defects in approving the action, such as a failure to obtain the votes required by statute or by the corporation's own articles, bylaws, or board resolution authorizing the transaction.

(2) Situations where the corporate action was procured by fraud, material misrepresentation, or an omission that makes statements made misleading. Section 13.40(b)(2).

(3) A corporate action that is an interested transaction. The same reasoning that supports the provision of appraisal rights for interested transactions in situations where the market out would otherwise apply under 13.02(b) supports the decision in section 13.40(b)(3) not to preclude judicial review or relief in connection with such transactions, unless other strong safeguards are present. Those safeguards are drawn from the treatment of director conflicting interest transactions in section 8.60 through 8.63. There a conflict of interest transaction may be protected if either qualified director or disinterested shareholder approval is obtained after required disclosure. Here, the protection is made available only if both those requirements are met. Absent compliance with those safeguards, the standard of review to be applied (such as entire fairness), and the extent of the relief that may be available is not addressed by this section. Subsection (b)(3) rejects, however, the doctrine of *Kahn v. Lynch Communications*

Systems, 638 A.2d 1110 (Del. 1994), holding that an interested transaction involving a merger is subject to entire fairness review even when the transaction has been approved by disinterested directors and disinterested shareholders.

(4) Finally, in those cases where a transaction is approved by less than unanimous consent and non-consenting shareholders are not given notice of the transaction before it is consummated, and thus do not have the chance to challenge the transaction before its consummation, section 13.40(b)(4) preserves essentially the same opportunity for those shareholders to challenge the transaction as they would have had if they had received notice.

The scope of section 13.40(b) is limited and does not otherwise affect applicable state law. Section 13.40(b) does not create any cause of action; it merely removes the bar to the types of post-transaction claims provided in section 13.40(a). Even then, whether the specific facts of a transaction subject to section 13.40(b) warrant invalidation or rescission is left to the discretion of the court. Similarly, section 13.40 leaves to applicable state law the question of remedies, such as injunctive relief, that may be available before the corporate action is approved by shareholders in light of other remedies that may be available after the transaction is approved or completed. Where post-shareholder approval claims outside the scope of section 13.40 are asserted, the availability of judicial review, the remedies (such as damages) that shareholders may have, and questions relating to election of remedies, will be determined by applicable state law. Section 13.40 addresses challenges only to the corporate action and does not address remedies, if any, that shareholders may have against directors or other persons as a result of the corporate action, even where subsection (b)(4) applies. See section 8.31 and the related Official Comment and the Introductory Official Comment to Subchapter F of Chapter 8 under the heading "Scope of Subchapter F."

CHAPTER 14. DISSOLUTION

SUBCHAPTER A. VOLUNTARY DISSOLUTION

§ 14.01 Dissolution by Incorporators or Initial Directors

A majority of the incorporators or initial directors of a corporation that has not issued shares or has not commenced business may dissolve the corporation by delivering to the secretary of state for filing articles of dissolution that set forth:

(1) the name of the corporation;

(2) the date of its incorporation;

(3) either (i) that none of the corporation's shares has been issued or (ii) that the corporation has not commenced business;

(4) that no debt of the corporation remains unpaid;

(5) that the net assets of the corporation remaining after winding up have been distributed to the shareholders, if shares were issued; and

(6) that a majority of the incorporators or initial directors authorized the dissolution.

§ 14.02 Dissolution by Board of Directors and Shareholders

(a) A corporation's board of directors may propose dissolution for submission to the shareholders.

(b) For a proposal to dissolve to be adopted:

(1) the board of directors must recommend dissolution to the shareholders unless the board of directors determines that because of conflict of interest or other special circumstances it should make no recommendation and communicates the basis for its determination to the shareholders; and

(2) the shareholders entitled to vote must approve the proposal to dissolve as provided in subsection (e).

(c) The board of directors may condition its submission of the proposal for dissolution on any basis.

(d) The corporation shall notify each shareholder, whether or not entitled to vote, of the proposed shareholders' meeting. The notice must also state that the purpose, or one of the purposes, of the meeting is to consider dissolving the corporation.

(e) Unless the articles of incorporation or the board of directors acting pursuant to subsection (c) require a greater vote, a greater number of shares to be present, or a vote by voting groups, adoption of the proposal to dissolve shall require the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast exists.

OFFICIAL COMMENT

Section 14.02(b) requires the board of directors, after approving a proposal to dissolve, to submit the proposal to the shareholders for their approval. When submitting the proposal the board of directors must make a recommendation to the shareholders that the plan be approved, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should make no recommendation. For example, the board of directors may make such a determination where there is not a sufficient number of directors free of a conflicting interest to approve the proposal or because the board of directors is evenly divided as to the merits of the proposal but is able to agree that shareholders should be permitted to consider dissolution. If the board of directors makes such a determination, it must describe the conflict of interest or special circumstances, and communicate the basis for the determination, when submitting the proposal to dissolve to the shareholders. The exception for conflicts of interest or other special circumstances is intended to be sparingly available. Generally, shareholders should not be asked to act on a proposal for dissolution in the absence of a recommendation by the board of directors. The exception is not intended to relieve the board of directors of its duty to consider carefully the proposed dissolution and the interests of shareholders.

Section 14.02(c) permits the board of directors to condition its submission of a proposal for dissolution on any basis. Among the conditions that a board might impose are that the proposal will not be deemed approved unless it is approved by a specified vote of the shareholders, or by one or more specified classes or series of shares, voting as a separate voting group, or by a specified percentage of disinterested shareholders. The board of directors is not limited to conditions of these types.

Section 14.02(d) provides that if the proposal is required to be approved by the shareholders, and if the approval is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the proposal is to be submitted. Requirements concerning the timing and content of a notice of meeting are set out in section 7.05. Section 14.02(d) does not itself require that notice be given to nonvoting shareholders where the proposal is approved, without a meeting, by unanimous consent. However, that requirement is imposed by section 7.04(d).

Section 14.02(e) provides that approval of a proposal for dissolution requires approval of the shareholders at a meeting at which a quorum consisting of a majority of the votes entitled to be cast on the proposal exists. If a quorum is present, then under sections 7.25 and 7.26 the proposal will be approved if more votes are cast in favor of the proposal than against it by the voting group or separate voting groups entitled to vote on the proposal. This represents a change from the Act's previous voting rule for dissolution, which required approval by a majority of outstanding shares.

The Act does not mandate separate voting by voting groups or appraisal rights in relation to dissolution proposals on the theory that, upon dissolution, the rights or all classes or series of shares are fixed by the articles of incorporation. Of course, group voting rights may be conferred by the articles of incorporation or by the board of directors, acting pursuant to subsection (c).

§ 14.03 Articles of Dissolution

(a) At any time after dissolution is authorized, the corporation may dissolve by delivering to the secretary of state for filing articles of dissolution setting forth:

(1) the name of the corporation;

(2) the date dissolution was authorized; and

(3) if dissolution was approved by the shareholders, a statement that the proposal to dissolve was duly approved by the shareholders in the manner required by this Act and by the articles of incorporation.

(b) A corporation is dissolved upon the effective date of its articles of dissolution.

(c) For purposes of this subchapter, "dissolved corporation" means a corporation whose articles of dissolution have become effective and includes a successor entity to which the remaining assets of the corporation are transferred subject to its liabilities for purposes of liquidation.

OFFICIAL COMMENT

The act of filing the articles of dissolution makes the decision to dissolve a matter of public record and establishes the time when the corporation must begin the process of winding up and cease carrying on its business except to the extent necessary for winding up. If dissolution was approved by the shareholders, the articles of dissolution must state that dissolution was duly approved by the shareholders in the manner required by the Act and the articles of incorporation of the corporation.

Under the Model Act, articles of dissolution may be filed at the commencement of winding up or at any time thereafter. This is the only filing required for voluntary dissolution; no filing is required to mark the completion of winding up since the existence of the corporation continues for certain purposes even after the business is wound up and the assets remaining after satisfaction of all creditors are distributed to the shareholders. No time limit for filing the articles is specified, and it often may be desirable to postpone filing until winding up is far along or even complete.

A corporation is dissolved on the date the articles of dissolution are effective. After this date the corporation is referred to as a ''dissolved corporation,'' although its existence continues under section 14.05 for purposes of winding up.

Subsection (c) defines ''dissolved corporation'' for purposes of subchapter A to include successor entities to which assets are transferred subject to liabilities for purposes of liquidation. This provision covers the situation where a liquidating trust or other successor entity is used to complete the liquidation.

§ 14.04 Revocation of Dissolution

(a) A corporation may revoke its dissolution within 120 days of its effective date.

(b) Revocation of dissolution must be authorized in the same manner as the dissolution was authorized unless that authorization permitted revocation by action of the board of directors alone, in which event the board of directors may revoke the dissolution without shareholder action.

(c) After the revocation of dissolution is authorized, the corporation may revoke the dissolution by delivering to the secretary of state for filing articles of revocation of dissolution, together with a copy of its articles of dissolution, that set forth:

(1) the name of the corporation;

(2) the effective date of the dissolution that was revoked;

(3) the date that the revocation of dissolution was authorized;

(4) if the corporation's board of directors (or incorporators) revoked the dissolution, a statement to that effect;

(5) if the corporation's board of directors revoked a dissolution authorized by the shareholders, a statement that revocation was permitted by action by the board of directors alone pursuant to that authorization; and

(6) if shareholder action was required to revoke the dissolution, the information required by section 14.03(a)(3).

(d) Revocation of dissolution is effective upon the effective date of the articles of revocation of dissolution.

(e) When the revocation of dissolution is effective, it relates back to and takes effect as of the effective date of the dissolution and the corporation resumes carrying on its business as if dissolution had never occurred.

§ 14.05 Effect of Dissolution

(a) A dissolved corporation continues its corporate existence but may not carry on any business except that appropriate to wind up and liquidate its business and affairs, including:

(1) collecting its assets;

(2) disposing of its properties that will not be distributed in kind to its shareholders;

(3) discharging or making provision for discharging its liabilities;

(4) distributing its remaining property among its shareholders according to their interests; and

(5) doing every other act necessary to wind up and liquidate its business and affairs.

(b) Dissolution of a corporation does not:

(1) transfer title to the corporation's property;

(2) prevent transfer of its shares or securities, although the authorization to dissolve may provide for closing the corporation's share transfer records;

(3) subject its directors or officers to standards of conduct different from those prescribed in chapter 8;

(4) change quorum or voting requirements for its board of directors or shareholders; change provisions for selection, resignation, or removal of its directors or officers or both; or change provisions for amending its bylaws;

(5) prevent commencement of a proceeding by or against the corporation in its corporate name;

(6) abate or suspend a proceeding pending by or against the corporation on the effective date of dissolution; or

(7) terminate the authority of the registered agent of the corporation.

OFFICIAL COMMENT

Section 14.05 (a) provides that dissolution does not terminate the corporate existence but simply requires the corporation thereafter to devote itself to winding up its affairs and liquidating its assets; after dissolution, the corporation may not carry on its business except as may be appropriate for winding up.

The Model Act uses the term ''dissolution'' in the specialized sense described above and not to describe the final step in the liquidation of the corporate business. This is made clear by section 14.05 (b), which provides that chapter 14 dissolution does not have any of the characteristics of common law dissolution, which treated corporate dissolution as analogous to the death of a natural person and abated lawsuits, vested equitable title to corporate property in the shareholders, imposed the fiduciary duty of trustees on directors who had custody of corporate assets, and revoked the authority of the registered agent. Section 14.05(b) expressly reverses all of these common law attributes of dissolution and makes clear that the rights, powers, and duties of shareholders, the directors, and the registered agent are not affected by dissolution and that suits by or against the corporation are not affected in any way.

§ 14.06 Known Claims Against Dissolved Corporation

(a) A dissolved corporation may dispose of the known claims against it by notifying its known claimants in writing of the dissolution at any time after its effective date.

(b) The written notice must:

(1) describe information that must be included in a claim;

(2) provide a mailing address where a claim may be sent;

(3) state the deadline, which may not be fewer than 120 days from the effective date of the written notice, by which the dissolved corporation must receive the claim; and

(4) state that the claim will be barred if not received by the deadline.

(c) A claim against the dissolved corporation is barred:

(1) if a claimant who was given written notice under subsection (b) does not deliver the claim to the dissolved corporation by the deadline; or

(2) if a claimant whose claim was rejected by the dissolved corporation does not commence a proceeding to enforce the claim within 90 days from the effective date of the rejection notice.

(d) For purposes of this section, ''claim'' does not include a contingent liability or a claim based on an event occurring after the effective date of dissolution.

OFFICIAL COMMENT

Sections 14.06 and 14.07 provide a simplified system for handling known and unknown claims against a dissolved corporation, including claims based on events that occur after the dissolution of the corporation. Section 14.06 deals solely with known claims while section 14.07 deals with unknown or subsequently arising claims. A claim can be a ''known'' claim even if it is unliquidated; a claim that is contingent or has not yet matured or in certain cases has matured but has not been asserted is not a ''known'' claim (see section 14.06(d). For example, an unmatured liability under a guarantee, a potential default under a lease, or an unasserted claim based upon a defective product manufactured by the dissolved corporation would not be a ''known'' claim.

Known claims are handled in section 14.06 through a process of written notice to claimants; the written notice must contain the information described in section 14.06(b). Section 14.06(c) then provides fixed deadlines by which claims are barred under various circumstances, as follows:

(1) If a claimant was given effective written notice satisfying section 14.06(b) but fails to file the claim by the deadline specified by the dissolved corporation, the claim is barred by section 14.06(c)(1). See section 1.41(e) as to the effectiveness of notice.

(2) If a claimant receives written notice satisfying section 14.06(b) and files the claim as required:

(i) but the dissolved corporation rejects the claim, the claimant must commence a proceeding to enforce the claim within 90 days of the rejection or the claim is barred by section 14.06(c)(2); or

(ii) if the dissolved corporation does not act on the claim or fails to notify the claimant of the rejection, the claimant is not barred by section 14.06(c) until the dissolved corporation notifies the claimant.

(3) If the dissolved corporation publishes notice under section 14.07, a claimant who was not notified in writing is barred unless a proceeding is commenced to enforce the claim within three years after publication of the notice.

(4) If the dissolved corporation does not publish notice, a claimant who was not notified in writing is not barred by section 14.06(c) from pursuing the his claim.

These principles, it should be emphasized, do not lengthen statutes of limitation applicable under general state law. Thus, claims that are not barred under the foregoing rules—for example, if the corporation does not act on a claim—will nevertheless be subject to the general statute of limitations applicable to claims of that type.

Even though the directors are not trustees of the assets of a dissolved corporation (see section 14.05(b)(3)), they must discharge or make provision for discharging the corporation's liabilities before distributing the remaining assets to the shareholders. See section sections 14.09.

§ 14.07 Other Claims Against Dissolved Corporation

(a) A dissolved corporation may also publish notice of its dissolution and request that persons with claims against the dissolved corporation present them in accordance with the notice.

(b) The notice must:

(1) be published one time in a newspaper of general circulation in the county where the dissolved corporation's principal office (or, if none in this state, its registered office) is or was last located;

(2) describe the information that must be included in a claim and provide a mailing address where the claim may be sent; and

(3) state that a claim against the dissolved corporation will be barred unless a proceeding to enforce the claim is commenced within three years after the publication of the notice.

(c) If the dissolved corporation publishes a newspaper notice in accordance with subsection (b), the claim of each of the following claimants is barred unless the claimant commences a proceeding to enforce the claim against the dissolved corporation within three years after the publication date of the newspaper notice:

(1) a claimant who was not given written notice under section 14.06;

(2) a claimant whose claim was timely sent to the dissolved corporation but not acted on;

(3) a claimant whose claim is contingent or based on an event occurring after the effective date of dissolution.

(d) A claim that is not barred by section 14.06(c) or section 14.07(c) may be enforced:

(1) against the dissolved corporation, to the extent of its undistributed assets; or

(2) except as provided in section 14.08(d), if the assets have been distributed in liquidation, against a shareholder of the dissolved corporation to the extent of the shareholder's pro rata share of the claim or the corporate assets distributed to the shareholder in liquidation, whichever is less, but a shareholder's total liability for all claims under this section may not exceed the total amount of assets distributed to the shareholder.

§ 14.08 Court Proceedings

(a) A dissolved corporation that has published a notice under section 14.07 may file an application with the [name or describe] court of the county where the dissolved corporation's principal office (or, if none in this state, its registered office) is located for a determination of the amount and form of security to be provided for payment of claims that are contingent or have not been made known to the dissolved corporation or that are based on an event occurring after the effective date of dissolution but that, based on the facts known to the dissolved corporation, are reasonably estimated to arise after the effective date of dissolution. Provision need not be made for any claim that is or is reasonably anticipated to be barred under section 14.07(c).

(b) Within 10 days after the filing of the application, notice of the proceeding shall be given by the dissolved corporation to each claimant holding a contingent claim whose contingent claim is shown on the records of the dissolved corporation.

(c) The court may appoint a guardian ad litem to represent all claimants whose identities are unknown in any proceeding brought under this section. The reasonable fees and expenses of such guardian, including all reasonable expert witness fees, shall be paid by the dissolved corporation.

(d) Provision by the dissolved corporation for security in the amount and the form ordered by the court under section 14.08(a) shall satisfy the dissolved corporation's obligations with respect to claims that are contingent, have not been made known to the dissolved corporation or are based on an event occurring after the effective date of dissolution, and such claims may not be enforced against a shareholder who received assets in liquidation.

OFFICIAL COMMENT

Section 14.08 adds a provision to the Model Act allowing a dissolved corporation to initiate a proceeding to establish the provision that should be made for unknown or contingent claims before a distribution in liquidation is made to shareholders. Similar proceedings are authorized in several states to remove the risk of director and shareholder liability for inadequate provision for claims.

Section 14.08(a) authorizes the proceeding and specifies that provision for unknown and contingent claims can only be for those claims that are estimated to arise after dissolution that are not expected to be barred by section 14.07(d). The same analysis may be made by the board of directors under section 14.09 if court proceedings are not used. As a result, estimates for unknown or contingent claims, such as product liability injury claims that might arise after dissolution, need only be made for those claims that the court determines are reasonably anticipated to be asserted within three years after dissolution. Such estimates might reasonably be based on the claims experience of the corporation prior to its dissolution.

If the dissolved corporation elects to initiate a proceeding, it must give notice of the proceeding within 10 days after filing the court application to each holder of a contingent claim whose claim is shown on the records of the corporation. Notice to holders of guarantees made by the corporation typically would be required under this subsection.

Subsection (c) allows the court to appoint a guardian ad litem for unknown claimants, but does not make the appointment mandatory. Reasonable fees and expenses of the guardian ad litem are to be paid by the dissolved corporation. Section 14.08 is designed to permit the court to adopt procedures appropriate to the circumstances.

If the proceeding is completed, section 14.08(d) establishes that the dissolved corporation is deemed to have satisfied its obligation to discharge or make provision for discharging its liabilities (see section 14.05(a)(3)). With respect to claims that have not matured, directors are protected from liability by section 14.09(b), and shareholders are protected from claims under section 14.08(d).

If a court determines that the corporation is dissolving for the primary purpose of avoiding anticipated claims of future tort claimants, it is expected that the court will use its general discretionary powers and deny the protections of section 14.08 to the dissolved corporation.

§ 14.09 Director Duties

(a) Directors shall cause the dissolved corporation to discharge or make reasonable provision for the payment of claims and make distributions of assets to shareholders after payment or provision for claims.

(b) Directors of a dissolved corporation which has disposed of claims under sections 14.06, 14.07, or 14.08 shall not be liable for breach of section 14.09(a) with respect to claims against the dissolved corporation that are barred or satisfied under sections 14.06, 14.07, or 14.08.

OFFICIAL COMMENT

New section 14.09(a) establishes the duty of directors to discharge or make provision for claims and to make distributions of the remaining assets to shareholders. The earlier version of chapter 14 inferred the obligation from sections 14.05(3) and (4) concerning the powers of the corporation to pay claims and make distributions upon dissolution. Liability of directors formerly was based on violations of section 6.40 concerning distributions. New section 6.40(h) removed distributions in liquidation from the coverage of section 6.40.

Section 14.09(b) provides that directors of a dissolved corporation that complies with sections 14.06, 14.07, or 14.08 are not liable for breach of section 14.09(a) with respect to claims that are disposed of under those sections. For example, directors need not make provision for claims of known creditors who are barred under section 14.06 for failure to file a claim or commence a proceeding within the specified times, for contingent claimants whose estimated claims are barred by the three-year period after publication, pursuant to section 14.07(c), or for claimants such as guarantors if provision for the claims have been approved by a court under section 14.08(d).

Section 14.09(b) leaves unchanged the section 8.33 provision that director liability is to the corporation. There are, however, cases that under various theories recognize liability directly to creditors for wrongful payments in liquidation. While there might be circumstances under which direct creditor claims are appropriate, the basic approach of chapter 14 is that claims for breach of duty of directors for breach of section 14.09(a) and claims against shareholders for recoupment of amounts improperly distributed in liquidation should be mediated through the corporation.

SUBCHAPTER B. ADMINISTRATIVE DISSOLUTION

§ 14.20 Grounds for Administrative Dissolution

The secretary of state may commence a proceeding under section 14.21 to administratively dissolve a corporation if:

(1) the corporation does not pay within 60 days after they are due any franchise taxes or penalties imposed by this Act or other law;

(2) the corporation does not deliver its annual report to the secretary of state within 60 days after it is due;

(3) the corporation is without a registered agent or registered office in this state for 60 days or more;

(4) the corporation does not notify the secretary of state within 60 days that its registered agent or registered office has been changed, that its registered agent has resigned, or that its registered office has been discontinued; or

(5) the corporation's period of duration stated in its articles of incorporation expires.

§ 14.21 Procedure for and Effect of Administrative Dissolution

(a) If the secretary of state determines that one or more grounds exist under section 14.20 for dissolving a corporation, he shall serve the corporation with written notice of his determination under section 5.04.

(b) If the corporation does not correct each ground for dissolution or demonstrate to the reasonable satisfaction of the secretary of state that each ground determined by the secretary of state does not exist within 60 days after service of the notice is perfected under section 5.04, the secretary of state shall administratively dissolve the corporation by signing a certificate of dissolution that recites the ground or grounds for dissolution and its effective date. The secretary of state shall file the original of the certificate and serve a copy on the corporation under section 5.04.

(c) A corporation administratively dissolved continues its corporate existence but may not carry on any business except that necessary to wind up and liquidate its business and affairs under section 14.05 and notify claimants under sections 14.06 and 14.07.

(d) The administrative dissolution of a corporation does not terminate the authority of its registered agent.

§ 14.22 Reinstatement Following Administrative Dissolution

(a) A corporation administratively dissolved under section 14.21 may apply to the secretary of state for reinstatement within two years after the effective date of dissolution. The application must:

(1) recite the name of the corporation and the effective date of its administrative dissolution;

(2) state that the ground or grounds for dissolution either did not exist or have been eliminated;

(3) state that the corporation's name satisfies the requirements of section 4.01; and

(4) contain a certificate from the [taxing authority] reciting that all taxes owed by the corporation have been paid.

(b) If the secretary of state determines that the application contains the information required by subsection (a) and that the information is correct, he shall cancel the certificate of dissolution and prepare a certificate of reinstatement that recites his determination and the effective date of reinstatement, file the original of the certificate, and serve a copy on the corporation under section 5.04.

(c) When the reinstatement is effective, it relates back to and takes effect as of the effective date of the administrative dissolution and the corporation resumes carrying on its business as if the administrative dissolution had never occurred.

§ 14.23 Appeal From Denial of Reinstatement

(a) If the secretary of state denies a corporation's application for reinstatement following administrative dissolution, he shall serve the corporation under section 5.04 with a written notice that explains the reason or reasons for denial.

(b) The corporation may appeal the denial of reinstatement to the [name or describe] court within 30 days after service of the notice of denial is perfected. The corporation appeals by petitioning the court to set aside the dissolution and attaching to the petition copies of the secretary of state's certificate of dissolution, the corporation's application for reinstatement, and the secretary of state's notice of denial.

(c) The court may summarily order the secretary of state to reinstate the dissolved corporation or may take other action the court considers appropriate.

(d) The court's final decision may be appealed as in other civil proceedings.

SUBCHAPTER C. JUDICIAL DISSOLUTION

§ 14.30 Grounds for Judicial Dissolution

(a) The [name or describe court or courts] may dissolve a corporation:

(1) in a proceeding by the attorney general if it is established that:

(i) the corporation obtained its articles of incorporation through fraud; or

(ii) the corporation has continued to exceed or abuse the authority conferred upon it by law;

(2) in a proceeding by a shareholder if it is established that:

(i) the directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered, or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally, because of the deadlock;

(ii) the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent;

(iii) the shareholders are deadlocked in voting power and have failed, for a period that includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired; or

(iv) the corporate assets are being misapplied or wasted;

(3) in a proceeding by a creditor if it is established that:

(i) the creditor's claim has been reduced to judgment, the execution on the judgment returned unsatisfied, and the corporation is insolvent; or

(ii) the corporation has admitted in writing that the creditor's claim is due and owing and the corporation is insolvent; or

(4) in a proceeding by the corporation to have its voluntary dissolution continued under court supervision.

(5) in a proceeding by a shareholder if the corporation has abandoned its business and has failed within a reasonable time to liquidate and distribute its assets and dissolve.

(b) Section 14.30(a)(2) shall not apply in the case of a corporation that, on the date of the filing of the proceeding, has shares that are:

(i) listed on the New York Stock Exchange, the American Stock Exchange or on any exchange owned or operated by the NASDAQ Stock Market LLC, or listed or quoted on a system owned or operated by the National Association of Securities Dealers, Inc.; or

(ii) not so listed or quoted, but are held by at least 300 shareholders and the shares outstanding have 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).

(c) In this section, ''beneficial shareholder'' has the meaning specified in section 13.01(2).

OFFICIAL COMMENT

Section 14.30(a) provides grounds for the judicial dissolution of corporations at the request of the state, a shareholder, a creditor, or a corporation which has commenced voluntary dissolution. This section states that a court ''may'' order dissolution if a ground for dissolution exists. Thus, there is discretion on the part of the court as to whether dissolution is appropriate even though grounds exist under the specific circumstances. The grounds listed in section 14.30(a)(2) are available only if the corporation does not meet the tests for being publicly traded set forth in section 14.30(b), whereas a shareholder may seek dissolution under section 14.30(5) regardless of whether or not the corporation meets those tests.

1. Involuntary Dissolution by State

Section 14.30(a)(1) preserves long standing and traditional provisions authorizing the state to seek to dissolve involuntarily a corporation by judicial decree. While this power has been exercises only rarely in recent years, this right of the state involves a policing action that provides a means by which the state may ensure compliance with, and nonabuse of, the fundamentals of corporate existence. Section 14.30(a)(1) limits the power of the state in this regard to grounds that are reasonably related to this objective.

The legality of proposed corporations or of proposed actions has sometimes been tested by the secretary of state's refusal to accept documents for filing. The role of the secretary of state in reviewing documents for filing has been restricted by the Model Act (see section 1.25 and its Official Comment). It is intended that suits under this subchapter will replace those actions.

2. Involuntary Dissolution By Shareholders

Section 14.30(a)(2) provides for involuntary dissolution at the suit of a shareholder under circumstances involving deadlock or significant abuse of power by controlling shareholders or directors. Section 14.30(a)(2) provides for involuntary dissolution at the suit of a shareholder under circumstances involving deadlock or significant abuse of power by controlling shareholders or directors. The remedy of judicial dissolution under section 14.30(a)(2) is appropriate only for shareholders of corporations that are not widely-held. Even in those situations, however, the court can take into account the number of shareholders and the nature of the trading market for the shares in deciding whether to exercise its discretion to order dissolution. Shareholders of corporations that meet the tests of section 14.30(b) will normally have the ability to sell their shares if they are dissatisfied with current management. In addition, (i) they may seek traditional remedies for breach of fiduciary duty; (ii) they may seek judicial removal of directors in case of fraud, gross abuse of power, or the intentional infliction of harm on the corporation, under section 8.09, or (iii) in the narrow circumstances covered in section 7.48(a), if irreparable injury is occurring or threatened, they may seek the appointment of a custodian or receiver outside the context of a dissolution proceeding. In contrast, a resort to litigation may result in an irreparable breach of personal relationships among the shareholders of a non-public corporation, making it impossible for them to continue in business to their mutual advantage, and making liquidation and dissolution (subject to the buy-out provisions of section 14.34) the appropriate solution. The grounds for dissolution under section 14.30(a)(2) are broader than those required to be shown for the appointment of a custodian or receiver under section 7.48(a). The difference is attributable to the different focus of the two proceedings. While some of the grounds listed in 14.30(a)(2), such as deadlock, may implicate the welfare of the corporation as a whole, the primary focus is on the effect of actions by those in control on the value of the complaining shareholder's individual investment: for example, the ''oppression'' ground in section 14.30(a)(2)(ii) is often cited in complaints for dissolution and generally describes action directed against a particular shareholder. In contrast, the primary focus of an action to appoint a custodian or receiver under section 7.48(a) is the corporate entity, and the action is intended to protect the interests of all shareholders, creditors and others who may have an interest therein. In other instances, action that is ''illegal'' or ''fraudulent'' under 14.30(a)(2) may be severely prejudicial to the interests of the individual complaining shareholder, whereas conduct that is illegal with respect to the corporation may be remedied by other causes of action available to shareholders, and ''fraudulent'' conduct or a board deadlock under section 7.48(a) must be accompanied by or threaten irreparable harm to warrant the appointment of a custodian or receiver. An action under section 7.48(a) may be brought by a shareholder of any corporation.

a. Deadlock

Dissolution because of deadlock is available if there is a deadlock at the directors' level but only if (1) the shareholders are unable to break the deadlock and (2) either ''irreparable injury'' to the corporation is being threatened or suffered or the business and affairs ''can no longer be conducted to the advantage of'' the shareholders. This language closely follows the earlier versions of the Model Act except that the requirement of ''irreparable injury'' has been relaxed to some extent. Dissolution because of deadlock at the director's level is not dependent on the lapse of time during which the deadlock continues.

Dissolution is also available because of deadlock at the shareholders' level if the shareholders are unable to elect directors over a two-year period. This remedy is particularly important in small or family-held corporations in which share ownership may be divided on a 50–50 basis or a supermajority provision (including possibly a requirement of unanimity) may effectively prevent the election of any directors. Dissolution under section 14.30(2)(iii) is not dependent on irreparable injury or misconduct by the directors then in office; if injury or misconduct is present, a deadlocked shareholder may proceed under another clause of section 14.30(2).

b. Abuse of power

A Shareholder may sue for involuntary dissolution upon proof either that those in control of the corporation are acting illegally, oppressively, or fraudulently (section 14.30 (2) (ii)) or that the corporate assets are being misapplied or wasted (section 14.30 (2) (iv)). The application of these grounds for dissolution to specific circumstances obviously involves judicial discretion in the application of a general standard to concrete circumstances. The court should be cautious in the application of these grounds so as to limit them to genuine abuse rather than instances of acceptable tactics in a power struggle for control of a corporation.

3. Dissolution By Creditors

Creditors may obtain involuntary dissolution only when the corporation is insolvent and only in the limited circumstances set forth in section 14.30(a)(3). Typically, a proceeding under the federal Bankruptcy Act is an alternative in these situations.

4. Dissolution By Corporation

A corporation that has commenced voluntary dissolution may petition a court to supervise its dissolution. Such an action may be appropriate to permit the orderly liquidation of the corporate assets and to protect the corporation from a multitude of creditors' suits or suits by dissatisfied shareholders.

5. Dissolution by Shareholder for Unreasonable Delay in Liquidation and Dissolution

Section 14.30(5) provides a basis for a shareholder to obtain involuntary dissolution in the event the corporation has abandoned its business, but those in control of the corporation have delayed unreasonably in either liquidating and distributing its assets or completing the necessary procedures to dissolve the corporation. Such a situation might result from negligence or from the desire of those in control to continue enjoying salaries or other perquisites of office from the corporation, even though it is no longer engaged in productive operations. In either event, continued delay in winding up the business and dissolving will prejudice the rights of creditors and shareholders. Whether a delay is reasonable will be determined by the reason for the delay.

§ 14.31 Procedure for Judicial Dissolution

(a) Venue for a proceeding by the attorney general to dissolve a corporation lies in [name the county or counties]. Venue for a proceeding brought by any other party named in section 14.30 lies in the county where a corporation's principal office (or, if none in this state, its registered office) is or was last located.

(b) It is not necessary to make shareholders parties to a proceeding to dissolve a corporation unless relief is sought against them individually.

(c) A court in a proceeding brought to dissolve a corporation may issue injunctions, appoint a receiver or custodian pendente lite with all powers and duties the court directs, take other action required to preserve the corporate assets wherever located, and carry on the business of the corporation until a full hearing can be held.

(d) Within 10 days of the commencement of a proceeding under section 14.30(2) to dissolve a corporation that is not a public corporation, the corporation must send to all shareholders, other than the petitioner, a notice stating that the shareholders are entitled to avoid the dissolution of the corporation by electing to purchase the petitioner's shares under section 14.34 and accompanied by a copy of section 14.34.

§ 14.32 Receivership or Custodianship

(a) Unless an election to purchase has been filed under section 14.34, a court in a judicial proceeding brought to dissolve a corporation may appoint one or more receivers to wind up and liquidate, or one or more custodians to manage, the business and affairs of the corporation. The court shall hold a hearing, after notifying all parties to the proceeding and any interested persons designated by the court, before appointing a receiver or custodian. The court appointing a receiver or custodian has jurisdiction over the corporation and all of its property wherever located.

(b) The court may appoint an individual or a domestic or foreign corporation (authorized to transact business in this state) as a receiver or custodian. The court may require the receiver or custodian to post bond, with or without sureties, in an amount the court directs.

(c) The court shall describe the powers and duties of the receiver or custodian in its appointing order, which may be amended from time to time. Among other powers:

(1) the receiver (i) may dispose of all or any part of the assets of the corporation wherever located, at a public or private sale, if authorized by the court; and (ii) may sue and defend in his own name as receiver of the corporation in all courts of this state;

(2) the custodian may exercise all of the powers of the corporation, through or in place of its board of directors or officers, to the extent necessary to manage the affairs of the corporation in the best interests of its shareholders and creditors.

(d) The court during a receivership may redesignate the receiver a custodian, and during a custodianship may redesignate the custodian a receiver, if doing so is in the best interests of the corporation, its shareholders, and creditors.

(e) The court from time to time during the receivership or custodianship may order compensation paid and expenses paid or reimbursed to the receiver or custodian from the assets of the corporation or proceeds from the sale of the assets.

§ 14.33 Decree of Dissolution

(a) If after a hearing the court determines that one or more grounds for judicial dissolution described in section 14.30 exist, it may enter a decree dissolving the corporation and specifying the effective date of the dissolution, and the clerk of the court shall deliver a certified copy of the decree to the secretary of state, who shall file it.

(b) After entering the decree of dissolution, the court shall direct the winding up and liquidation of the corporation's business and affairs in accordance with section 14.05 and the notification of claimants in accordance with sections 14.06 and 14.07.

§ 14.34 Election to Purchase in Lieu of Dissolution

(a) In a proceeding under section 14.30(2) to dissolve a corporation, the corporation may elect or, if it fails to elect, one or more shareholders may elect to purchase all shares owned by the petitioning shareholder at the fair value of the shares. An election pursuant to this section shall be irrevocable unless the court determines that it is equitable to set aside or modify the election.

(b) An election to purchase pursuant to this section may be filed with the court at any time within 90 days after the filing of the petition under section 14.30(2) or at such later time as the court in its discretion may allow. If the election to purchase is filed by one or more shareholders, the corporation shall, within 10 days thereafter, give written notice to all shareholders, other than the petitioner. The notice must state the name and number of shares owned by the petitioner and the name and number of shares owned by each electing shareholder and must advise the recipients of their right to join in the election to purchase shares in accordance with this section. Shareholders who wish to participate must file notice of their intention to join in the purchase no later than 30 days after the effective date of the notice to them. All shareholders who have filed an election or notice of their intention to participate in the election to purchase thereby become parties to ownership of shares as of the date the first election was filed, unless they otherwise agree or the court otherwise directs. After an election has been filed by the corporation or one or more shareholders, the proceeding under section 14.30(2) may not be discontinued or settled, nor may the petitioning shareholder sell or otherwise dispose of his shares, unless the court determines that it would be equitable to the corporation and the shareholders, other than the petitioner, to permit such discontinuance, settlement, sale, or other disposition.

(c) If, within 60 days of the filing of the first election, the parties reach agreement as to the fair value and terms of purchase of the petitioner's shares, the court shall enter an order directing the purchase of petitioner's shares upon the terms and conditions agreed to by the parties.

(d) If the parties are unable to reach an agreement as provided for in subsection (c), the court, upon application of any party, shall stay the section 14.30(2) proceedings and determine the fair value of the petitioner's shares as of the day before the date on which the petition under section 14.30(2) was filed or as of such other date as the court deems appropriate under the circumstances.

(e) Upon determining the fair value of the shares, the court shall enter an order directing the purchase upon such terms and conditions as the court deems appropriate, which may include payment of the purchase price in installments, where necessary in the interests of equity, provision for security to assure payment of the purchase price and any additional costs, fees, and expenses as may have been awarded, and, if the shares are to be purchased by shareholders, the allocation of shares among them. In allocating petitioner's shares among holders of different classes of shares, the court should attempt to preserve the existing distribution of voting rights among holders of different classes insofar as practicable and may direct that holders of a specific class or classes shall not participate in the purchase. Interest may be allowed at the rate and from the date determined by the court to be equitable, but if the court finds that the refusal of the petitioning shareholder to accept an offer of payment was arbitrary or otherwise not in good faith, no interest shall be allowed. If the court finds that the petitioning shareholder had probable grounds for relief under paragraphs (ii) or (iv) of section 14.30(2), it may award to the petitioning shareholder reasonable fees and expenses of counsel and of any experts employed by him.

(f) Upon entry of an order under subsections (c) or (e), the court shall dismiss the petition to dissolve the corporation under section 14.30, and the petitioning shareholder shall no longer have any rights or status as a shareholder of the corporation, except the right to receive the amounts awarded to him by the order of the court which shall be enforceable in the same manner as any other judgment.

(g) The purchase ordered pursuant to subsection (e), shall be made within 10 days after the date the order becomes final unless before that time the corporation files with the court a notice of its intention to adopt articles of dissolution pursuant to sections 14.02 and 14.03, which articles must then be adopted and filed within 50 days thereafter. Upon filing of such articles of dissolution, the corporation shall be dissolved in accordance with the provisions of sections 14.05 through 07, and the order entered pursuant to subsection (e) shall no longer be of any force or effect, except that the court may award the petitioning shareholder reasonable fees and expenses in accordance with the provisions of the last sentence of subsection (e) and the petitioner may continue to pursue any claims previously asserted on behalf of the corporation.

(h) Any payment by the corporation pursuant to an order under subsections (c) or (e), other than an award of fees and expenses pursuant to subsection (e), is subject to the provisions of section 6.40.

SUBCHAPTER D. MISCELLANEOUS

§ 14.40 Deposit With State Treasurer

Assets of a dissolved corporation that should be transferred to a creditor, claimant, or shareholder of the corporation who cannot be found or who is not competent to receive them shall be reduced to cash and deposited with the state treasurer or other appropriate state official for safekeeping. When the creditor, claimant, or shareholder furnishes satisfactory proof of entitlement to the amount deposited, the state treasurer or other appropriate state official shall pay him or his representative that amount.

CHAPTER 15. [FOREIGN CORPORATIONS—OMITTED]

CHAPTER 16. RECORDS AND REPORTS

SUBCHAPTER A. RECORDS

§ 16.01 Corporate Records

(a) A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.

(b) A corporation shall maintain appropriate accounting records.

(c) A corporation or its agent shall maintain a record of its shareholders, in a form that permits preparation of a list of the names and addresses of all shareholders, in alphabetical order by class of shares showing the number and class of shares held by each.

(d) A corporation shall maintain its records in written form or in another form capable of conversion into written form within a reasonable time.

(e) A corporation shall keep a copy of the following records at its principal office:

(1) its articles or restated articles of incorporation, all amendments to them currently in effect and any notices to shareholders referred to in section 1.20(k)(5) regarding facts on which a filed document is dependent;

(2) its bylaws or restated bylaws and all amendments to them currently in effect;

(3) resolutions adopted by its board of directors creating one or more classes or series of shares, and fixing their relative rights,

preferences, and limitations, if shares issued pursuant to those resolutions are outstanding;

(4) the minutes of all shareholders' meetings, and records of all action taken by shareholders without a meeting, for the past three years;

(5) all written communications to shareholders generally within the past three years, including the financial statements furnished for the past three years under section 16.20;

(6) a list of the names and business addresses of its current directors and officers; and

(7) its most recent annual report delivered to the secretary of state under section 16.22.

§ 16.02 Inspection of Records by Shareholders

(a) A shareholder of a corporation is entitled to inspect and copy, during regular business hours at the corporation's principal office, any of the records of the corporation described in section 16.01(e) if he gives the corporation written notice of his demand at least five business days before the date on which he wishes to inspect and copy.

(b) A shareholder of a corporation is entitled to inspect and copy, during regular business hours at a reasonable location specified by the corporation, any of the following records of the corporation if the shareholder meets the requirements of subsection (c) and gives the corporation written notice of his demand at least five business days before the date on which he wishes to inspect and copy:

(1) excerpts from minutes of any meeting of the board of directors, records of any action of a committee of the board of directors while acting in place of the board of directors on behalf of the corporation, minutes of any meeting of the shareholders, and records of action taken by the shareholders or board of directors without a meeting, to the extent not subject to inspection under section 16.02(a);

(2) accounting records of the corporation; and

(3) the record of shareholders.

(c) A shareholder may inspect and copy the records described in subsection (b) only if:

(1) his demand is made in good faith and for a proper purpose;

(2) he describes with reasonable particularity his purpose and the records he desires to inspect; and

(3) the records are directly connected with his purpose.

(d) The right of inspection granted by this section may not be abolished or limited by a corporation's articles of incorporation or bylaws.

(e) This section does not affect:

(1) the right of a shareholder to inspect records under section 7.20 or, if the shareholder is in litigation with the corporation, to the same extent as any other litigant;

(2) the power of a court, independently of this Act, to compel the production of corporate records for examination.

(f) For purposes of this section, ''shareholder'' includes a beneficial owner whose shares are held in a voting trust or by a nominee on his behalf.

§ 16.03 Scope of Inspection Right

(a) A shareholder's agent or attorney has the same inspection and copying rights as the shareholder represented.

(b) The right to copy records under section 16.02 includes, if reasonable, the right to receive copies by xerographic or other means, including copies through an electronic transmission if available and so requested by the shareholder.

(c) The corporation may comply at its expense with a shareholder's demand to inspect the record of shareholders under section 16.02(b)(3) by providing the shareholder with a list of shareholders that was compiled no earlier than the date of the shareholder's demand.

(d) The corporation may impose a reasonable charge, covering the costs of labor and material, for copies of any documents provided to the shareholder. The charge may not exceed the estimated cost of production, reproduction or transmission of the records.

OFFICIAL COMMENT

The right of inspection set forth in section 16.02 includes the general right to copy the documents inspected. Section 16.03 follows precedent established under earlier statutes and extends the right of inspection to an agent or attorney of a shareholder as well as the shareholder. The right to copy means more than a right to copy by longhand and extends to the right to receive copies made by copying machines or through an electronic transmission with the cost of reproduction and transmission being paid by the shareholder. The requirement of availability with respect to electronic transmissions is intended to insure that the corporation can provide the document electronically and that an undue burden is not placed on the corporation to provide copies through an electronic transmission or other similar means.

Section 16.03(c) is designed to give the corporation the option of providing a reasonably current list of its shareholders instead of granting the right of inspection; a "reasonably current" list is defined in section 16.03(c) as one compiled no earlier than the date of the written demand, which under section 16.02(b) must provide at least five days' notice.

Many corporations make available to shareholders without charge some or all of the basic documents described in section 16.01(e). Section 16.03(d) authorizes the corporation to charge a reasonable fee based on reproduction costs (including labor and materials) for providing a copy of any document. The phrase "estimated cost of production, reproduction or transmission of the records" in section 16.03(d) refers to the cost of assembling information and data to meet a demand as well as the cost of reproducing and transmitting documents that are already in existence.

Under applicable law, a list of shareholders generally will include underlying information in the corporation's possession relating to stock ownership, including, where applicable, breakdowns of stock holdings by nominees and nonobjecting beneficial ownership (NOBO) lists. However, a corporation generally is not required to generate this information for the requesting shareholder and is only required to provide NOBO and other similar lists to the extent such information is in the corporation's possession.

Section 7.20 creates a right of shareholders to inspect a list of shareholders in advance of and at a meeting that is independent of the rights of shareholders to inspect corporate records under chapter 16.

§ 16.04 Court–Ordered Inspection

(a) If a corporation does not allow a shareholder who complies with section 16.02(a) to inspect and copy any records required by that subsection to be available for inspection, the [name or describe court] of the county where the corporation's principal office (or, if none in this state, its registered office) is located may summarily order inspection and copying of the records demanded at the corporation's expense upon application of the shareholder.

(b) If a corporation does not within a reasonable time allow a shareholder to inspect and copy any other record, the shareholder who complies with section 16.02(b) and (c) may apply to the [name or describe court] in the county where the corporation's principal office (or, if none in this state, its registered office) is located for an order to permit inspection and copying of the records demanded. The court shall dispose of an application under this subsection on an expedited basis.

(c) If the court orders inspection and copying of the records demanded, it shall also order the corporation to pay the shareholder's expenses incurred to obtain the order unless the corporation proves that it refused inspection in good faith because it had a reasonable basis for doubt about the right of the shareholder to inspect the records demanded.

(d) If the court orders inspection and copying of the records demanded, it may impose reasonable restrictions on the use or distribution of the records by the demanding shareholder.

§ 16.05 Inspection of Records by Directors

(a) A director of a corporation is entitled to inspect and copy the books, records and documents of the corporation at any reasonable time to the extent reasonably related to the performance of the director's duties as a director, including duties as a member of a committee, but not for any other purpose or in any manner that would violate any duty to the corporation.

(b) The [name or describe the court] of the county where the corporation's principal office (or if none in this state, its registered office) is located may order inspection and copying of the books, records and documents at the corporation's expense, upon application of a director who has been refused such inspection rights, unless the corporation establishes that the director is not entitled to such inspection rights. The court shall dispose of an application under this subsection on an expedited basis.

(c) If an order is issued, the court may include provisions protecting the corporation from undue burden or expense, and prohibiting the director from using information obtained upon exercise of the inspection rights in a manner that would violate a duty to the corporation, and may also order the corporation to reimburse the director for the director's expenses incurred in connection with the application.

OFFICIAL COMMENT

The purpose of subsection 16.05(a) is to confirm the principle that a director always is entitled to inspect books, records and documents to the extent reasonably related to the performance of the director's oversight or decisional duties provided that the requested inspection is not for an improper purpose and the director's use of the information obtained would not violate any duty to the corporation. The statute attempts to reconcile and balance competing principles articulated in the common law which suggest that a director has a nearly "absolute" right to information subject only to limitation if it can be shown that the director has an improper motive or intent in asking for the information or would violate law by receiving the information. In addition, the statutory provision sets forth a remedy for the director in circumstances where the corporation improperly denies the right of inspection.

Under subsection (a), a director typically would be entitled to review books, records and documents relating to matters such as (i) compliance by a corporation with applicable law, (ii) adequacy of the corporation's system of internal controls to provide accurate and timely financial statements and disclosure documents, or (iii) the proper operation, maintenance and protection of the corporation's assets. In addition, a director would be entitled to review records and documents to the extent required to consider and make decisions with respect to matters placed before the Board.

Subsection (b) provides a director with the right to seek on an expedited basis a court order permitting inspection and copying of the books, records and documents of the corporation, at the corporation's expense. There is a presumption that significant latitude and discretion should be granted to the director, and the corporation has the burden of establishing that a director is not entitled to inspection of the documents requested. Circumstances where the director's inspection rights might be denied include requests which (i) are not reasonably related to performance of a director's duties (e.g., seeking a specified confidential document not necessary for the performance of a director's duties), (ii) impose an unreasonable burden and expense on the corporation (e.g., compliance with the request would be duplicative of information already provided or would be unreasonably expensive and time-consuming), (iii) violate the director's duty to the corporation (e.g., the director could reasonably be expected to use or exploit confidential information in personal or third-party transactions), or (iv) violate any applicable law (e.g., the director does not have the necessary governmental security clearance to see the requested classified information).

Section 16.05 does not directly deal with the ability of a director to inspect records of a subsidiary of which he or she is not also a director. A director's ability to inspect records of a subsidiary generally should be exercised through the parent's rights or power and subsection (a) does not independently provide that right or power to a director of the parent. In the case of wholly-owned subsidiaries, a director's ability to inspect should approximate his or her rights with respect to the parent. In the case of a partially-owned subsidiary, the ability of the director to inspect is likely to be influenced by the level of ownership of the parent (this ability can be expected to be greater for a subsidiary which is part of a consolidated group than for a minority-owned subsidiary). In any case, the inspection by a director of the parent will be subject to the parent's fiduciary obligation to the subsidiary's other shareholders.

Subsection (c) provides that the court may place limitations on the use of information obtained by the director and may include in its order other provisions protecting the corporation from undue burden or expense. Further, the court may order the corporation to reimburse the director for expenses incurred in connection with the application. The amount of any reimbursement is left in the court's discretion, since it must consider the reasonableness of the expenses incurred, as well as the fact that a director may be only partially successful in the application.

§ 16.06 Exception to Notice Requirement

(a) Whenever notice is required to be given under any provision of this Act to any shareholder, such notice shall not be required to be given if:

(i) Notice of two consecutive annual meetings, and all notices of meetings during the period between such two consecutive annual meetings, have been sent to such shareholder at such shareholder's address as shown on the records of the corporation and have been returned undeliverable; or

(ii) All, but not less than two, payments of dividends on securities during a twelve-month period, or two consecutive payments of dividends on securities during a period of more than twelve months, have been sent to such shareholder at such shareholder's address as shown on the records of the corporation and have been returned undeliverable.

(b) If any such shareholder shall deliver to the corporation a written notice setting forth such shareholder's then-current address, the requirement that notice be given to such shareholder shall be reinstated.

OFFICIAL COMMENT

Section 16.06 balances the requirement that the corporation provide notice to shareholders regarding meetings and the practical need to allow corporations to cease providing notices where notices are being returned undelivered and it is clear that the shareholder no longer is located at the address previously provided to the corporation. Absent such a provision, the corporation technically may be required to continue to attempt to provide a notice to the shareholder in order to satisfy a statutory requirement regarding notices to shareholders or otherwise risk questions concerning the validity of the meeting for which the notice is required. A number of states have adopted statutory provisions eliminating the obligation of the corporation to provide notice under certain circumstances. In addition, the federal proxy rules have adopted a similar provision.

Section 16.06 provides that notice is not required to be given to a shareholder if a notice of two consecutive annual meetings, and all notices required during the period between the meetings, are returned undeliverable. In addition, no notice is required if all dividends required to be paid during a twelve-month period (assuming at least two dividends were payable during that period) or two consecutive payments of dividends during a period of more than twelve months, are returned undeliverable. In both of these instances, written notice is not required, and any meeting which is held will have the same force and effect as if notice had been given. The notice for a particular shareholder is reinstated if a written notice to the corporation setting forth the shareholder's then current address is sent to the corporation.

Based upon these provisions, the corporation generally will be required to continue to provide the notice unless undeliverable items are returned over a period that could not be less than twelve months and could extend for up to twenty-four months. For instance, if the first undeliverable communication were sent to a shareholder six months before the next notice of an annual meeting is required, the corporation would have to wait until the annual meeting notice proves to be undeliverable to commence the nondelivery period, and then would have to wait until the next annual meeting notice after that also proves to be undeliverable before suspending the notification requirement. This amounts to a nondelivery period of eighteen months which could extend to two years under the right circumstances. It is believed that this accomplishes the proper balance between protecting the rights of shareholders and eliminating unnecessary notices.

Section 16.06 only deals with notices and does not have application to payment of dividends or other distributions to shareholders. There is no statutorily mandated practice with respect to payment of dividends. However, a decision by a corporation to withhold dividends pending location of the shareholder will not affect the validity of corporate action. Under state law, dividend payments unclaimed by shareholders eventually will escheat to the state in accordance with applicable statutory provisions.

SUBCHAPTER B. REPORTS

§ 16.20 Financial Statements for Shareholders

(a) A corporation shall furnish its shareholders annual financial statements, which may be consolidated or combined statements of the corporation and one or more of its subsidiaries, as appropriate, that include a balance sheet as of the end of the fiscal year, an income statement for that year, and a statement of changes in shareholders' equity for the year unless that information appears elsewhere in the financial statements. If financial statements are prepared for the corporation on the basis of generally accepted accounting principles, the annual financial statements must also be prepared on that basis.

(b) If the annual financial statements are reported upon by a public accountant, his report must accompany them. If not, the statements must be accompanied by a statement of the president or the person responsible for the corporation's accounting records:

(1) stating his reasonable belief whether the statements were prepared on the basis of generally accepted accounting principles and, if not, describing the basis of preparation; and

(2) describing any respects in which the statements were not prepared on a basis of accounting consistent with the statements prepared for the preceding year.

(c) A corporation shall mail the annual financial statements to each shareholder within 120 days after the close of each fiscal year. Thereafter, on written request from a shareholder who was not mailed the statements, the corporation shall mail him the latest financial statements.

OFFICIAL COMMENT

The requirement that a corporation regularly submit some financial information to shareholders is appropriate considering the relationship between corporate management and the shareholders as the ultimate owners of the enterprise. This requirement was first added as an amendment in 1979 to the 1969 Model Act.

Section 16.20 has its principal impact on small, closely held corporations, since enterprises whose securities are registered under federal statutes are required to supply audited financial statements to shareholders. The securities of the vast majority of corporations in the Untied States are not registered under federal law. It is these corporations that section 16.20 principally affects.

Section 16.20 requires every corporation to prepare and submit to shareholders annual financial statements consisting of a balance sheet as of the end of the fiscal year, an income statement for the year, and a statement of changes in shareholders' equity for the year. The last statement may be omitted if the data that normally appears in that statement appears in the other financial statements or in the notes thereto. Consolidated statements of the corporation and any subsidiary, or subsidiaries, or combined statements for corporations under common control, may be used. Section 16.20 does not require financial statements to be prepared on the basis of generally accepted accounting principles (''GAAP''). May small corporations have never prepared financial statements on the basis of GAAP. ''Cash basis'' financial statements (often used in preparing the tax returns of small corporations) do not comply with GAAP. Even closely held corporations that keep accrual basis records, and file their federal income tax returns on that basis, frequently do not make the adjustments that may be required to present their financial statements on a GAAP basis. In light of these considerations, it would be too burdensome on some small and closely held corporations to require GAAP statements. Accordingly, internally or externally prepared financial statements prepared on the basis of other accounting practices and principles that are reasonable in the circumstances, including tax returns filed with the Federal Internal Revenue Service (if that is all that is prepared), will suffice for these types of corporations. If a corporation does prepare financial statements on a GAAP basis for any purpose for the particular year, however, it must send those statements to the shareholders as provided by the last sentence of section 16.20(a).

Section 16.20(b) requires an accompanying report or statement in one of two forms: (1) if the financial statements have been reported upon by a public accountant, his report must be furnished; or (2) in other cases, a statement of the president or the person responsible for the corporation's accounting records must be furnished (i) stating his reasonable belief as to whether the financial statements were prepared on the basis of generally accepted accounting principles, and, if not, describing the basis on which they were prepared, and (ii) describing any respects in which the financial statements were not prepared on a basis of accounting consistent with those prepared for the previous year.

Section 16.20 refers to a ''public accountant.'' The same terminology is used in section 8.30 (standards of conduct for directors) of the Model Act. In various states different terms are employed to identify those persons who are permitted under the state licensing requirements to act as professional accountants. Phrases like ''independent public accountant,'' ''certified public accountant,'' ''public accountant,'' and others may be used. In adopting the term ''public accountant,'' the Model Act uses the words in a general sense to refer to any class or classes of persons who, under the applicable requirements of a particular jurisdiction, are professionally entitled to practice accountancy.

In requiring a statement by the president or person responsible for the corporation's financial affairs, it is recognized that in many cases this person will not be a professionally trained accountant and that he should not be held to the standard required of a professional. To emphasize this difference, section 16.20 requires a ''statement'' (rather than a ''report'' or ''certificate'') and calls for the person to express his ''reasonable belief'' (rather than ''opinion'') about whether or not the statements are prepared on the basis of GAAP or, if not, to describe the basis of presentation and any inconsistencies in the basis of the presentation as compared with the previous year. He is not required to describe any inconsistencies between the basis of presentation and GAAP. If the statements are not prepared on a GAAP basis, the description would normally follow guidelines of the accounting profession as to the reporting format considered appropriate for a presentation which departs from GAAP. See, e.g., " 'Statement on Auditing Standards No. 14" of the American Institute of Certified Public Accountants. For example, the description might state, with respect to a cash basis statement of receipts and disbursements, that the statement was prepared on that basis and that it presents the cash receipts and disbursements of the entity for the period but does not purport to present the results of operations on the accrual basis of accounting.

Section 16.20(c) specifies that annual financial statements are to be mailed to each shareholder within 120 days after the close of each fiscal year, further emphasizing that the statements required to be delivered are annual statements and not interim statements. In addition, if a shareholder was not mailed the corporation's latest annual financial statements, he may obtain them on written request. See also section 16.01 (e)(5).

Failure to comply with the requirements of section 16.20 does not adversely affect the existence or good standing of the corporation. Rather, failure to comply gives an aggrieved shareholder rights to compel compliance or to obtain damages, if they can be established, under general principles of law.

§ 16.21 Annual Report for Secretary of State

(a) Each domestic corporation, and each foreign corporation authorized to transact business in this state, shall deliver to the secretary of state for filing an annual report that sets forth:

(1) the name of the corporation and the state or country under whose law it is incorporated;

(2) the address of its registered office and the name of its registered agent at that office in this state;

(3) the address of its principal office;

(4) the names and business addresses of its directors and principal officers;

(5) a brief description of the nature of its business;

(6) the total number of authorized shares, itemized by class and series, if any, within each class; and

(7) the total number of issued and outstanding shares, itemized by class and series, if any, within each class.

(b) Information in the annual report must be current as of the date the annual report is executed on behalf of the corporation.

(c) The first annual report must be delivered to the secretary of state between January 1 and April 1 of the year following the calendar year in which a domestic corporation was incorporated or a foreign corporation was authorized to transact business. Subsequent annual reports must be delivered to the secretary of state between January 1 and April 1 of the following calendar years.

(d) If an annual report does not contain the information required by this section, the secretary of state shall promptly notify the reporting domestic or foreign corporation in writing and return the report to it for correction. If the report is corrected to contain the information required by this section and delivered to the secretary of state within 30 days after the effective date of notice, it is deemed to be timely filed.

CHAPTER 17. TRANSITION PROVISIONS

§ 17.01 Application to Existing Domestic Corporations

This Act applies to all domestic corporations in existence on its effective date that were incorporated under any general statute of this state providing for incorporation of corporations for profit if power to amend or repeal the statute under which the corporation was incorporated was reserved.

§ 17.02 Application to Qualified Foreign Corporations

A foreign corporation authorized to transact business in this state on the effective date of this Act is subject to this Act but is not required to obtain a new certificate of authority to transact business under this Act.

§ 17.03 Saving Provisions

(a) Except as provided in subsection (b), the repeal of a statute by this Act does not affect:

(1) the operation of the statute or any action taken under it before its repeal;

(2) any ratification, right, remedy, privilege, obligation, or liability acquired, accrued, or incurred under the statute before its repeal;

(3) any violation of the statute, or any penalty, forfeiture, or punishment incurred because of the violation, before its repeal;

(4) any proceeding, reorganization, or dissolution commenced under the statute before its repeal, and the proceeding, reorganization, or dissolution may be completed in accordance with the statute as if it had not been repealed.

(b) If a penalty or punishment imposed for violation of a statute repealed by this Act is reduced by this Act, the penalty or punishment if not already imposed shall be imposed in accordance with this Act.

§ 17.04 Severability

If any provision of this Act or its application to any person or circumstance is held invalid by a court of competent jurisdiction, the invalidity does not affect other provisions or applications of the Act that can be given effect without the invalid provision or application, and to this end the provisions of the Act are severable.

§ 17.05 Repeal

The following laws and parts of laws are repealed: [to be inserted].

§ 17.06 Effective Date

This Act takes effect ______.