

HOUSE BILL REPORT

HB 1052

As Reported by House Committee On: Judiciary

Title: An act relating to the authority of shareholders and boards of directors to take certain actions under the corporation act.

Brief Description: Addressing the authority of shareholders and boards of directors to take certain actions under the corporation act.

Sponsors: Representatives Pedersen, Rodne, Eddy and Moeller; by request of Washington State Bar Association.

Brief History:

Committee Activity:

Judiciary: 1/10/11, 1/13/11 [DP].

Brief Summary of Bill

- Amends provisions of the Washington Business Corporation Act governing: the powers of the board of directors; content and adoption of bylaws; indemnification rights for directors, officers, employees, and agents; and authority of corporations to enter into "force the vote" agreements.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: Do pass. Signed by 12 members: Representatives Pedersen, Chair; Goodman, Vice Chair; Rodne, Ranking Minority Member; Shea, Assistant Ranking Minority Member; Chandler, Frockt, Kirby, Klippert, Nealey, Orwall, Rivers and Roberts.

Staff: Edie Adams (786-7180).

Background:

The Washington Business Corporations Act (WBCA) provides requirements for the creation, organization, and operation of corporations and the relationship between shareholders, directors, and officers of the corporation. Many of the provisions of the WBCA provide default rules that may be altered or modified in the corporation's articles of incorporation or

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bylaws. The articles of incorporation and the bylaws are the governing documents for the corporation and set forth rules with respect to numerous organizational and operational issues.

Board of Directors, Shareholders, and Bylaws.

Provisions of the WBCA governing directors require a corporation to have a board of directors unless the articles of incorporation dispense with the board of directors. All corporate powers must be exercised by or under the authority of the board of directors, and the business and affairs of the corporation must be managed under the direction of the board of directors, except as limited by the articles of incorporation. However, a separate provision of the WBCA authorizes shareholders to enter into unanimous shareholder agreements that may eliminate or restrict the power of the board of directors.

The bylaws of a corporation may contain any provision that is not in conflict with law or the articles of incorporation. The board of directors has authority to adopt, amend, or repeal bylaws, unless that power is specifically reserved for the shareholders under the articles of incorporation or the WBCA, or unless the shareholders in adopting or amending a bylaw specifically provide that the particular bylaw may not be amended by the board of directors. Shareholders also have concurrent authority to amend or repeal bylaws, or adopt new bylaws.

Indemnification Rights.

The WBCA contains a number of provisions requiring or allowing indemnification of directors, officers, employees, or agents of the corporation for expenses and liabilities they incur as a result of their positions with the corporation. Unless the articles of incorporation provide otherwise, a corporation must indemnify a director or officer for reasonable expenses incurred if the director or officer was wholly successful in the defense of a proceeding. A corporation has discretion to indemnify or advance expenses to a director for any liability or expenses incurred in a proceeding as long as certain standards of conduct are met. In addition, a corporation has broad discretion to indemnify and advance expenses to officers, employees, or agents of the corporation as provided in its articles of incorporation or bylaws, or through action of the board.

"Force the Vote" Agreements.

A "force the vote" agreement is a provision in an agreement regarding a proposed corporate action that requires the board of directors to submit the proposed corporate action to a vote of the shareholders even if the board of directors determines later that it no longer recommends the action. "Force the vote" agreements are often used as deal protection devices in merger agreements. In 2008 the Committee on Corporate Laws of the American Bar Association Section on Business Law adopted amendments to the Model Business Corporations Act authorizing corporations to enter into agreements containing "force the vote" provisions.

Under the WBCA, there are a number of corporate actions that may be taken by the board of directors only upon approval of the shareholders. These include: (a) amendments to some provisions of the articles of incorporation; (b) mergers or share exchanges; (c) the sale of the

assets of the corporation other than in the regular course of business; and (d) dissolution of the corporation.

With respect to all of these actions, the WBCA requires the board of directors to recommend adoption of the proposed action to the shareholders unless the board of directors determines that it should make no recommendation because of a conflict of interest or other special circumstances. It is not clear whether "force the vote" agreements are valid under these requirements in the WBCA.

Summary of Bill:

Revisions are made to provisions of the WBCA governing the powers of the board of directors, content and adoption of bylaws, indemnification rights for directors, officers, employees, and agents, and authority of corporations to enter into "force the vote" agreements.

Board of Directors, Shareholders, and Bylaws.

The authority of the board of directors is revised to explicitly state that the board of directors has exclusive authority as to the substantive decisions concerning management of the corporation's affairs.

Provisions governing the content of bylaws, and the authority of the board of directors and shareholders to adopt, amend, or repeal bylaws, are amended to specifically state that bylaws may not contain a provision that infringes upon the exclusive authority of the board of directors to make substantive decisions concerning the management of the corporation's business.

In addition, these provisions governing board of director authority and amendment of the bylaws are revised to reference the right of shareholders to alter these rules through unanimous shareholder agreements.

Indemnification Rights.

A new provision is added to the WBCA governing the vesting of rights to indemnification or advancement of expenses for directors, officers, employees, or agents of a corporation. A right to indemnification or advancement of expenses that is provided in the articles of incorporation or the bylaws may not be eliminated or impaired after occurrence of the act or omission that is the basis of the proceeding for which indemnification or advancement of expenses is sought, unless the provision specifically authorizes elimination of the right after the act or omission occurs.

"Force the Vote" Agreements.

A new provision is added authorizing a corporation to agree to submit a corporate action to a vote of the shareholders whether or not the board of directors determines after approving the

corporate action that the board no longer recommends the action. Conforming amendments are made to provisions of the WBCA governing amendments to the articles of incorporation, plans of merger or share exchanges, the sale of assets other than in the regular course of business, and dissolution. For any of these corporate actions, the board of directors may submit the proposed action to the shareholders without recommending approval of the action if the corporation has agreed to submit the proposed action to the shareholders for approval.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) Washington is somewhat unusual in that we have a large number of Washington businesses that are organized in Washington. In most other states, businesses will choose to organize elsewhere, particularly in Delaware, which is the leading jurisdiction in the country, and probably the world, in corporate governance.

This proposal comes from the Corporate Act Revision Committee of the Business Law Section of the Washington State Bar Association, which jealously guards the WBCA. There are three main objectives taken into consideration when revising the WBCA. One objective is to maintain competitiveness to encourage Washington businesses to support our state by incorporating here. A second objective is to make our law clear so that we do not create any traps for practitioners and businesses. Lastly, Washington's statute is modeled after the Model Business Corporations Act and we need to keep our statute up to date with changes made to the model act.

All of the issues in the bill are in response to court decisions or changes made to Delaware law. Most of the provisions clarify what practitioners think is already the law, or are in response to what we think is a bad outcome in a case in another jurisdiction that we want to avoid.

(Opposed) None.

Persons Testifying: Representative Pedersen, prime sponsor; and John Reed, Washington State Bar Association, Business Law Section.

Persons Signed In To Testify But Not Testifying: None.