Changes in the Model Business Corporation Act—Proposed Amendments to Section 11.04 and Section 13.02

By the Corporate Laws Committee, ABA Business Law Section

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

The Committee has approved, on second reading, amendments to section 11.04 and certain provisions in chapter 13 (the “Amendments”) of the Act, permitting the merger of corporations without a shareholder vote following a tender offer, if certain conditions are met, and invites comments from interested persons. Comments should be addressed to Karl John Ege, Chair, Corporate Laws Committee, 1201 3d Avenue, Suite 4900, Seattle, Washington 98101, or sent to him by e-mail at kege@perkinscoie.com. Comments should be received by February 28, 2016, in order to be considered by the Committee before adoption of the Amendments.

The Amendments establish a procedure that allows a corporation to consummate a merger without a shareholder vote if the merger follows a tender offer following which the tender offeror owns sufficient shares that it could approve the merger if it were submitted to a vote at a meeting at which all shares entitled to vote on the approval were present and voted. The Amendments allow a corporation to enter into a “two-step” merger agreement, where the first step is a tender offer by the acquiror and the second step is a merger in which the shares not tendered are converted into the same merger consideration offered in the tender offer. Where the tender offeror acquires sufficient shares in the tender offer to approve the agreement at a meeting at which all shares are voted, the holding of such a meeting would be a mere formality but might take a significant amount of time and impose a significant cost that was otherwise unnecessary. Corresponding changes are made to the provisions regarding appraisal to ensure that shareholders who do not tender would have the same rights to seek appraisal that they would in a merger that was approved at a meeting.

The Amendments are set forth below. Changes to the existing provisions are marked with deletions shown by strikeout and additions by double underscoring.
§ 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, the plan of merger or share exchange shall be adopted in the following manner:

(a) The plan of merger or share exchange must first be adopted by the board of directors.

(b) Except as provided in subsection (g) and subsections (h) and (j) and in section 11.05, after adopting the plan of merger or share exchange, the plan must then be approved by the shareholders. In submitting the plan of merger or share exchange to the shareholders for approval, 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 or, in the case of an offer referred to in subsection (j)(1)(B), that the shareholders tender their shares to the offeror in response to the offer, unless (i) the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation or (ii) section 8.26 applies. If either (i) or (ii) applies, the board must inform the shareholders of the basis for so proceeding.

(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) Subject to subsection (g), 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 securi-
        ties, interests, obligations, rights to acquire shares, other secu-
        rities or interests, cash, other property, or any combination of
        the foregoing; or

   (ii) are entitled to vote as a separate group on a provision in the
        plan that constitutes a proposed amendment to articles of incor-
        poration of a surviving corporation, that requires action by sep-
        arate voting groups under section 10.04;

(2) on a plan of share exchange, by each class or series of shares in-
    cluded in the exchange, with each class or series constituting a sep-
    arate voting group; and

(3) on a plan of merger or share exchange, if the voting group is enti-
    tled under the articles of incorporation to vote as a voting group to
    approve a plan of merger or share exchange.

(g) The articles of incorporation may expressly limit or eliminate the sepa-
    rate voting rights provided in subsections (f)(1)(i) and (f)(2) as to any
    class or series of shares, except for a transaction that (A) includes what
    is or would be, if the corporation were the surviving corporation, an
    amendment subject to subsection (f)(1)(ii), and (B) will effect no signif-
    icant change in the assets of the resulting entity, including all parents
    and subsidiaries on a consolidated basis.

(h) 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 corpora-
    tion 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 ex-
    change will hold the same number of shares, with identical prefer-
    ences, 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).

(i) 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.

(j) (1) 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:

(A) the plan of merger or share exchange expressly (A) permits or requires the merger or share exchange to be effected under this subsection and (B) provides that, if the merger or share exchange is to be effected under this subsection, the merger or share exchange will be effected as soon as practicable following the satisfaction of the requirement set forth in subsection (j)(1)(F);

(B) another party to the merger or share exchange, or a parent of another party to the merger or share exchange, makes an offer to purchase, on the terms provided in the plan of merger or share exchange, any and all of the outstanding shares of the corporation that, absent this subsection, would be entitled to vote on the plan of merger or share exchange, except that the offer may exclude shares of the corporation that are owned at the commencement of the offer by the corporation, the offeror, or any parent of the offeror, or by any wholly owned subsidiary of any of the foregoing;

(C) the offer discloses that the plan of merger or share exchange provides that the merger or share exchange will be effected as soon as practicable following the satisfaction of the requirement set forth in subsection (j)(1)(F) and that the shares of the corporation that are not tendered in response to the offer will be treated as set forth in subsection (j)(1)(H);

(D) the offer remains open for at least 10 days;

(E) the offeror purchases all shares properly tendered in response to the offer and not properly withdrawn;

(F) the shares (I) purchased by the offeror in accordance with the offer, (II) otherwise owned by the offeror or by any parent or wholly owned subsidiary of the offeror, or (III) subject to an agreement to be transferred, contributed or delivered to the offeror, any parent of the offeror, or any wholly owned subsidiary of the offeror in
exchange for stock or other equity interests in such offeror, parent
or subsidiary are collectively entitled to cast at least the minimum
number of votes on the merger or share exchange that, absent
this subsection, would be required by this chapter and by the arti-
cles of incorporation of the corporation for the approval of the
merger or share exchange by the shareholders and by any other vot-
ing group entitled to vote on the merger or share exchange at a
meeting at which all shares entitled to vote on the approval were
present and voted;

(G) the offeror or a wholly owned subsidiary of the offeror merges with
or into, or effects a share exchange in which it acquires shares of
the corporation; and

(H) each outstanding share of each class or series of shares of the cor-
poration that the offeror is offering to purchase in accordance with
the offer, and that is not purchased in accordance with the offer, is
to be converted in the merger into, or into the right to receive, or is
to be exchanged in the share exchange for, or for the right to re-
ceive, the same amount and kind of securities, interests, obligations,
rights, cash, or other property to be paid or exchanged in accor-
dance with the offer for each share of that class or series of shares
that is tendered in response to the offer, except that shares of the
corporation that are owned by the corporation or that are described
in clause (II) or (III) of subsection (j)(1)(F) need not be converted
into or exchanged for the consideration described in this subsec-
tion (j)(1)(H).

(2) As used in this subsection only:

(A) “offer” means the offer referred to in subsection (j)(1)(B);

(B) “offeror” means the person making the offer;

(C) “parent” of an entity means a person that owns, directly or indi-
directly (through one or more wholly owned subsidiaries), all of
the outstanding shares of or interests in that entity;

(D) shares tendered in response to the offer shall be deemed to have
been “purchased” in accordance with the offer at the earliest time
as of which (i) the offeror has irrevocably accepted those shares
for payment and (ii) either (A) in the case of shares represented
by certificates, the offeror, or the offeror’s designated depository
or other agent, has physically received the certificates representing
those shares or (B) in the case of shares without certificates, those
shares have been transferred into the account of the offeror or its
designated depository or other agent, or an agent’s message relating
to those shares has been received by the offeror or its designated depository or other agent; and

(E) “wholly owned subsidiary” of a person means an entity of or in which that person owns, directly or indirectly (through one or more wholly owned subsidiaries), all of the outstanding shares or interests.

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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.

Under section 11.04(h), shareholder action by selling shares in a tender offer or exchange offer is accepted as an alternative to the traditional consent by voting if the conditions specified in section 11.04(j) are met.

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, interests, obligations, rights to acquire shares, other securities or 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 constitutes an amendment to the articles of incorporation that requires approval by that class or series, voting as a separate voting group, under section 10.04.

Under section 11.04(g) the articles of incorporation may expressly authorize under section 11.04(g) for the articles of incorporation to limit or eliminate separate voting as a voting group for any class or series of shares in a merger or share exchange. This authorization does not apply if a plan of merger includes amendments requiring a separate vote under section 10.04. It also does not apply if the merger or share exchange involves both (i) what is or would be an amendment to which section 10.04 would apply and (ii) if the corporation were the surviving corporation and the transaction effects no significant change in the assets of the enterprise on a consolidated basis, i.e., the transaction has no substantive
business combination effect, such as a reincorporation or recapitalization. For example, suppose a corporation that is a holding company with a single wholly owned operating subsidiary has two classes of stock, preferred and common, and the articles of incorporation expressly eliminate a separate group vote and provide that the preferred stock and common stock vote together as a single voting group on a merger. The corporation proposes to merge itself into its subsidiary in a merger in which each class will get shares of common stock of the subsidiary as the surviving corporation. In such a case, the transaction would be in substance an amendment of the preferred stock (an exchange or reclassification under Section 10.04(a)(1)) and the preferred stock would have separate voting rights notwithstanding the provision eliminating the separate group vote. On the other hand, if the subsidiary were not wholly owned but was 60% owned and the holders of the 40% minority were being cashed out in the merger, the elimination of the separate group vote would be effective and the preferred stock and common stock would vote together as a single voting group because the merger would have business substance. The requirement that a provision limiting or eliminating group voting rights on a merger or share exchange be “express” is meant to avoid any ambiguity that might arise from a provision that generally denies voting rights.

The introduction of section 11.04(g) in 2010 is accompanied by changes to Section 11.04(g), together with the appraisal rights provisions of Chapter 13. Section 11.04(g), together with the appraisal rights provisions of Chapter 13, is designed to assure that, in the broad array of fundamental transactions or actions that may occur under Chapters 9, 10, 11 and 12, a shareholder has at least one of either a group voting right or an appraisal right. In many cases, a shareholder will have both, but in some cases only one. For example, group voting rights are assured for the amendments covered in Section 10.02, even if the shares otherwise have no voting rights, but appraisal rights are not available. On the other hand, under Section 13.02(c), appraisal rights may be denied to preferred shares in the articles but, as amended in 2010, Section 13.02(c) authorizes such a provision to be effective only if the shareholder has a group voting right on the transaction and does not permit it to be effective if the transaction is a nonprofit conversion under subchapter 9C or an entity conversion under subchapter 9E. See the Official Comment to Sections 13.01 and 13.02 or both.

Under Section 10.04(c), and therefore under Section 11.04(f)(1)(ii), if a change that requires voting by separate voting groups affects two or more classes or series in the same or a substantially similar way, the relevant classes or series vote together, rather than separately, on the change, unless otherwise provided in the articles of incorporation or required by the board of directors. 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(h). 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.
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.

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 must make a recommendation to the shareholders that the plan be approved, unless (i) the board makes a determination that because of conflicts of interest or other special circumstances it should make no recommendation or (ii) section 8.26 applies. The board might make a determination when submitting a plan of merger or share exchange to shareholders, the board of directors must recommend the transaction, subject to two exceptions in section 11.04(b). The board might exercise the exception under clause (i) where the number of directors having a conflicting interest makes it inadvisable for them to recommend the transaction or where the board is evenly divided as to the merits of the transaction but is able to agree that shareholders should be permitted to consider the transaction. This exception is intended to be used sparingly. Generally, shareholders should not be asked to vote on a plan of merger or share exchange in the absence of a recommendation by the board. Clause (ii) is intended to provide for situations in which the board might wish to commit in advance to submit a plan of merger or share exchange to the shareholders but later determines it is inadvisable or withdraws the recommendation for some other reason. If the board proceeds under either clause (i) or (ii), it must communicate the basis for its determination, when so proceeding. Clauses (i) and (ii) are not intended to relieve the board 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 under section 11.04(c) 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. These are examples and the board of directors is not limited to conditions of these types.

Section 11.04(d) provides that if the sets forth the notice requirements if a plan of merger or share exchange is required to be approved considered 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 at a meeting. 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 address the notice to be given to nonvoting sharehold-
ers 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 sets forth the quorum requirements, applicable to a shareholder vote to approve 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. See sections 7.25(f) and 10.04(c) for rules governing when separate classes or series vote together as a single voting group. If a quorum is present, then and subject to any greater vote required by the articles of incorporation or the board of directors pursuant to section 11.04(c), 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 share-
holder consent under 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.

4. TWO-STEP TRANSACTIONS

Section 11.04(j) authorizes a two-step transaction meeting the requirements of that section to proceed without the shareholder vote that would otherwise be required by section 11.04(b). The first step is an offer to the shareholders to tender their shares in response to which enough shareholders tender so that, upon consummation of the offer, the offering party (and any parent or wholly owned subsidiary) owns or has the right to acquire shares with sufficient voting power to satisfy the shareholder approval that would otherwise be re-
quired to approve the plan of merger pursuant to section 11.04. The second step is a merger providing the remaining shareholders the same consideration as was offered in the first step. The shareholder action in selling in response to the offer provides the necessary consent for the transaction, in lieu of a share-
holder vote, if the other conditions set forth in section 11.04(j) are met. The re-
quirements of section 11.04(j), together with sections 11.04(b), 13.20, 13.21 and 13.22, are intended to ensure that shareholders are not disadvantaged by
the absence of a vote, and that they receive the same protection in terms of timing, director duties and appraisal rights that they would in a transaction approved by a shareholder vote. For example, section 11.04(b) requires, subject to limited exceptions, that the board make a recommendation with respect to the offer that shareholders tender their shares. This ensures that there is a corporate action implicated by the offer, and that the same director duties will apply to the recommendation to tender into the offer as to conversion or exchange pursuant to a plan of merger or share exchange.

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 another 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 other entity will be determined by section 11.07(e).

§ 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, or would be required but for the provisions of section 11.04(j), 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, 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, except that appraisal rights shall not be available to any shareholder of the corporation with respect to shares of any class or series if (i) under the terms of the corporate action approved by the shareholders there is to be distributed to shareholders in cash its net assets, in excess of a reasonable amount reserved to meet claims of the
type described in sections 14.06 and 14.07, (A) within one year after the shareholders’ approval of the action and (B) in accordance with their respective interests determined at the time of distribution, and (ii) the disposition of assets is not an interested transaction;

(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 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% of such shares); or

(iii) issued by an open end management investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and may be redeemed at the option of the holder at net asset value.
(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 the meeting of shareholders to act upon the corporate action requiring appraisal rights or, in the case of an offer made pursuant to section 11.04(j), the date of such offer; or

   (ii) the day before the effective date of such corporate action if there is no meeting of shareholders and no offer made pursuant to section 11.04(j).

(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 (i) 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 or (ii) in the case of the consummation of a disposition of assets pursuant to section 12.02, unless such cash, shares or proprietary interests are, under the terms of the corporate action approved by the shareholders, to be distributed to the shareholders, as part of a distribution to shareholders of the net assets of the corporation in excess of a reasonable amount to meet claims of the type described in sections 14.06 and 14.07, (A) within one year after the shareholders’ approval of the action, and (B) in accordance with their respective interests determined at the time of the distribution.

(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, except that (i) no such limitation or elimination shall be effective if the class or series does not have the right to vote separately as a voting group (alone or as part of a group) on the action or if the action is a nonprofit conversion under subchapter 9C or a conversion to an unincorporated entity under subchapter 9E, or a merger having a similar effect, and (ii) 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.

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OFFICIAL COMMENT

1. TRANSACTIONS REQUIRING APPRAISAL RIGHTS

Section 13.02(a) establishes the scope of appraisal rights by identifying those transactions that 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 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 set forth in section 13.02(a), subject to the exceptions set forth in section 13.02(b). In a two-step transaction authorized by section 11.04(j), shareholders at the time of the back-end merger could have appraisal rights even though there is no shareholder vote. Shareholders who tender in response to the offer in the front end of such a transaction would not have appraisal rights, with their tendering in response to an offer that meets the other requirements of section 11.04(j) having the same effect on appraisal rights as if they had voted for the transaction.

(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 to appraisal under section 13.02(a)(1). Similarly, shareholders of a subsidiary that is a party to a merger under section 11.05 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, subsection (2) provides appraisal only for those shares that will be exchanged.

(3) A disposition of assets under section 12.02. As a general rule, shareholders of all classes or series of the corporation, whether or not they are entitled to vote under section 12.02, will be entitled to assert appraisal rights. An exception from appraisal rights is also provided, how-
ever, in addition to the exception provided in section 13.02(b), if liquidation is required to take place within one year of the shareholder vote and shareholders are to receive cash in accordance with their respective interests, so long as the transaction is not an interested transaction. In these circumstances, where shareholders are being treated on a proportionate basis in accordance with the corporation’s governing documents in an arm’s length transaction (akin to a distribution in dissolution), there is no need for the added protection of appraisal rights. 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. Under section 13.02(b)(4), the reasons for granting appraisal rights in this situation—reverse stock split in which shares are cashed out—are similar to those for granting such rights in cases of cash-out mergers, as both transactions could compel affected shareholders to receive 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. 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.

(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 rights 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 in connection with a corporate action will thereby automatically make all of the provisions of chapter 13 applicable to the corporation and such holders regarding that 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 material 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 foregoing 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 corporation that appraisal rights are provided to all of the shareholders.

(8) A conversion of the corporation to an unincorporated entity pursuant 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 Exception to Appraisal Rights**

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

For purposes of this chapter, the market out exception 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” as described in section 13.02(b)(1), and the value of the shares established by the appraisal-triggering event must be “reliable,” the result of a process reasonably calculated to arrive at a price reflective of an arm’s length transaction. Except as provided in section 13.02(b)(1)(iii), liquidity is addressed in section 13.02(b)(1) and requires the class or series of stock to satisfy either one of two requirements: (1) The class or series must be a covered security under section 18(a)(1)(A) or (B) of the Securities Act of 1933. This means that it must be listed on the New York Stock Exchange or the American Stock Exchange, or on the NASDAQ Global Select Market or the NASDAQ Global Market.
(successors to the NASDAQ National Market), or on certain other markets having comparable listing standards as determined by the Securities and Exchange Commission. (2) If not in these categories, the class or series must be traded in an organized market and have at least 2,000 record or beneficial shareholders (provided that using both concepts does not result in duplication) and have a market value of at least $20 million, excluding the value of shares held by the corporation’s subsidiaries, senior executives, directors and beneficial shareholders owning more than 10% 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 exception 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 rights, cash from the transaction, or shares or other proprietary interests in the survivor entity that are liquid. Section 13.02(b)(2) provides that specifies when 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), must satisfy the requirements of section 13.02(b)(1) must be met as of the day before the corporate action becomes effective for the market exception to be applicable.

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 an interested transaction of the type listed in 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 exception will not apply in those instances where the transaction constitutes an interested transaction (as defined in section 13.01(5-4)).

3. Elimination of Appraisal Rights for Preferred Shares

Section 13.02(c) permits the corporation to eliminate or limit appraisal rights that would otherwise be available for the holders of one or more series or classes of preferred shares provided that no such elimination or limitation may be effective if the holders of the series or class of preferred shares do not have a group vote
on the action that would otherwise give rise to appraisal rights, or with respect to a conversion into a nonprofit entity under subchapter 9C or a conversion to an unincorporated entity under subchapter 9E, or a merger having a similar effect. 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—the standards in that section are met. Chapter 13 does not permit the corporation to eliminate or limit the appraisal rights of common shares.

* * *

§ 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 or where no approval of such action is required pursuant to section 11.04(j), the meeting notice or, if applicable, the offer made pursuant to section 11.04(j) 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 or offer 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 sent 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 or offer 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.

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OFFICIAL COMMENT

Before a vote at a meeting is taken on a corporate action, the corporation is The notice required by section 13.20(a) to notify 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.

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). Section 13.20(d) specifies certain disclosure requirements for corporate actions for which appraisal rights are provided. Disclosure of additional information may be necessary under common law disclosure duties.

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 sections 13.20, as well as the related sections and 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 AND CONSEQUENCES OF VOTING OR CONSENTING

(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 as-
sert appraisal rights with respect to any class or series of shares must
not sign a consent in favor of the proposed action with respect to
that class or series of shares.

(c) If a corporate action specified in section 13.02(a) does not require
shareholder approval pursuant to section 11.04(j), 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 shares are purchased
pursuant to the offer written notice of the shareholder’s intent to
demand payment if the proposed action is effectuated; and

(2) must not tender, or cause or permit to be tendered, any shares of
such class or series in response to such offer.

(d) A shareholder who fails to satisfy the requirements of subsection (a)
or (b) or (c) is not entitled to payment under this chapter.

* * *

OFFICIAL COMMENT

Section 13.21 applies to all transactions requiring appraisal, except short-form
mergers under section 11.05. In the latter case, in which shareholders of the
subsidiary do not vote on the transaction but are nevertheless entitled to
appraisal.

Section 13.21(a) requires The notice from the shareholder to give notice of an
intent to demand payment before the vote on the corporate action is taken. This
notice required by section 13.21(a) or 13.21(c) enables the corporation to deter-
mine, among other things, to estimate how much of a cash payment may be re-
quired. It also serves to limit, by reference to the maximum number of shares for
which appraisal may be sought. It also limits the number of persons to whom the
corporation must give further notice during the remainder of the appraisal
process.

In order for a shareholder to remain eligible to demand payment, section
13.21(a)(2) mandates that the shareholder must not vote (or, in the case of a
beneficial shareholder, cause or permit to be voted) any shares of any class or
series for which the shareholder is demanding appraisal in favor of the proposal.
§ 13.22. Appraisal Notice and Form

(a) If a corporate action requiring appraisal rights under section 13.02(a) becomes effective, the corporation must send a written appraisal notice and the form required by subsection (b)(1) to all shareholders who satisfy the requirements of section 13.21(a) or section 13.21(b) or section 13.21(c). In the case of a merger under section 11.05, the parent must deliver an appraisal notice and form to all record shareholders who may be entitled to assert appraisal rights.

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

(1) supply a form that (i) specifies the first date of any announcement to shareholders made prior to the date the corporate action became effective of the principal terms of the proposed corporate action, and (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 is 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.

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

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, although 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 13.22(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.