

# Introduction

## GENERAL DESCRIPTION OF THE MODEL ACT

The Model Business Corporation Act (the “Model Act”) is a free-standing general corporation statute that can be enacted substantially in its entirety by a state legislature. The Model Act today is the general corporation statute for 32 states and the District of Columbia, and is the source of many provisions in the general corporation statutes of other states.<sup>1</sup> The Model Act is also an important and often cited reference for courts, lawyers, and scholars as well as a useful source of study and discussion in law schools in the United States and elsewhere.

Through periodic amendments noted below, the Model Act has evolved in significant ways over the years. Since 1984, however, when it was most recently completely revised, the Corporate Laws Committee (the “Committee”) of the American Bar Association’s Business Law Section did not undertake a comprehensive revision of the Model Act in a form that could be adopted by state legislatures as a means to capture all of the important changes that have been approved since 1984. Nor had there been any systematic attempt to revise the Model Act to eliminate inconsistent terminology and adjust provisions that had become outdated since the 1984 revision.

Accordingly, beginning in 2010, under the leadership of Karl John Ege and A. Gilchrist Sparks, III, as its chairs, the Committee has undertaken a thorough review and revision of the Model Act and its Official Comment. This effort has resulted in the adoption and publication of the 2016 Revision of the Model Business Corporation Act (the “2016 MBCA”). The 2016 MBCA is based on the 1984 version and incorporates the amendments to the Model Act published in supplements regularly thereafter, and includes changes to both the Act and its Official Comment.

The 2016 MBCA includes notes on adoption and revised transitional provisions in chapter 17 that are intended to facilitate legislative consideration in adopting the new version of the Model Act. The Committee intends and hopes

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1. The following jurisdictions have adopted all or a substantial part of the Model Act: Alabama, Arizona, Arkansas, Colorado, Connecticut, District of Columbia, Florida, Georgia, Guam, Hawaii, Idaho, Indiana, Iowa, Kentucky, Louisiana, Maine, Massachusetts, Mississippi, Montana, Nebraska, New Hampshire, North Carolina, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. In addition, Alaska and New Mexico adopted a prior version of the Model Act.

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that the promulgation of the 2016 MBCA will encourage state legislatures—in states that have already adopted all or a substantial part of the Model Act and in other states as well—to consider adopting the Model Act in full and thereby bring their corporate statutes into line with recent developments in corporate law. The 2016 Revision, by incorporating terminology and selected provisions from the Uniform Business Organizations Code, also is suitable for use by those jurisdictions that wish to avail themselves of the Uniform Law Commission’s “hub and spoke” structure for their business entity statutes.

### THE CORPORATE LAWS COMMITTEE

The Model Act has been drafted and revised by the Committee, the membership of which consists of a chair, appointed by the chair of the Business Law Section for a three-year term, and 25 members, one of whom is the reporter and 24 of whom serve for staggered six-year terms. By tradition, in order to promote turnover and broader participation, members of the Committee are not reappointed at the end of their terms. Active former chairs participate as senior advisers, and the Committee appoints, from time to time, liaisons from other committees of the Business Law Section, and special consultants. Over the years there has been a tradition of balanced membership. Committee members have included partners in law firms, general counsel and other inside counsel, law and business school professors, federal and state judges (including justices of the Delaware Supreme Court (one a current chief justice and another a former chief justice) and a chancellor of the Delaware Court of Chancery), members, a general counsel, and division directors of the Securities and Exchange Commission, and a former director of the Central Intelligence Agency.

The Committee meets quarterly, generally for two days at a time. Much of the work of the Committee is done in task forces assigned to review and offer proposed revisions to various parts of the Model Act. After review and discussion, a task force may make recommendations to the Committee for revisions to the Model Act. After deliberation by the Committee (which may include referring matters back to the task force), the Committee adopts a proposed revision to the Model Act on first reading and then, after further consideration, on second reading. After second reading, the Committee publishes the proposed changes to the Model Act in *The Business Lawyer*, the official publication of the Business Law Section, and invites comments from interested persons. After expiration of the comment period and the Committee’s consideration of comments received, the Committee considers the revisions on third reading. If adopted by the Committee on third and final reading, the revisions are adopted and published in *The Business Lawyer*. Upon adoption, the revisions become part of the Model Act.

Each section of the Model Act is followed by Official Comment, prepared by the Committee, that amplifies and explains the purpose, rationale, and

operation of the statute, often giving examples or further information. Some states that have adopted the Model Act have also adopted the Official Comment as legislative history, sometimes with state-specific changes. Cross-references to other relevant provisions of the Act are also included after each section.

The Committee also prepares policy statements and guidebooks, maintains a network of state liaisons, and presents programs at ABA and other meetings.<sup>2</sup>

The reporter for the committee is generally a distinguished corporation law professor, who serves as a member of the Committee and supervises the publication of the Model Act and of the Model Business Corporation Act Annotated, including its annotations.

## HISTORY OF THE MODEL ACT

In 1928, the commissioners on uniform state laws promulgated a Uniform Business Corporation Act, which was adopted by three states (Louisiana, Washington, and Kentucky) and partially adopted by a fourth (Idaho). *See* Robert W. Hamilton, “The Revised Model Business Corporation Act: Comment and Observation: Reflections of a Reporter,” 63 *Tex. L. Rev.* 1455, 1457 n. 16 (1985). Professor Hamilton suggests that the lack of wide acceptance of the Uniform Business Corporation Act may be attributed in part to the fact that it was then “ahead of its time” and in part to the perception by state legislatures that there was no need to adopt a “uniform” general corporation statute that would be the same from state to state. *Id.* One of the benefits of state legislation of corporation law has been the ability to experiment with different approaches to corporation law. “Model,” as opposed to “uniform,” legislation tends to suggest a greater opportunity for departure from the norm, for recognition of special local considerations and for experimentation with new or different ideas. While there are benefits to uniform state legislation in areas of interstate commerce such as sales and negotiable instruments, these benefits are less significant in corporation law since a corporation can generally be governed by the corporation law of only one state. In any event, in 1943, the Uniform Business Corporation Act was withdrawn as a “uniform” act and was renamed the “Model Business Corporation Act.” *Id.* at 1457. It was finally withdrawn by the uniform laws commissioners altogether in 1958. *Id.*

In 1950, the Committee promulgated its own Model Business Corporation Act. After that, the Committee continued to review and periodically revise the Model Act, and, in 1984, the Committee published a complete revision of the Model Act. Since 1984, the Committee has continued to review and revise various provisions of the Model Act. Those revisions and other revisions are now reflected in the 2016 MBCA.

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2. Neither the Model Act nor any other Committee publications are approved by the ABA House of Delegates, the ABA Board of Governors or the ABA Business Law Section and thus do not represent policy of the ABA or any of its entities other than the Committee.

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Over the years, the Model Act has introduced a number of important concepts to the statutory law of corporations, a number of the more important of which are highlighted below.

### MODEL ACT INNOVATIONS THROUGH 1984

Innovations that were introduced through 1984 include the following:

- simplification and modernization of statutory financial provisions that:
  - eliminated the traditional (but arbitrary) concepts of par value, stated capital, and treasury shares;
  - permitted the consideration for shares to consist of any tangible or intangible benefit to the corporation, including promissory notes or promises of future services;
  - established uniform standards for determining the legality for all types of distributions, whether by way of dividends, redemptions or repurchases of shares, or other distributions of capital; and
  - permitted maximum flexibility in the design of equity shares by eliminating artificial restrictions on the rights of classes and traditional distinctions between common and preferred shares;
- readily determinable quorum and voting rules, using the concept of “voting groups;”
- an additional form of corporate combination, the compulsory share exchange, and standardized procedures for mergers, share exchanges, and sales of substantially all assets;
- simplified procedures for shareholder appraisal rights that were structured to encourage a negotiated, rather than a judicial, determination of the fair value of shares;
- shareholder inspection rights designed to preserve the basic rights of access, while minimizing the risk of abuse, and additional reporting requirements; and
- standardized filing requirements consolidated in a single chapter.

### MAJOR AMENDMENTS AFTER 1984

#### BOARD OF DIRECTORS

##### *Proxy Statement Access for Shareholder Nominees*

In 2010, section 2.06 was amended to authorize a bylaw provision that would permit shareholders to include in the corporation’s proxy statement and any form of proxy or consent one or more candidates for election to the board of directors, subject to such procedures or conditions, including those relating to reimbursement, as the board of directors may provide. In that regard, section 2.06 was also amended to provide that no such bylaw may limit the authority of the board of

directors to amend, repeal or add any procedure or condition to provide a reasonable, practicable and orderly process.

### *Majority Voting Option*

In 2006, the Committee approved amendments to several sections of the Model Act to enable corporations to change the plurality vote default rule for the election of directors. Before these amendments, section 7.28 required that a change from plurality voting could be authorized only in the articles of incorporation. As a result of new section 10.22, either the board of directors or the shareholders may unilaterally adopt a bylaw provision (absent an article provision specifically prohibiting such a provision or specifying a different method) providing for votes for or against director nominees. If a nominee receives more votes “against” than “for,” the nominee will serve as a director for no more than 90 days unless the board earlier selects an individual to fill the position of such director. The board may select any qualified individual, including the person who received more votes “against” than “for” in the original election. If such a bylaw provision is adopted by the shareholders, it may not be repealed by the board of directors unless the bylaw otherwise provides. Such a majority voting provision is not available in a contested election or if the corporation has cumulative voting. Corresponding amendments were made to section 8.05(e) authorizing a provision in the articles of incorporation modifying or eliminating the “hold-over rule” whereby incumbent directors remain in office until their successors are elected and qualified and to section 8.07, which now recognizes that a director may agree to resign upon failure to receive a specified vote for election to the board and that such resignation may be made irrevocable.

### *Standards of Conduct and Liability*

In 1998, the Committee approved a major revision of section 8.30, Standards of Conduct for Directors, and added a new section 8.31 to the Model Act, dealing with director liability. Both revisions were prompted by a growing tendency by courts to confuse standards of conduct with standards of liability. In particular, some courts relied on language in the prior version of section 8.30, which described the director’s duty of care in terms of the degree of care to be expected of “an ordinarily prudent person in a like position ... under similar circumstances,” as establishing a simple negligence test for imposing liability on a director. Other courts regarded the duty of care language as a codification of the common-law “business judgment rule,” notwithstanding a disclaimer in the Official Comment to former section 8.30. Amended sections 8.30 and 8.31 distinguish a director’s standard of conduct from the standard for liability, and treat each subject separately. Amended section 8.30 further distinguishes between the director’s duty to become “informed” in connection with the “decision-making” function and to “devote attention” to oversight of the

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corporation. New section 8.31, which had no counterpart in any then existing state statute, recognizes defenses based upon liability-limiting charter provisions under section 2.02(b)(4) and the protection afforded by section 8.61 for a director's conflicting interest transaction that has been approved in accordance with section 8.62 or 8.63. It stipulates the grounds for imposing liability on a director and the burden of proof to be borne by plaintiffs seeking money damages.

### *Liability Limitation*

In response to a disruption in the market for directors' and officers' liability insurance and several controversial court decisions, a number of states beginning in the mid-1980s enacted various forms of statutory limitations on the liability of directors. In 1990, a charter option provision was added to the Model Act through the adoption of section 2.02(b)(4). That section authorizes the inclusion in the articles of incorporation of a provision eliminating or limiting, with certain exceptions, the liability of directors to the corporation or its shareholders. The provision covers only monetary damages and does not affect the availability of injunctive or other equitable relief. Section 2.02(b)(4) is optional and provides to shareholders of individual corporations wide latitude in allocating the economic risk of director conduct. Accordingly, the exceptions to the statute are narrowly drawn, and shareholders may limit or eliminate all director liability other than liability for receipt of a financial benefit to which the director is not entitled, intentional infliction of harm, harm to the corporation resulting from intentional violation of criminal law, and liability under section 8.33 for unlawful distributions.

### *Indemnification*

The indemnification provisions of the Model Act were extensively revised in 1994. Among other things, amended subchapter E expands the authority of a corporation to indemnify a director through an optional charter provision, adopted pursuant to new section 2.02(b)(5), permitting indemnification of a director to the same extent that the director's liability could be limited under section 2.02(b)(4). Other significant revisions included a definition of "disinterested director" for purposes of indemnification determinations, changes in the procedures for awarding indemnification or advance of expenses and clarification of a number of recurring issues, including the availability of court orders to enforce indemnification or advance of expenses, the indemnification rights of officers and persons acting in the dual capacities of officer and director, the power of the corporation to obligate itself in advance to provide indemnification or advance of expenses, and the exclusivity of the subchapter.

Section 8.58 was amended in 2010 to provide that a right to indemnification or advancement of expenses may not be eliminated or impaired after the act or



omission has occurred, except as otherwise expressly provided at the time of the act or omission.

In 2014, sections 8.53 and 8.54 were amended to eliminate the requirement that a director or officer seeking advancement of expenses provide a written affirmation that he or she has met the applicable standards for indemnification under the Model Act, or, in the case of a director, that the proceeding involves conduct for which liability has been eliminated under the articles of incorporation.

### *Conflicting Interest Transactions*

During 1988, then sections 8.31 and 8.32 were replaced by subchapter F, comprised of new sections 8.60 through 8.63. These sections deal with director's conflicting interest transactions.

Former section 8.31 simply provided that “[a] conflict of interest transaction is a transaction with the corporation in which a director of the corporation has a direct or indirect conflict of interest,” and it then attempted to describe when a director has such an indirect interest. In contrast, subchapter F provides specific guidance to corporations and directors that want to engage in business transactions with each other, while providing protection for shareholders against unfair dealing by their directors. Subchapter F also spells out a practical, working definition of “conflicting interest,” and makes that definition exclusive. Finally, to a greater degree than its predecessors, the subchapter specifies when judicial intervention is appropriate and when it is not. In 2005, subchapter F was significantly revised to clarify, simplify, and refine its bright-line rules with respect to director's conflicting interest transactions, although no substantive change was made in its coverage.

### *Business Opportunities*

Also in 2005, a new subchapter G (section 8.70), dealing with business opportunities, was added to the Model Act. Incorporating the qualified director and shareholder approval mechanisms of subchapter F, subchapter G provides non-exclusive safe-harbor protection for a director considering involvement in a business opportunity that might be deemed to be a “corporate opportunity.” “Corporate opportunity” is a common law doctrine that, if applicable, recognizes that, as between the corporation and a director, the corporation has a prior right to certain business opportunities that come to the attention of the director. If the director acts on the “corporate opportunity” without first presenting it to the corporation, the director may be held to have “usurped” or “intercepted” the opportunity with consequent liability to the corporation. The concept of “business opportunity” is not defined in section 8.70 but is broader than the common law doctrine and provides an opportunity for a director to receive a disclaimer from the corporation before acting on an opportunity,

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regardless of whether it would constitute a “corporate opportunity” under common law. Section 8.31 (Standards of Liability for Directors) was also amended to recognize defenses based upon compliance with section 8.70.

In 2014 and 2016, the Committee adopted amendments to sections 2.02 and 8.70 (and related amendments to sections 1.43, 8.31 and 8.60) that permit corporations to include in their articles of incorporation a provision that limits or eliminates a director’s or an officer’s duty to present a business opportunity to the corporation.

### *Qualifications for Nomination and Election*

In 2013, the Committee adopted amendments to section 8.02 that clarify the scope and operation of qualifications for nomination and election as directors.

### *Qualified Directors*

The amendments to the Official Comment to sections 8.01 and 8.25 dealing with directors of public corporations refer to “independent directors,” a concept that is not defined in the Model Act and is variously defined in listing standards for the several public securities exchanges. In general, the term is understood to describe a director who is not a current or recent member of senior management and who does not have any other significant professional, financial or similar relationship with the corporation. The concept of “independence” is similar to, but not necessarily synonymous with, the concept of “disinterestedness.” The latter concept had been used in the Model Act, under a variety of different terms (“independent director,” “disinterested director” and “qualified director”) to describe a director who is sufficiently disinterested with respect to a particular matter to act on it when the matter is presented to the board. These matters include derivative proceedings (section 7.44), indemnification (sections 8.53 and 8.55), a director’s conflicting interest transaction (section 8.62) and disavowal of the corporation’s interest in a business opportunity (section 8.70). To avoid confusion with the term “independent director” and to provide uniformity, section 1.43 was added to the Model Act in 2005 to define the concept of “qualified director,” that is, the characteristics necessary for a director to be eligible to approve corporate action in each of the contexts mentioned above.

### *Board and Committee Composition and Procedures*

Revisions to a number of sections dealing with board and committee composition and procedures were made in 2000 and again in 2001. Section 8.03, relating to the number and election of directors, was amended to provide greater flexibility and simplicity than the former rules, namely replacing them with a provision stating that the number of directors may be increased or decreased in the manner provided in the articles of incorporation or bylaws. Section 8.06 was amended to eliminate the requirement that a board



of directors must consist of nine or more members as a precondition to staggered terms for directors. The committee structure provided for in section 8.25 was updated in a number of respects. As revised, section 8.25 now permits a single director committee, unless the relevant statute or the corporation's articles of incorporation or bylaws provide otherwise. This amendment does not affect the Model Act's requirements dealing with committee action in connection with derivative suits, determination of eligibility for indemnification and approval of directors' conflicting interest transactions, all of which require that a board committee consist of at least two qualified directors, as defined in section 1.43. Other amendments to section 8.25 reduced the list of non-delegable powers and provided a mechanism for the replacement of absent or disqualified committee members.

### *Submission of Matters to Shareholders*

The Model Act and other corporation statutes provide that certain fundamental changes, such as merger, conversion, amendment of the articles and the like, must first be approved by the board of directors and then submitted to the shareholders with the board's recommendation that the shareholders approve the matter. The Model Act previously provided an exception to this requirement where the board determined that there were conflicts of interest or other special circumstances that made it inappropriate for the board to make a recommendation. In 2008, the Model Act was amended to clarify that the board may agree to submit a matter to the shareholders even if the board later determines to withdraw its recommendation because of changed circumstances. Such "force the vote" provisions are generally authorized in new section 8.26 and specifically authorized in connection with shareholder action on domestication (section 9.21), conversion (section 9.32), amendment of the articles (section 10.03), merger and share exchange (section 11.04), disposition of assets (section 12.02), and dissolution (section 14.02).

In 2016, the Committee adopted amendments to section 11.04 and certain provisions in chapter 13, permitting the merger of corporations without a shareholder vote following a tender offer, if certain conditions are met.

## **OFFICERS**

Amendments pertaining to standards of conduct for and functions of officers have paralleled similar amendments relating to directors. In 1998, section 8.42 (Standards of Conduct for Officers) was amended to apply to all officers, rather than just those with "discretionary authority" as in the prior version, and clarifies an officer's right to delegate. Amended section 8.42 provides that compliance with the standards set forth in that section insulates an officer from liability to the corporation or its shareholders, and makes clear that

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noncompliance does not result in automatic liability but, instead, liability depends on other applicable law, including section 8.31.

Sections 8.41 and 8.42, dealing with the functions of officers, were amended in 2005. The amendments emphasize the responsibility of officers to inform others in the corporation of matters that come to their attention, including any material violation of law involving the corporation or material breach of duty by an officer, employee or agent of the corporation that the officer believes has occurred or is likely to occur. Section 8.40(b) was also amended at that time to clarify that an officer, if authorized by the bylaws or the board of directors, may appoint one or more officers. A corresponding amendment was made to section 8.43 to provide that an officer who was appointed by an officer may be removed by that officer (or his or her successor), as well as by the board of directors, unless the corporation's bylaws or board, acting in accordance with the bylaws, provide otherwise.

### SHAREHOLDER MEETINGS AND VOTING<sup>3</sup>

#### *Remote Participation in Shareholder Meetings*

Section 7.09 was added in 2010 to permit shareholder participation in annual or special meetings by remote means, such as over the internet or telephone conference call, to the extent authorized by the board of directors.

#### *Bifurcated Record Dates*

Also in 2010, sections 7.03, 7.05, 7.07, and 7.09 were amended to authorize the board of directors to set different record dates for notice of a meeting and for determining the shareholders eligible to vote at the meeting.

#### *Fundamental Changes*

In 1999, the Committee approved a number of changes to the provisions of the Model Act dealing with fundamental changes. Section 6.21(f) was amended to require shareholder approval of any issuance of shares, other than for cash, that will result in an increase of more than 20% of the voting power of shares that were outstanding immediately before the transaction. "Voting power" was defined in section 1.40 as the "current power to vote in the election of directors." As a result of section 6.21(f), approval of a parent corporation's shareholders is required in any merger, share exchange, or acquisition of assets resulting in an increase in more than 20% of the parent's voting power, notwithstanding the fact that the merger or other transaction is effected through a subsidiary.

The amendments to chapter 11 (Mergers and Share Exchanges) provided definitions and authorized mergers or share exchanges between a corporation and another type of entity, such as a limited liability company or other organization.

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3. See also "Board of Directors—Proxy Statement Access for Shareholder Nominees" and "—Majority Voting Option," *supra*.

The “short-form merger” provision, section 11.05, broadened the availability of the form to include mergers between subsidiaries or a merger of a parent into a subsidiary.

The 1999 amendments also adopted a uniform voting rule for all share issuances, article amendments, mergers, share exchanges, dispositions of assets, or dissolutions that require shareholder approval. All such transactions must be approved at a meeting at which exists a quorum consisting of at least a majority of the votes entitled to be cast, and the transaction must be approved by a plurality of the votes cast. Sections 10.04 and 11.04(f) specify the circumstances under which separate group voting by individual classes or series of shares is required for amendments to the articles or to approve a merger or share exchange, respectively. In 2010, section 11.04(g) was added to the Model Act to authorize an article provision limiting or eliminating a separate group vote that would otherwise be provided under section 11.04(f). This authorization does not apply if the plan of merger or share exchange contains a provision that is, or would be, an amendment to the articles subject to section 10.04 and does not otherwise have a substantive business effect. At the same time, the appraisal provisions were amended to provide appraisal rights for any class or series of shares for which group voting rights had been eliminated. See *Shareholder Remedies—Appraisal, infra*.

As amended in 1999, chapter 12, dealing with “Disposition of Assets,” clarifies when shareholder approval is required for a disposition of significant corporate assets. Under the 1984 revision of the Model Act and most then existing state statutes, shareholder approval was required for a sale of “all or substantially all” assets. Amended section 12.02 puts the test in terms of whether the disposition will “leave the corporation without a significant continuing business activity” and then provides a safe harbor: shareholder approval is not required for a transaction in which the corporation will retain a business activity that represented at least (i) 25% of total assets at the end of the most recently completed fiscal year, and (ii) 25% 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.

For changes relating to domestication and conversions, see *Domestication and Conversion, infra*.

### *General Provisions*

Several sections dealing with shareholder meetings and voting were amended and others added in 1996. Amended section 7.02(a)(2) permits a provision in the articles of incorporation setting a higher or lower percentage than 10% of the shareholdings required to compel a special meeting of shareholders and also establishes procedures for revoking written demands. Other provisions

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authorize the electronic transmission of proxies, establish procedures for the conduct of meetings, require that publicly traded corporations appoint inspectors of election and specify the duties of such inspectors.

### *Shareholder Action by Consent*

Section 7.04 formerly permitted shareholder action by written consent without a meeting only if unanimous. In 2006, section 7.04 was amended to authorize a provision in the articles of incorporation to permit shareholder action without prior notice by written consent signed by holders of outstanding shares having not less than the minimum number of votes necessary to authorize or take the action if it were voted on at a meeting. Absent such a provision in the articles, unanimous written consent is still required.

## SHAREHOLDER REMEDIES

### *Derivative Proceedings*

A significant increase in the number of judicial decisions dealing with the shareholder demand requirement and the authority of independent (now “qualified”) directors to dismiss a properly commenced derivative suit led to another reappraisal of the procedural and substantive requirements of the derivative proceeding. The result was the replacement in 1990 of section 7.40 with a comprehensive new subchapter D, consisting of sections 7.40 through 7.47. The new subchapter eliminated the traditional “demand required/demand excused” distinction in favor of a “universal demand” requirement. Section 7.42 requires that a demand be served on the corporation at least 90 days before a derivative suit can be commenced, unless irreparable injury to the corporation would result. Section 7.44 requires that a derivative suit be dismissed if qualified directors determine that maintenance of the suit would not be in the best interests of the corporation. Such a determination must be made in good faith after a reasonable inquiry upon which the determination is based and may be made by a majority of qualified directors, a committee consisting of two or more qualified directors appointed by a majority vote of qualified directors (whether or not a quorum), or a panel of one or more independent persons appointed by the court. Section 7.44 was amended in 2005 to incorporate the concept of “qualified director” adopted in section 1.43 and to make other clarifying changes.

### *Inspection Rights and Notices*

Amendments to chapter 16 provisions dealing with shareholder and director inspection rights and certain notices were approved by the Committee in 1998. Among other things, section 16.03 was amended to take account of transmittal of records by electronic means and to authorize reasonable charges for the corporation’s expense in providing records; section 16.05 covers a director’s inspection

rights; and section 6.22, requiring notice to shareholders of indemnification payments and certain share issuances, was deleted.

In 2016, the Committee adopted amendments to section 16.20 and certain other sections of chapter 16 that address, among other things, the obligations of corporations to make financial statements available to shareholders, the maintenance of corporate records, and the inspection rights of shareholders and directors of corporations.

### *Proceeding for Judicial Removal of a Director*

In 2001, section 8.09, authorizing judicial removal of a director, was extensively revised. The former distinction between 10% shareholders, who were afforded a direct cause of action, and other shareholders was eliminated. An action under section 8.09 may be brought by the corporation or by a shareholder suing derivatively and, if the latter, subject to all of the Model Act's derivative suit provisions, except the contemporaneous ownership requirement. The grounds for judicial removal were more clearly defined. The amended section directs the court to consider both the director's course of conduct and the inadequacy of other remedies and emphasizes that section 8.09 is not exclusive and does not limit the court's ability to afford other equitable relief.

### *Action to Appoint a Receiver or Custodian*

Section 7.48 was added in 2006 to provide a shareholder action to appoint a custodian or, if the corporation is insolvent, a receiver for a corporation where it is established that the directors are deadlocked or threatening irreparable harm to the corporation, or that the directors or those in control are acting fraudulently, also threatening irreparable harm. The Model Act previously provided for the appointment of a custodian or receiver only in connection with a judicial dissolution proceeding (section 14.32).

### *Appraisal*

In 1999, the Committee approved important amendments to chapter 13's appraisal provisions. Refinements to those were made in 2006. Section 13.01 added a number of new definitions that are specialized to chapter 13, including a definition of "fair value." The definition in section 13.01 directs the court to determine fair value by "using customary and current valuation concepts and techniques employed for similar businesses" and rejects the use of illiquidity or minority discounts for all transactions, except, if appropriate, in the case of voluntarily provided appraisal for article amendments. Section 13.02 decreases the number of transactions that trigger statutory appraisal rights but provides greater freedom for private ordering. Thus, appraisal rights are not available for amendments to the articles of incorporation, other than certain reverse stock splits, or for shareholder distributions upon dissolution; appraisal rights are

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available only for holders of shares that are exchanged or converted in a merger or share exchange and may be limited or completely eliminated by charter provision for any class or series of preferred shares. On the other hand, section 13.02(a)(5) permits appraisal rights to be made available by article or bylaw provision or by board resolution for any fundamental change, such as merger, disposition of assets or amendment to the articles, for which statutory appraisal rights are not provided.

The 1999 amendments also reintroduced a “market out” to the Model Act, providing that holders of publicly traded shares are not entitled to appraisal if they receive other publicly traded shares or cash as consideration. The 2006 amendments changed the criteria for determining the applicability of the market out. Section 13.02(b)(1) now requires that the relevant class or series either be (i) a covered security under section 18(a)(1)(A) or (B) of the Securities Act of 1933 or (ii) traded in an organized securities market, have at least 2,000 record or beneficial shareholders and have a market value of at least \$20 million (excluding shares held by subsidiaries, senior executives, directors and beneficial shareholders owning more than 10% of the class or series). The market out now also applies to shares issued by an open end management company provided it is registered under the Investment Company Act of 1940 and the shares are redeemable at net asset value at the option of the holder.

In an important innovation, the concept of conflicting interest transaction was added in 1999 and revised by the 2006 amendments. Both provided that the market out exception is withdrawn and appraisal is available for an “interested transaction,” as defined. As a result of the 2006 amendments, whether a particular transaction is an interested transaction also determines the scope of remedies available under new section 13.40.

Section 13.40 is the successor to various “exclusivity” provisions in earlier versions of the Model Act. It replaces former section 13.02(d) which, as amended in 1999, made the appraisal remedy the exclusive remedy with respect to completed corporate transactions, excepting only the same serious procedural errors now specified in section 13.40(b)(1) or instances where the corporate action was “procured as a result of fraud or material misrepresentation.” Section 13.40 applies to any completed corporate transaction of a type described in section 13.02(a), regardless of whether appraisal is available as a remedy.

Other 2006 amendments to the appraisal provisions require specific financial disclosure to shareholders in connection with notice and payment provisions (sections 13.20 and 13.24) and revisions reflecting the availability of shareholder action by consent under section 7.04.

In connection with the 2010 amendments to section 11.04 authorizing article provisions limiting or eliminating group voting rights for certain mergers and



share exchanges, section 13.02 was amended to eliminate the previous linkage between the shareholder's right to vote and the availability of the appraisal remedy. Accordingly, in a transaction under chapters 9, 11, and 12, a shareholder will at least have group voting or appraisal rights and, in some cases, both will be available.

### *Exclusive Forum Provisions*

In 2016, the Committee adopted section 2.08, which permits the articles of incorporation or the bylaws to specify the forum or forums for litigation of internal corporate claims.

## **NON-PUBLIC CORPORATIONS**

In 1990 and again in 2006, the Model Act was amended to provide both greater certainty and more flexibility to non-public corporations. In contrast to the former Model Close Corporation Supplement and similar legislation enacted in several states which apply only if specifically elected in a corporation's articles, the Model Act provisions are available to any incorporated entity that meets the shareholding and trading criteria of the respective statutes.

### *Shareholder Agreements*

Section 7.32, adopted in 1990 and amended subsequently, provides shareholders wide latitude in tailoring their own governance rules. This latitude is most useful for shareholders of corporations that are closely held. An agreement in writing among all shareholders is effective even though it eliminates or restricts the discretion of the board of directors or contains other governance provisions that are inconsistent with other sections of the Model Act.

### *Judicial Dissolution and Buyouts*

The second major provision introduced in 1990 seeks to provide a more orderly means of exit from the corporation by dissatisfied minority shareholders of non-publicly traded companies. Section 14.34 provides the corporation or the remaining shareholders a limited right to purchase at fair value the shares of a shareholder who has petitioned to dissolve the corporation under section 14.30(a)(2).

The 2006 amendments preserved traditional grounds for a shareholder petition for judicial dissolution—deadlock, fraud, illegality or oppression—but new section 14.30(b) defines corporations that are not subject to judicial dissolution on grounds described in section 14.30(a)(2) in terms of, in subsection (b)(i), the markets in which shares of the corporation are traded and, in subsection (b)(ii), market capitalization and number of shareholders for corporations whose shares are not traded in markets specified in subsection (b)(i).

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In section 14.30(b)(5), the 2006 amendments added a new ground for judicial dissolution—failure to dissolve within a reasonable time after abandoning the business of the corporation—that is applicable to both public and non-public corporations.

### DOMESTICATION AND CONVERSION

Procedures for changing an entity's state of incorporation or even for changing from one form of organization to another have been greatly simplified by the adoption in 2002 of chapter 9, "Domestication and Conversion." Previously, such transactions could be accomplished only by merger—in the case of incorporating in another state, by forming a new subsidiary in the desired jurisdiction and then merging the previously existing corporation into the new one. Although a change in the state of incorporation may still be carried out by merger under the Model Act, subchapter 9B provides a simpler and more direct means whereby a domestic corporation may become a foreign business corporation and vice-versa. Nonprofit corporations and unincorporated entities will be able to participate in a variety of transactions under new chapter 9 and related amendments to chapter 11, dealing with mergers. Subchapter 9C permits a domestic corporation to convert to a domestic or foreign nonprofit corporation or unincorporated entity, and also permits a domestic or foreign nonprofit corporation or unincorporated entity to become a domestic business corporation.

A prerequisite to all of these transactions is that a domestic business corporation be present immediately before or after the transaction. Chapter 9 does not address the conversion of one form of unincorporated entity into another, such as the conversion of a limited partnership into a limited liability company. Transactions of that type must be provided for in separate legislation, such as the Model Entity Transactions Act. Recognizing that individual states may have existing requirements for specially regulated entities, such as insurance companies or banks, chapter 9 provides optional provisions for states wishing to exclude certain entities from one or more types of transactions or requiring the approval of one or more state officials or authorities. A business combination of two or more entities into a single entity is not authorized under chapter 9 but must continue to be carried out under chapters 11 or 12. At the same time, section 11.02(a) has been amended to provide expressly for the merger of two or more foreign parties to form a domestic business corporation.

The adoption of chapter 9 required not only conforming amendments to various related provisions in the Model Act but also a number of amendments to existing definitions and the adoption of new definitions in section 1.40. The definition of "articles of incorporation" has been revised, and among the more important

definitions are “eligible entity,” “interest,” “organic law,” “organic rules,” “owner liability,” and “unincorporated entity.”

## **DISTRIBUTIONS**

During 1987, section 6.40, dealing with distributions to shareholders, and section 8.33 (now section 8.32), dealing with liability for unlawful distributions, were amended. Section 6.40 addresses the practical implication of the equity insolvency test more fully than before. The section also emphasizes the director’s right to rely on others in determining compliance with the section. Current section 8.32 makes clear that directors may rely on all the defenses ordinarily available to a director by requiring the plaintiff to prove that the director from whom liability is sought did not comply with the standards of conduct under section 8.30 when approving the distribution. The section also clarifies that directors are entitled to recoupment, rather than contribution, from any shareholder who knowingly received a distribution in excess of that permitted by section 6.40 and requires that any action for contribution or recoupment must be brought within one year after the director’s liability has been finally adjudicated.

## **ELECTRONIC TECHNOLOGY**

In 1997, several amendments were made to subchapters B and D of chapter 1 to accommodate the use of electronic means to transmit and file the various corporate reports and documents that are required by the Model Act to be filed with the secretary of state. More amendments were made in 2009 to incorporate into the Model Act terminology and concepts from the Uniform Electronic Transmissions Act and the federal Electronic Signatures in Global and National Commerce Act. The amendments added defined terms “document,” “electronic,” “electronic record,” and “writing” or “written” and made changes in the definition of “deliver” or “delivery,” “electronic transmission,” and “sign” or “signature.”

## **VOLUNTARY DISSOLUTION**

Amendments to the voluntary dissolution provisions of chapter 14 were adopted in 2000, together with conforming amendments to section 6.40 (distributions) and section 8.33 (director liability for unlawful distributions). The amendments removed distributions in liquidation from the limitations on distributions in section 6.40 and add a new section 14.09, coordinated with section 8.33, to clarify director liability, defenses, contribution, and recoupment in connection with liquidating distributions. Section 14.08 was amended to provide a judicial proceeding that affords directors and shareholders a safe harbor in providing for contingent claims. Section 14.07 was amended to shorten from five to three years the period in which claims must be presented following publication of notice of dissolution.

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### **DEFECTIVE CORPORATE ACTIONS**

In 2016, the Committee adopted subchapter E of chapter 1, permitting the ratification of defective corporate actions, including actions in connection with the issuance of shares.

### **EXTRINSIC FACTS AND TERMS OF SHARES AND OPTIONS**

Broad authorization for the use of extrinsic facts—i.e., facts objectively ascertainable outside the pertinent plan or document—is provided by the addition to the Model Act in 2002 of section 1.20(k). Corresponding amendments were made to other sections to authorize the use of extrinsic facts in setting the terms of shares, provisions in the articles of incorporation or amendments to the articles, plans (including plans of merger and share exchange) and certain notices to shareholders. At the same time, a number of innovative amendments were made to section 6.01 (authorized shares) and 6.02 (terms of a class or series determined by the board of directors). In addition to providing for terms of shares determined by reference to extrinsic facts, section 6.01(e) was added to permit the creation of classes or series of shares with terms that vary among the holders of such classes or series so long as the variations are expressly set forth in the articles of incorporation. As amended, section 6.02 sanctions an article provision that permits the board of directors to allocate authorized but unissued shares of one class to other classes or series without shareholder approval. Section 6.24 was also amended to authorize the use of options, rights and warrants in shareholder rights plans, including those already adopted by the board of directors. In 2008, section 6.24 was further amended to clarify the extent to which the board may delegate to officers its rights with regard to options and other forms of equity compensation.