Changes in the Model Business Corporation Act—Proposed Shareholder Proxy Access Amendments to Chapters 2 and 10

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

The Committee on Corporate Laws of the ABA Section of Business Law (“Committee”) develops, and from time to time proposes changes in, the Model Business Corporation Act (“Act”).

As part of its ongoing review of the Act’s provisions governing the respective roles of shareholders and directors, the Committee has approved on second reading the changes described in this Report 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 60611, or sent to him by e-mail at hwander@kattenlaw.com. Comments should be received by October 30, 2009, in order to be considered by the Committee before adoption of the amendments on third reading.

The proposed amendments to section 2.06 clarify that a bylaw may not restrict the authority of the board of directors to direct or oversee the management of the business and affairs of the corporation under section 8.01(c). Further, the amendments clarify that a corporation’s bylaws may include provisions requiring the inclusion of shareholder nominees in the corporation’s proxy statement and form of proxy or consent and providing for reimbursement to the extent and subject to such procedures and conditions as the bylaws may provide. The amendments also provide that bylaws providing for access or reimbursement cannot deprive the board of directors of the authority to make changes that provide for a reasonable, practicable, and orderly process. Accordingly, a conforming amendment to section 10.20(b)(2), which otherwise expressly limits the rights of directors to amend certain shareholder adopted bylaws, is also proposed.

Changes to existing provisions are first presented marked to show changes from the current Act, followed by a clean version, as amended. New language is indicated by underscoring and deletions by strikeout.

* Herbert S. Wander, Chair.
(i) Amend section 2.06 and Official Comment as follows:

§ 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.

(c) The bylaws may contain one or both of the following provisions:

1. A requirement that if the corporation solicits proxies or consents with respect to an election of directors, the corporation include in its proxy statement and any form of its proxy or consent, to the extent and subject to such procedures or conditions as are provided in the bylaws, one or more individuals nominated by a shareholder in addition to individuals nominated by the board of directors; and

2. A requirement that the corporation reimburse the expenses incurred by a shareholder in soliciting proxies or consents in connection with an election of directors, to the extent and subject to such procedures or conditions as are provided in the bylaws, provided that no bylaw so adopted shall apply to elections for which any record date precedes its adoption.

(d) Notwithstanding section 10.20(b)(2), the shareholders in amending, repealing, or adopting a bylaw described in subsection (c) may not limit the authority of the board of directors to amend or repeal any condition or procedure set forth in or to add any procedure or condition to such a bylaw in order to provide for a reasonable, practicable, and orderly process.

Official Comment

The responsibility for adopting the original bylaws is placed on the person or persons completing the organization of the corporation. Section 2.06(b) restates the accepted scope of bylaw provisions permits any bylaw provision that is not inconsistent with the articles of incorporation or law. This limitation precludes provisions that limit the managerial authority of directors that is established by section 8.01(b). For a list of Model Act provisions that become effective only if specific reference is made to them in the bylaws, see Official Comment to section 2.02. Provisions set forth in bylaws may additionally be contained in shareholder or board resolutions unless this Act requires them to be set forth in the bylaws.

The power to amend or repeal bylaws, or adopt new bylaws after the formation of the corporation is completed, is addressed in sections 10.20, 10.21, and 10.22 of the Model Act.

Section 2.06(c) expressly authorizes bylaws that require the corporation to include individuals nominated by shareholders for election as directors in its proxy statement and proxy cards (or consents) and that require the reimbursement by the corporation of expenses incurred by a shareholder in soliciting proxies (or
consents) in an election of directors, in each case subject to such procedures or conditions as may be provided in the bylaws. Expenses reimbursed under section 2.06(c)(1) must be reasonable as contemplated in the definition of expenses set forth in section 1.40(9AA).

Examples of the procedures and conditions that may be included in such bylaws include provisions that relate to the ownership of shares (including requirements as to the duration of ownership); informational requirements; restrictions on the number of directors to be nominated or on the use of the provisions by shareholders seeking to acquire control; provisions requiring the nominating shareholder to indemnify the corporation; limitations on reimbursement based on the amount spent by the corporation or the proportion of votes cast for the nominee; and limitations concerning the election of directors by cumulative voting. In that respect, the function of such bylaws in a corporation with cumulative voting may present unique issues.

Section 2.06(c) clarifies that proxy access and expense reimbursement provisions do not infringe upon the scope of authority granted to the board of directors of a corporation under section 8.01(b). See CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227, 235–37 (Del. 2008) (holding that a reimbursement bylaw regulates “procedural” rather than “substantive” matters, and is therefore a proper matter for shareholder action). Section 2.06(c) underscores the model of corporate governance embodied by the Act and reflected in section 8.01, but recognizes that different corporations may wish to grant shareholders varying rights in selecting directors through the election process.

Section 2.06(d) limits the rule set forth in section 10.20(b)(2) that shareholder-adopted bylaws may limit the authority of directors to amend bylaws, by specifying that such a limit will not apply absolutely to conditions and procedures set forth in access or reimbursement bylaws authorized by section 2.06(c). Section 2.06(d) allows directors to ensure that such bylaws adequately provide for a reasonable, practicable, and orderly process, but is not intended to allow the board of directors to frustrate the purpose of a shareholder-adopted proxy access or expense reimbursement provision.

§ 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 that is not inconsistent with law or the articles of incorporation.

(c) The bylaws may contain one or both of the following provisions:

(1) A requirement that if the corporation solicits proxies or consents with respect to an election of directors, the corporation include in its proxy statement and any form of its proxy or consent, to the extent and subject to such procedures or conditions as are provided in the bylaws, one or more individuals nominated by a shareholder in addition to individuals nominated by the board of directors; and
(2) A requirement that the corporation reimburse the expenses incurred by a shareholder in soliciting proxies or consents in connection with an election of directors, to the extent and subject to such procedures or conditions as are provided in the bylaws, provided that no bylaw so adopted shall apply to elections for which any record date precedes its adoption.

(d) Notwithstanding section 10.20(b)(2), the shareholders in amending, repealing, or adopting a bylaw described in subsection (c) may not limit the authority of the board of directors to amend or repeal any condition or procedure set forth in or to add any procedure or condition to such a bylaw in order to provide for a reasonable, practicable, and orderly process.

**OFFICIAL COMMENT**

The responsibility for adopting the original bylaws is placed on the person or persons completing the organization of the corporation. Section 2.06(b) permits any bylaw provision that is not inconsistent with the articles of incorporation or law. This limitation precludes provisions that limit the managerial authority of directors that is established by section 8.01(b). For a list of Model Act provisions that become effective only if specific reference is made to them in the bylaws, see Official Comment to section 2.02.

The power to amend or repeal bylaws, or adopt new bylaws after the formation of the corporation is completed, is addressed in sections 10.20, 10.21, and 10.22 of the Model Act.

Section 2.06(c) expressly authorizes bylaws that require the corporation to include individuals nominated by shareholders for election as directors in its proxy statement and proxy cards (or consent) and that require the reimbursement by the corporation of expenses incurred by a shareholder in soliciting proxies (or consents) in an election of directors, in each case subject to such procedures or conditions as may be provided in the bylaws. Expenses reimbursed under section 2.06(c)(1) must be reasonable as contemplated in the definition of expenses set forth in section 1.40(9AA).

Examples of the procedures and conditions that may be included in such bylaws include provisions that relate to the ownership of shares (including requirements as to the duration of ownership); informational requirements; restrictions on the number of directors to be nominated or on the use of the provisions by shareholders seeking to acquire control; provisions requiring the nominating shareholder to indemnify the corporation; limitations on reimbursement based on the amount spent by the corporation or the proportion of votes cast for the nominee; and limitations concerning the election of directors by cumulative voting. In that respect, the function of such bylaws in a corporation with cumulative voting may present unique issues.

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Section 2.06(d) limits the rule set forth in section 10.20(b)(2) that shareholder-adopted bylaws may limit the authority of directors to amend bylaws, by specifying that such a limit will not apply absolutely to conditions and procedures set forth in access or reimbursement bylaws authorized by section 2.06(c). Section 2.06(d) allows directors to ensure that such bylaws adequately provide for a reasonable, practicable, and orderly process, but is not intended to allow the board of directors to frustrate the purpose of a shareholder-adopted proxy access or expense reimbursement provision.

(ii) Amend section 10.20 and Official Comment as follows:

§ 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 part; or

(2) except as provided in section 2.06(d), 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. The provision, however, is made expressly subject to section 2.06(d), which limits the authority of shareholders to restrict board action on bylaws with regard to procedures or conditions set forth in certain bylaws regulating the election of directors. See the Official Comment to section 2.06.
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 that opts in to the provisions of that section. See section 10.22 and the Official Comment thereto.

§ 10.20. Amendment by Board of Directors of 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 part; or

   (2) except as provided in section 2.06(d), 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. The provision, however, is made expressly subject to section 2.06(d), which limits the authority of shareholders to restrict board action on bylaws with regard to procedures or conditions set forth in certain bylaws regulating the election of directors. See the Official Comment to section 2.06.

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 that opts in to the provisions of that section. See section 10.22 and the Official Comment thereto.