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SFA BILL ANALYSIS

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Senate Bill 414 (as introduced 4-16-97)
Sponsor: Senator Michael J. Bouchard
Committee: Financial Services

Date Completed: 5-14-97

CONTENT

The bill would amend the Business Corporation Act to make a number of revisions. Among other issues addressed, the bill would do all of the following:

- **Allow shareholders of certain corporations to contract among themselves without restrictions under the Act.**
- **Revise the Act's provisions limiting directors' liability.**
- **Specify procedures for other types of business organizations, such as a limited liability company (LLC) or limited partnership, to combine with a corporation.**
- **Repeal a section of the Act commonly referred to as the "greenmail" provision.**

A more detailed description of these issues follows.

Shareholder Contracts

An agreement among a corporation's shareholders that complied with the bill would be effective among the shareholders and the corporation, even if it were inconsistent with the Act in any of the following ways:

- It eliminated the board of directors or restricted the discretion or powers of the board.
- Subject to the Act's limitations pertaining to the protection of creditors, it governed the authorization or making of distributions, regardless of whether the distributions were in proportion to ownership of shares.
- It established who would be directors or officers of the corporation, or the terms of office or manner of selection or removal of corporate directors or officers.
- It governed, in general or in regard to specific matters, the exercise or division of voting power by or between the shareholders and directors or by or among any of the shareholders or directors, including the use of weighted voting rights or director proxies.
- It established the terms and conditions of any agreement for the transfer or use of property or the provision of services between the corporation any shareholder, director, officer, or employee of the corporation, or among any shareholder, director, officer, or employee of the corporation.
- It transferred to one or more shareholders or other persons all or part of the authority to exercise the corporate powers or to manage the business and affairs of the corporation, including the resolution of any issue about which there existed a deadlock among directors or shareholders.
- It required dissolution of the corporation at the request of one or more of the shareholders or upon the occurrence of a specified event or contingency.
- It otherwise governed the exercise of the corporate powers or the management of the business and affairs of the corporation or the relationship among the shareholders, the directors, and the corporation, or among any of the shareholders or directors and was not contrary to public policy.

An agreement authorized by this provision would have to be set forth in a provision of the articles of incorporation or bylaws approved by all persons who were shareholders at the time of the agreement, or in a written agreement that was signed by all persons who were shareholders at the time of the agreement and was made known to the corporation. The agreement also would have to be subject to amendment by all persons who were shareholders at the time of the amendment, unless the agreement provided otherwise. In addition, if amended by an amendment to the articles of incorporation or bylaws, the amendment would have to be approved by all shareholders. If amended by written agreement, the amendment would have to be in a writing signed by all shareholders and made known to the corporation.

The existence of an agreement under this provision would have to be noted conspicuously on the face or back of a certificate for shares issued by the corporation or on an information statement required under the bill. If, at the time of the agreement, the corporation had shares outstanding represented by certificates, the corporation would have to recall the outstanding certificates and issue substitute certificates that complied with the bill's shareholder agreement provisions. Failure to note the existence of an agreement on the certificate or information statement would not affect the validity of the agreement or any action taken pursuant to it. Any purchaser of shares who, at the time ownership was transferred, did not have knowledge of the existence of an agreement would be entitled to recision of the purchase.

A purchaser would be considered to have knowledge of the agreement at the time of transfer of ownership, if the agreement's existence were noted on the certificate or information statement in compliance with the bill and, if the shares were not represented by a certificate, the information statement were delivered to the purchaser at or prior to the time of transfer of ownership. An action to enforce the right of recision authorized by this subsection would have to be commenced within 90 days after the existence of the agreement was discovered or two years after the shares were transferred, whichever was earlier.

An agreement authorized under the bill would cease to be effective if shares of the corporation were listed on a national securities exchange or were regularly traded in a market maintained by one or more members of a national or affiliated securities association. If an agreement ceased to be effective for any reason and were contained or referred to in the corporation's articles of incorporation or bylaws, the board of directors could adopt an amendment to the articles or bylaws, without shareholder action, to delete the agreement and any references to it.

A shareholders' agreement under the bill that limited the discretion or powers of the board of directors would have to relieve the directors of, and impose upon the person or persons in whom the agreement vested discretion or powers, liability for acts or omissions imposed by law on directors, to the extent that the discretion or powers of the directors were limited by the agreement. The person or persons in whom the discretion or powers were vested would have to be treated as a director or directors for purposes of any indemnification and any limitation on liability under the Act.

The existence or performance of an agreement authorized by the bill would not be grounds for imposing personal liability on any shareholder for the acts or debts of the corporation or for treating the corporation as if it were a partnership or unincorporated entity, even if the agreement or its performance resulted in failure to observe the corporate formalities otherwise applicable to the matters governed by the agreement.

Dissolution of the corporation pursuant to an agreement authorized by the bill would have to be implemented by the filing of a certificate of dissolution.

Incorporators or subscribers for shares could act as shareholders with respect to an agreement authorized under the bill if no shares had been issued when the agreement was made.

Failure to satisfy the bill's unanimity requirement with respect to an agreement authorized by the bill would not invalidate any agreement that would otherwise be considered valid.

Directors' Liability

The Act allows a corporation's articles of incorporation to include a provision that a director is not personally liable to the corporation or its shareholders for monetary damages for a breach of the director's fiduciary duty. The provision, however, may not eliminate or limit the liability of a director for any of the following:

-- A breach of the director's duty of loyalty to the corporation or its shareholders.
-- Acts or omissions not in good faith or that involve intentional misconduct or knowing violation of law.
-- A violation of the Act's provisions regulating distribution of dividends (MCL 450.1551).
-- A transaction from which the director derived an improper personal benefit.
-- An act or omission occurring prior to the date

on which the provision of the articles of incorporation took effect.

The bill provides, instead, that the articles could contain a provision eliminating or limiting a director's liability to the corporation or its shareholders for money damages for any action taken or any failure to take any action as director, except liability for any of the following:

- The amount of a financial benefit received by a director to which he or she was not entitled.
- An intentional infliction of harm on the corporation or the shareholders.
- A violation of the Act's provision regulating distribution of dividends (MCL 450.1551).
- An intentional criminal act.

The bill also specifies that, if the articles of incorporation contained a provision eliminating the liability of a director under the Act prior to the bill's effective date, that provision would be considered to eliminate or limit the liability of a director as provided in the bill.

Mergers Between Corporations and Other Entities

The bill would provide for mergers between a "domestic corporation" and a "business organization". Under the Act, "domestic corporation" means a corporation formed under the Act, or existing on January 1, 1973, and formed under any other Michigan statute for a purpose for which a corporation may be formed under the Act. Under the bill, "business organization" would mean a domestic or foreign limited liability company, limited partnership, general partnership, or any other type of domestic or foreign business enterprise, incorporated or unincorporated, except a domestic corporation.

All of the following would apply to a merger between a domestic corporation and a business organization:

- One or more domestic corporations could merge with one or more business organizations if the bill's requirements were satisfied. (If all of the business organizations were foreign corporations, the merger would have to proceed under the Act's provisions governing those types of mergers.)
- The merger was permitted by the law of the jurisdiction in which each constituent business organization was organized and each constituent business organization complied with that law in effecting the merger, and each foreign constituent business organization transacting business in Michigan complied with the applicable Michigan laws.
- Each domestic corporation complied with the bill's provisions for merger with a business organization.

The board of each domestic corporation proposing to participate in a merger would have to adopt a plan of merger, setting forth all of the following:

- The name of each constituent entity, the name of the constituent entity that would be the surviving entity, the street address of the surviving entity's principal place of business, and the type of organization of the surviving entity.
- For the domestic corporation, the designation and number of outstanding shares of each class and series, specifying the classes and series entitled to vote, each class and series entitled to vote as a class, and, if the number of shares were subject to change before the merger's effective date, the manner in which the change could occur.
- The terms and conditions of the proposed merger, including the manner and basis of converting shares, partnership interests, membership interests, or other ownership interests of each constituent entity into ownership interests or obligations of the surviving entity, or into cash or other consideration (which could include ownership interests or obligations of an entity not a party to the merger), or into a combination of those interests and obligations and cash or other considerations.
- If the surviving entity were to be a domestic corporation, a statement of any amendment to the articles of incorporation of the surviving corporation to be effected by the merger or any restatement of the articles, which would have to be in a form restated as provided in the Act.
- Other provisions with respect to the proposed merger as the board considered necessary or desirable.

A plan of merger adopted by the board of each constituent domestic corporation would have to submitted for approval at a meeting of the shareholders.

A domestic corporation that had not yet commenced business, had not issued any shares, and had not elected a board could merge with any domestic or foreign entity by unanimous consent of its incorporators. To effect such a merger, the majority of the incorporators would have to execute a certificate of merger.

After a plan of merger was approved, a certificate of merger would have to be executed and filed on behalf of each domestic corporation. The certificate would have to set forth all of the following:

-- A statement of the requirements for a plan of merger (described above) and the manner and basis of converting the ownership interests of each constituent entity.
-- A statement that the plan of merger had been adopted by the board.
-- A statement that the plan of merger would be furnished by the surviving entity, on request and without cost, to any shareholder of the domestic corporation.
-- If approval of the shareholders of the domestic corporation were required, a statement that the plan was approved by the shareholders.
-- In the case of a merger by a domestic corporation that had not yet commenced business, a statement that the corporation had not commenced business, had not issued any shares, and had not elected a board, and that the plan of merger had been approved by the unanimous consent of the incorporators.
-- A statement of any assumed names of merging entities transferred to the surviving entity, specifying each transferred assumed name and the name of the entity from which it was transferred. If the surviving entity were a domestic corporation or a foreign corporation authorized to transact business in Michigan, the certificate could include a statement of the names or assumed names of merging entities that were to be treated as newly filed assumed names of the surviving corporation.

A certificate of merger would become effective in accordance with the Act. If a merger took effect, all of the following would apply:

-- Every other entity party to the merger would merge into the surviving entity and the separate existence of every other entity that was party to the merger would cease.
-- The title to all real estate and other property and rights owned by each entity party to the merger would be vested in the surviving entity without reversion or impairment.
-- The surviving entity could use the name and the assumed names of any merging entity, if filings required under the Act or other applicable statute were made.
-- The surviving entity had all liabilities of each constituent entity. The continued liability of a person who was an "obligated person" with respect to a constituent entity for acts or omissions before the merger would be in accordance with the law applicable to the type of business organization with respect to which the person was an obligated person. ("Obligated person" would mean a general partner of a limited partnership, a partner of a general partnership, or a participant in or an owner of an interest in any other type of business enterprise who, under applicable law, was generally liable for the obligations of the business enterprise.)
-- A proceeding pending against any entity party to the merger could be continued as if the merger had not occurred, or the surviving entity could be substituted in the proceeding for the entity whose existence ceased.
-- The articles of incorporation of a surviving domestic corporation would be amended to the extent provided in the plan of merger.
-- The ownership interests of each entity party to the merger that were to be converted into ownership interests or obligations of the surviving entity or into cash or other property would be considered converted.

If the surviving entity were a foreign business organization, it would be subject to Michigan laws pertaining to the transaction of business in Michigan if it transacted business in this State. The surviving entity would be liable, and would be subject to service of process in a proceeding in Michigan, for the enforcement of an obligation of a domestic corporation that was party to the merger, and in a proceeding for the enforcement of a right of a dissenting shareholder of a domestic corporation against the surviving entity.

<u>Greenmail</u>

The bill would repeal a section of the Act (MCL 450.1368) that prohibits a corporation from purchasing, directly or indirectly, any of its shares that are listed on a national securities exchange from any person who holds 3% or more of its shares, unless one of the following applies:

-- The corporation makes an offer, of at least equal value, to all other holders of the same shares.

- -- The purchase is authorized in advance by the holders of the shares entitled to vote on the purchase by a vote that may be required by the articles of incorporation or the Act.
- -- The purchase meets the requirement of the articles of incorporation for the purchase of shares from any person having 3% or more of the shares.
- -- The shares have been beneficially owned by the person for at least two years before the date of purchase.
- -- The purchase is made on the open market and not as a result of a privately negotiated transaction.
- -- The purchase price per share is not greater than the average market price per share during the 30 business days before the date of purchase.
- -- The purchase is authorized by the Act.

MCL 450.1132 et al.

Legislative Analyst: P. Affholter

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: M. Tyszkiewicz