Changes in the Model Business Corporation Act—Proposed Amendment to Section 6.24*

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

The Committee on Corporate Laws of the ABA Section of Business Law develops, and from time to time proposed changes in, the Model Business Corporation Act.

The Committee has approved the proposed changes described in this Report on second reading and invites comments from interested persons. Comments should be addressed to Herbert S. Wander, Chair, Committee on Corporate Laws, 525 West Monroe Street, Chicago, Illinois 60661, or sent to him by email at hwander@kattenlaw.com. Comments should be received by May 1, 2008, to be considered by the Committee before adoption on third reading.

The Committee has proposed on second reading adding subsection (c) to section 6.24 to expressly provide that a board may delegate to officers some or all of its rights regarding the award of rights, options, warrants or other forms of equity compensation. The title of the section has been changed to indicate its broader coverage. The Official Comment to section 6.24 has been revised to integrate the comment to section 6.24(c). Changes to the existing provisions are first presented marked to show changes from the current Act, followed by a clean version, as changed. New language is indicated by underlining and deletions by strikeout.

§ 6.24 SHARE OPTIONS AND OTHER AWARDS

... (c) The board of directors may authorize one or more officers to (1) designate the recipients of rights, options, warrants or other equity compensation awards that involve the issuance of shares and (2) determine, within an amount and subject to any other limitations established by the board, and, if applicable, the stockholders, the number of such rights, options, warrants or other equity compensation awards and the terms thereof to be received by the recipients, provided that an officer may not use such authority to designate either himself or herself or such other persons as the board of directors may specify as a recipient of such rights, options, warrants or other equity compensation awards.

* Editor’s Note: This report is published in the form approved by the Committee on Corporate Laws on December 8, 2007, without any further editing by The Business Lawyer.

** Herbert S. Wander, Chair.
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.

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Changes in the MBCA—Proposed Amendment to Section 6.24

share rights or options to compensation committees composed of non-management directors, subject to the general oversight of the board of directors. Section 8.25 authorizes boards to create such committees. The law on the authority of a board to permit officers to exercise some or all of the board’s functions regarding the award of rights, options, warrants or other forms of equity compensation is, however, not always clear. Section 6.24(c) provides express authority for the delegation to officers of the designation of recipients of compensatory awards involving the issuance of shares, either directly or upon exercise of rights to acquire shares, and the determination of the amount and other terms of the awards, subject to any applicable limitations established by the board or the stockholders. A board (or a committee with authority delegated to it under section 8.25) may decide whether to exercise the authority under section 6.24(c) and, to the extent it does so, it must specify the total amount that may be awarded and may impose any other limits it desires as part of the board's oversight of the award process. A board or committee delegating authority under section 6.24(c) would typically include appropriate limits. These limits might include, for example, the amount or range of shares to be awarded to different classes of employees, the timing and pricing of awards and the vesting terms or other variable provisions of awards. The board or committee also might provide for periodic reporting to it of awards made under the delegated authority. Section 6.24(c) does not permit authorizing an officer to make awards to himself or herself or to other persons the board of directors may specify, such as other officers. In exercising the authority under section 6.24(c), the board or committee and any officer to whom authority is delegated should take into account the terms of any stockholder-approved plan or other stockholder approval and compliance with applicable legal and stock exchange requirements. Any awards made pursuant to the authority under section 6.24(c) should be properly documented. Section 6.24(c) does not address the extent to which the board or a committee may delegate authority in other circumstances.

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