



BUSINESS LAW SECTION
CORPORATIONS COMMITTEE
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***REVISIONS TO UPDATE CALIFORNIA CORPORATIONS CODE TO ADD
EMERGENCY POWERS AND BYLAW PROVISIONS***

LEGISLATIVE PROPOSAL (BLS-2013-01)

To: Office of Governmental Affairs

From: Emily Yukich, Co-Chair, and Jeff Drake, Co-Chair, Corporations Committee (the "Committee"), Business Law Section (the "Section")

Date: May 1, 2012

Re: Proposal to Amend Sections 207 and 212 of the California Corporations Code (the "Code")

SECTION ACTION AND CONTACTS

Date of Approval by Section Executive Committee (the "Executive Committee"): June 1, 2012
Approval Vote: For: 14 Against: 0

| Executive Committee Contact: | Committee Contact: |
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HISTORY, DIGEST AND PURPOSE

The mission statement of the Committee provides that it shall study, consider, take a position on and advocate that position with respect to, among other things, “[n]eeded changes to the California Corporations Code” and, “[o]ther statutory changes that would promote efficiency or effectiveness in practice if made . . .” The Committee has concluded that it is consistent with this mission to propose the amendment of Sections 207 and 212 of the Code (the “Proposed Amendments”) to allow corporations to maintain business operations during an emergency like a majority of United States jurisdictions have done. The Proposed Amendments, if enacted, would promote efficiency and effectiveness in practice by improving and modernizing relevant provisions of the Code.

History.

Section 207: Section 207 provides that a corporation shall have all of the powers of a natural person in carrying out its business activities. Section 207 offers eight examples of such powers, but notes that the powers are limited only by the articles of incorporation (the “articles”) and any applicable laws, and does not specifically address the adoption of emergency powers. The section was enacted as part of the General Corporation Law (the “GCL”) adopted in 1975 that became effective on January 1, 1977 (Stats. 1975, ch. 682 § 7). Section 207 was amended in 1977, but the amendment is not relevant to this proposal.

Section 212: Section 212 addresses mandatory and permissible bylaw provisions. Section 212(a) requires corporate bylaws to provide for the number of directors of the corporation unless that number is established in the articles. Section 212(b) provides a non-exhaustive list of potential bylaw provisions that a corporation may adopt to manage and conduct its business and does not specifically address the adoption of emergency bylaws. The section was enacted as part of the GCL adopted in 1975 (Stats. 1975, ch. 682 § 7) and was amended in 1976 (Stats. 1976, ch. 641, § 6.6) prior to becoming effective on January 1, 1977. Section 212 was amended again in 1977 (Stats. 1977, ch. 235, p. 1045, § 1.8). Both amendments were to the text of subdivision (a) and do not affect the substance of this proposal.

Proposal.

The Committee proposes that Sections 207 and 212 be amended as set forth below under the section entitled “Text of Proposal.” The proposed amendment to Section 207 provides California corporations with the power to take specific actions to continue to function during a catastrophic event (an “emergency”). The proposed amendment to Section 212 expressly permits California corporations to adopt emergency bylaws allowing any actions not conflicting with the articles to manage the corporation during an emergency. Both amendments protect corporate actions taken in good faith. The proposed amendment to Section 207 would complement the proposed amendment to Section 212.

The Model Business Corporation Act (the “MBCA”) contains emergency powers and bylaw provisions. While the 1969 MBCA combined the two provisions, the 1984 MBCA addresses these subjects in separate sections. Rather than adopt one or more new separate Code section(s) to address emergencies, the amendments are proposed to existing statutes that already

address corporate powers and bylaws. The Proposed Amendments logically fit within the respective Code sections, and therefore are more likely to be easily found by practitioners. Additionally, combining the provisions and adding a new section or including them together in an existing section could be confusing.

Finally, the proposal is to adopt both the emergency powers and bylaw provisions. The amendment to add emergency powers specifies those actions that can be taken during an emergency and will provide some basic protections for a corporation that does not adopt emergency bylaws. As the MBCA authors recognized, corporations that do not adopt emergency bylaws will still be able to function during an emergency under the proposed amendment to Section 207. MBCA Annotated § 3.03 official cmt. (2008).

Reasons for the Proposal.

The term “emergency” is specifically defined in the proposal and includes events or circumstances such as a natural catastrophe, enemy attacks, acts of terrorism or a state of emergency proclaimed by the Governor. Although there is no ready example of a corporation facing managerial setbacks because of an emergency, the possibility of catastrophic events effectively disabling boards cannot be ignored. Recent acts of terrorism, earthquakes, tsunamis and nuclear disasters are timely reminders of the vulnerability of the ordinary course of business in the face of large-scale emergencies.

The Committee believes that Sections 207 and 212 should be amended to add emergency powers and bylaw provisions, respectively. The Code does not provide operational powers for a corporation’s board during an emergency. In the case of an emergency, under an emergency powers statute, a corporation would be expressly authorized to take certain actions it might not otherwise be able to take. Under an emergency bylaw statute, a corporation would be authorized to adopt any provisions not conflicting with the articles necessary to manage the business. Under both statutes, the corporation would be provided with some certainty that the actions taken would be binding provided they were taken in good faith to maintain ordinary business operations. This lack of legislatively-sanctioned powers becomes particularly problematic when a quorum of the board cannot be readily convened for action. For example, under Code Section 307(a)(7), the minimum quorum requirement is one-third of the authorized directors or two, whichever is larger, unless the authorized number is one. Without emergency powers and/or bylaws, a corporation may be unable to continue its business, or risk a challenge to any actions taken with a lesser quorum, during an emergency. Additionally, an emergency could prevent the officers from conducting the corporation’s ordinary business operations. Providing the board with the necessary powers to act in lieu of the officers or to elect temporary officers to act would be critical.

Emergency Powers.

The MBCA authors originally combined the emergency powers and bylaw provisions. In 1984, however, the authors separated the provisions into Sections 3.03 (emergency powers) and 2.07 (emergency bylaws), noting that the emergency powers statute grants every corporation limited powers to act and enables a company to continue to operate when emergency bylaws

have not been adopted. MBCA Annotated § 3.03 official cmt. (2008). Allowing and permitting certain corporate actions in emergency conditions is crucial when a corporation has not adopted emergency bylaws.

Thirty-eight of 52 U.S. jurisdictions have adopted emergency powers provisions for for-profit corporations. California is one of the 14 jurisdictions that have not adopted an emergency powers statute. Twenty-eight of the 38 jurisdictions that have an emergency powers provision have adopted the provision separate from an emergency bylaw provision, per the 1984 MBCA. The majority of states that have provisions addressing emergency powers have adopted Section 3.03 of the MBCA without substantively changing the language. This majority includes California neighbor-states Arizona and Oregon, and Colorado, Florida, and Hawaii—states like California, with a notable history of large-scale emergencies (natural or otherwise). None of the 28 jurisdictions has neglected to adopt both emergency provisions, and all do so in conformity with the MBCA. The remaining 10 jurisdictions, including Delaware, have either followed the 1969 MBCA with a combined separate provision, or have amended their general bylaw statute to include provisions for both emergency powers and bylaws.

The proposed amendment to add emergency powers defines an “emergency” and provides that boards of directors may do the following both before and during an emergency: relax notice requirements for a board meeting, permit corporate officers to serve as directors to achieve a quorum, modify lines of succession, and relocate the corporation’s principal business office. “Emergency” is defined in the proposed amendment to Section 207 where it can be easily found, naturally fits, and is unlikely to be overlooked, rather than in Chapter 1 of the Code, “General Provisions and Definitions.” The MBCA defines an emergency to exist if a quorum cannot be readily assembled because of some “catastrophic” event. The MBCA authors broadened the definition of emergency in 1984 intending to expand the prior definition that included nuclear disasters and attacks on the U.S. to include attacks on a corporation’s customary place of business, natural catastrophes, and similar emergencies that make quorum assembly difficult. MBCA Annotated § 2.07 official cmt. (2008). A few variations on the definition of an “emergency” include: (i) An “extraordinary” event that prevents a quorum from assembling in time to deal with the business for which a meeting has been called or is to be called. Ind. Code Ann. § 23-1-22-3. The Indiana legislature thought that “catastrophic” event was too restrictive, and the broader definition was more useful in practice. (ii) Any emergency resulting from an attack on the U.S., a nuclear disaster or another catastrophe as a result of which a quorum cannot be readily assembled. This provision was meant to broaden the definition to include events like earthquakes or floods. 15 Pa. Cons. Stat. Ann. § 1509. (iii) Attacks on the U.S. and a corporation’s locality, nuclear or atomic disaster, or any catastrophe, “or similar emergency condition” as a result of which a quorum cannot be readily convened. Kan. Stat. Ann. § 17-6010. (iv) A civil defense emergency determined by the U.S. President, Congress or the Governor, which relates to an attack or imminent attack on the U.S. or its possessions, with the emergency ending when such person determines. IL ST CH 805 § 5/2.30.

To provide clarity as to the types of events deemed emergencies and to prevent minority boards from inappropriately deeming an event an emergency, the proposed amendment, borrowing from the federal National Emergencies Act and California’s Emergency Services Act, specifically defines an “emergency.” 50 U.S.C.A. §1601; Cal.Gov’t Code §8558. Additionally,

to prevent a board from taking inappropriate or unnecessary actions during an emergency, the amendment to Section 207 limits the authorized actions. Boards would not be authorized to take extraordinary actions, including those requiring a shareholder vote, or to thwart actions for which the required vote has already been obtained.

Emergency Bylaws.

The MBCA authors unqualifiedly recommended adoption of an emergency bylaw provision as the problem addressed is potentially present in every state and for every corporation. MBCA Annotated §207 official cmt. (2008). The authors state: “While there apparently has been no recent illustration of a public corporation facing such a catastrophic event, its possibility should not be ignored.” (*Id.*) The authors recognized that the adoption of emergency bylaws clarifies the lines of command and responsibility, helps to ensure continuity of responsibility, and requires specific statutory authorization because their provisions may be at variance with conventional standards of corporate practice. These statutes recognize that the sudden loss of a substantial portion of the management or board presents problems relating to the continuity of the corporate business and affairs. MBCA Annotated §207 historical background (2008).

Amending Section 212 to explicitly permit the adoption of emergency bylaws would potentially encourage more corporations to do so and thus be better positioned to handle large-scale emergencies and catastrophes. California would benefit because the economy and infrastructure could suffer to the extent that our corporations are not able to maintain operations during an emergency.

The proposed amendment to Section 212 encourages corporations to adopt emergency bylaws before an emergency. The Code does not contain a provision that expressly sanctions the adoption of emergency bylaws. In fact, Section 212 gives corporations discretion to adopt any bylaws “not in conflict with the law or the articles for the management of the business and for the conduct of the affairs of the corporation.” Without explicitly sanctioning the adoption of emergency bylaws that conflict with the laws governing during normal business operations, like the prescribed quorum requirements in Code Section 307(a)(7), uncertainty is created regarding, among other things, the validity of any actions taken by a board under emergency circumstances. This amendment will provide clarity about the permissibility of actions taken, thereby mitigating or avoiding unnecessary litigation. Immunity is provided for all directors, officers, employees, and agents of the corporation for actions taken in good faith in accordance with the bylaws for the purpose of maintaining business operations during an emergency. Finally, the amendment clarifies that while emergency bylaws trump regular bylaws during an emergency, they are not effective after the emergency ends.

To prevent a board from taking inappropriate or unnecessary actions during an emergency, the proposed amendment to Section 207 limits authorized actions. Boards would not be authorized to take extraordinary actions, including those actions requiring a shareholder vote, or to thwart actions for which the required vote has already been obtained. The proposed amendment also defines and clarifies those events deemed emergencies. Further, pursuant to Code Section 211, shareholders will continue to have the right to amend or repeal emergency bylaws.

APPLICATION

If enacted, the proposed amendments to Sections 207 and 212 would become effective on January 1, 2014.

PENDING LITIGATION

As of the date submitted, the Committee is unaware of any pending litigation that is relevant to this legislative proposal.

LIKELY SUPPORT AND OPPOSITION

The Committee anticipates that the Proposed Amendments would receive support from California corporations, shareholders, and corporate law practitioners. The Committee is aware of no opposition to this proposal.

FISCAL IMPACT

No negative fiscal impact is expected. The Proposed Amendments may make California a more attractive location for companies to conduct business, which would have a positive fiscal impact.

GERMANENESS

The subject matter of the Proposed Amendments is one in which the members of the Section (and, in particular, the Committee members) have special expertise because they are called upon to interpret provisions of the Code and provide guidance on California corporate and securities law matters.

DISCLAIMER

This position is only that of the Corporations Committee of the Business Law Section of the State Bar of California. This position has not been adopted by the State Bar's Board of Trustees or overall membership, and is not to be construed as representing the position of the State Bar of California.

Membership in the Corporations Committee and in the Business Law Section is voluntary and funding for their activities, including all legislative activities, is obtained entirely from voluntary sources.

TEXT OF PROPOSAL

SECTION 1. Section 207 of the Corporations Code is amended to read:

207. Subject to any limitations contained in the articles and to compliance with other provisions of this division and any other applicable laws, a corporation shall have all of the powers of a natural person in carrying out its business activities, including, without limitation, the power to:

(a) Adopt, use and at will alter a corporate seal, but failure to affix a seal does not affect the validity of any instrument.

(b) Adopt, amend and repeal bylaws.

(c) Qualify to do business in any other state, territory, dependency or foreign country.

(d) Subject to the provisions of Section 510, issue, purchase, redeem, receive, take or otherwise acquire, own, hold, sell, lend, exchange, transfer or otherwise dispose of, pledge, use and otherwise deal in and with its own shares, bonds, debentures and other securities.

(e) Make donations, regardless of specific corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic or similar purposes.

(f) Pay pensions, and establish and carry out pension, profit-sharing, share bonus, share purchase, share option, savings, thrift and other retirement, incentive and benefit plans, trusts and provisions for any or all of the directors, officers and employees of the corporation or any of its subsidiary or affiliated corporations, and to indemnify and purchase and maintain insurance on behalf of any fiduciary of such plans, trusts or provisions.

(g) Subject to the provisions of Section 315, assume obligations, enter into contracts, including contracts of guaranty or suretyship, incur liabilities, borrow and lend money and otherwise use its credit, and secure any of its obligations, contracts or liabilities by mortgage, pledge or other encumbrance of all or any part of its property, franchises and income.

(h) Participate with others in any partnership, joint venture or other association, transaction or arrangement of any kind, whether or not such participation involves sharing or delegation of control with or to others.

(i) (1) In advance of and/or during an emergency, take any or all of the following actions necessary to conduct the corporation's ordinary business operations and affairs during an emergency, unless emergency bylaws provide otherwise pursuant to subdivision (c) of Section 212:

(i) modify lines of succession to accommodate the incapacity of any director, officer, employee, or agent resulting from the emergency;

(ii) relocate the principal office, designate alternative principal offices or regional offices, or authorize the officers to do so;

(iii) give notice to a director or directors in any practicable manner under the circumstances, including by publication and radio, when notice of a meeting of the board cannot be given to that director or directors in the manner prescribed by the bylaws or Section 307; and

(iv) deem that one or more officers of the corporation present at a board meeting is a director, in order of rank and within the same rank in order of seniority, as necessary to achieve a quorum for that meeting.

(2) During an emergency, the board may not take any action that requires the vote of the shareholders or otherwise is not in the corporation's ordinary course of business, unless the required vote of the shareholders was obtained prior to the emergency.

(3) Any actions taken in good faith during an emergency under this subsection binds the corporation and may not be used to impose liability on a corporate director, officer, employee, or agent.

(4) An "emergency" means any one of the following events or circumstances as a result of which a quorum of the corporation's board of directors cannot be readily convened for action: (i) a natural catastrophe (including any hurricane, tornado, storm, high water, wind-driven water, tidal wave, tsunami, earthquake, volcanic eruption, landslide, mudslide, snowstorm, or drought), or, regardless of cause, any fire, flood, or explosion; (ii) an attack on this state or nation by an enemy of the United States, or upon receipt by this state of a warning from the federal government indicating that such an enemy attack is probable or imminent; (iii) an act of terrorism or other man-made disaster that results in extraordinary levels of casualties or damage or disruption severely affecting the population (including mass evacuations), infrastructure, environment, economy, or government functions; or (iv) a state of emergency duly proclaimed by the Governor.

SEC. 2. Section 212 of the Corporations Code is amended to read:

212. (a) The bylaws shall set forth (unless such provision is contained in the articles, in which case it may only be changed by an amendment of the articles) the number of directors of the corporation; or that the number of directors shall be not less than a stated minimum nor more than a stated maximum (which in no case shall be greater than two times the stated minimum minus one), with the exact number of directors to be fixed, within the limits specified, by approval of the board or the shareholders (Section 153) in the manner provided in the bylaws, subject to paragraph (5) of subdivision (a) of Section 204. The number or minimum number of directors shall not be less than three; provided, however, that (1) before shares are issued, the number may be one, (2) before shares are issued, the number may be two, (3) so long as the corporation has only one shareholder, the number may be one, (4) so long as the corporation has only one shareholder, the number may be two, and (5) so long as the corporation has only two shareholders, the number may be two. After the issuance of shares, a bylaw specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa may only be adopted by approval of the outstanding shares (Section 152); provided, however, that a bylaw or amendment of the articles reducing the fixed number or the minimum number of directors to a number less than five cannot be adopted if the votes cast against its adoption at a meeting or the shares not consenting in the case of action by written consent are equal to more than $16 \frac{2}{3}$ percent of the outstanding shares entitled to vote.

(b) The bylaws may contain any provision, not in conflict with law or the articles for the management of the business and for the conduct of the affairs of the corporation, including but not limited to:

- (1) Any provision referred to in subdivision (b), (c) or (d) of Section 204.
- (2) The time, place and manner of calling, conducting and giving notice of shareholders', directors' and committee meetings.
- (3) The manner of execution, revocation and use of proxies.
- (4) The qualifications, duties and compensation of directors; the time of their annual election; and the requirements of a quorum for directors' and committee meetings.
- (5) The appointment and authority of committees of the board.
- (6) The appointment, duties, compensation and tenure of officers.
- (7) The mode of determination of holders of record of its shares.
- (8) The making of annual reports and financial statements to the shareholders.

(c) Notwithstanding anything to the contrary contained herein:

(1) The bylaws may contain any provision, not in conflict with the articles, to manage and conduct the ordinary business affairs of the corporation effective only in an emergency as defined in paragraph (4) of subdivision (i) of Section 207, including but not limited to procedures for calling a board meeting, quorum requirements for a board meeting, and designation of additional or substitute directors.

(2) During an emergency, the board may not take any action that requires the vote of the shareholders or otherwise is not in the corporation's ordinary course of business, unless the required vote of the shareholders was obtained prior to the emergency.

(3) All provisions of the regular bylaws consistent with the emergency bylaws shall remain effective during the emergency; provided however, that the emergency bylaws shall not be effective after the emergency ends.

(4) Corporate action taken in good faith in accordance with the emergency bylaws binds the corporation, and may not be used to impose liability on a corporate director, officer, employee, or agent.