



BUSINESS LAW SECTION

CORPORATIONS COMMITTEE
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REVISIONS TO STREAMLINE AND UPDATE CORPORATIONS CODE PROVISIONS RELATING TO ACTIONS BY WRITTEN CONSENT OF SHAREHOLDERS

LEGISLATIVE PROPOSAL (BLS-2013-02)

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 Section 603 of the Corporations 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 that mission to propose amending portions of Section 603(b) of the California Corporations Code (the “**Code**”) concerning shareholder action taken by written consent. The proposed amendments, if enacted, would promote efficiency and effectiveness in practice in that it would simplify, improve and modernize relevant provisions of the Code.

Background.

In 1977, California significantly modified corporate law restrictions on shareholder action taken by written consent. Prior to 1977, the law permitted shareholder action without a meeting if such action was authorized by a writing signed by all of the persons who would be entitled to vote upon such action at a meeting.

The current law, embodied in Section 603 of the Code¹ and adopted in 1977, provides that, subject to any provision in a corporation’s articles of incorporation, shareholders may take any action without a meeting if the holders of outstanding shares, having not less than the minimum number of votes that would be necessary to take that action at a meeting at which all shares entitled to vote thereon were present and voted, provide their written consent to such action. If the consents of all shareholders entitled to vote have not been solicited, Section 603(b) (the “**Existing Statute**”) requires notice of certain corporate actions to be delivered to all shareholders who did not consent to such action at least 10 days prior to consummation of such actions, and requires that prompt notice of other corporate actions be delivered to those shareholders who did not consent to such actions. The text of the Existing Statute is set forth below:

(b) Unless the consents of all shareholders entitled to vote have been solicited in writing, both of the following shall apply:

(1) Notice of any shareholder approval pursuant to Section 310, 317, 1152, 1201 or 2007 without a meeting by less than unanimous written consent shall be given at least 10 days before the consummation of the action authorized by that approval. Notice shall be given as provided in subdivision (b) of Section 601.

(2) Prompt notice shall be given of the taking of any other corporate action approved by shareholders without a meeting by less than unanimous written consent, to those shareholders entitled to vote who have not consented in writing. Notice shall be given as provided in subdivision (b) of Section 601.

¹ Unless otherwise specified, all section references herein are to sections of the Code.

Proposal.

The Committee proposes that the Existing Statute be amended as set forth below under the section entitled “Text of Proposal” (the “**Proposed Statute**”). The Proposed Statute eliminates the 10-day waiting period for consummating certain corporate reorganizations that is currently required under the Existing Statute. The Proposed Statute would amend Section 603(b)(1) by exempting therefrom reorganizations as to which shareholders have the right under Chapter 13 of the Code (dissenters’ rights) to demand payment of cash for their shares (“**Reorganizations with Dissenters’ Rights**”) and thereby eliminating the 10-day waiting period that currently applies to such reorganizations when approved by the shareholders of the corporation without a meeting by less than unanimous written consent and the consents of all shareholders entitled to vote were not solicited in writing.

Reasons for the Proposal.

A. Summary of Position.

The Committee believes that the provision in the Existing Statute, which results in a 10-day waiting period before Reorganizations with Dissenters’ Rights are approved by written consent of shareholders may be consummated, should be eliminated. Compliance with the Existing Statute unnecessarily subjects the consummation of such reorganizations to risk and increases corporate costs. Some practitioners believe that the 10-day waiting period was included to afford shareholders an opportunity to seek to enjoin a reorganization or take other action to protect their interests. However, the 10-day waiting period does not afford this opportunity with respect to Reorganizations with Dissenters’ Rights. Section 1312(a) expressly prohibits shareholders with dissenters’ rights from attacking the validity of the transaction and it prohibits any suit for an injunction to stop the reorganization. In addition, the Existing Statute is among the provisions of the Code that collectively are an impediment to transacting business as a California corporation.

The Proposed Statute, on the other hand, would further the goals of the legislature when it authorized shareholder action by written consent, promoting efficiency and providing flexibility to corporations, without impairing shareholder protection afforded by other existing laws. The Committee believes that any distinctions between the procedures for shareholder approval of Reorganizations with Dissenters’ Rights with or without a meeting should exist only to the extent necessary to safeguard shareholder rights.

B. Statutory Background.

In considering the proposed amendment to the Existing Statute, it is important to review the evolution of the California law permitting shareholders to act by written consent. Prior to the Existing Statute, shareholder action could only be taken at a shareholders’ meeting. One rationale for requiring a meeting was that the corporation was originally developed as a medium for public investment, and shares were typically widely held. In the 1800s, there was no conception of a large group of people making decisions other than at a meeting. Another rationale for requiring shareholder action be taken at a meeting might have been to safeguard

shareholder rights afforded by the opportunity to attend, participate in discussion and debate, and vote at a meeting. In many cases, however, shareholder meetings did not give rise to lively (or even any) discourse, were expensive, sparsely attended or both, and were unnecessary in the case of many closely-held corporations. Recognizing that requiring a meeting was unduly restrictive, the legislature enacted the Existing Statute, eliminating the requirement for shareholder meetings in all cases and allowing for speed and flexibility of action by the corporation where shareholder approval is necessary.

C. The Existing Statute Increases Consummation Risk and Costs.

The Existing Statute requires corporations to solicit the consent of all shareholders or subject certain proposed corporate actions (including Reorganizations with Dissenters' Rights) to a 10-day waiting period. If the latter is chosen, it places the consummation of the corporate action at unnecessary risk. The waiting period could apply, for example, to a merger involving a corporation with one shareholder who holds 95% of the outstanding shares, who has approved the transaction, and with a large number of employee shareholders who hold the remaining 5% by operation of an employee stock incentive plan. If this corporation wishes to close the transaction quickly and have its shareholders approve the merger by written consent, it will be required to either absorb the costs of soliciting the consent of all shareholders or subject the closing of the transaction to a 10-day waiting period. The 10-day waiting period creates significant consummation risk for the parties even though approval of the transaction is certain. For example, the additional period of time provides an opportunity for new laws or regulations to be enacted, for facts or circumstances to develop or exist that may cause a material adverse effect to one of the parties, for an act of God to occur or for the conditions of the financial or credit markets to worsen, any of which may change the landscape of the transaction and affect the ability or obligation of a party to close.

The cost of avoiding the unnecessary risks described above is to incur the additional costs of soliciting the consent of all shareholders. Requiring California corporations to do so imposes incremental costs and related inefficiencies on such corporations, including costs associated with preparing, printing and mailing solicitation materials to all shareholders. In addition to administrative costs, corporations will often incur attorneys' fees in preparing solicitation materials, which can be substantial. These costs and fees seem entirely unnecessary and burdensome if shareholders holding the required number of shares to approve the reorganization have already approved the transaction. Even if these costs and fees are low for a particular transaction, there is no justification why a corporation should bear any additional costs to avoid a waiting period that does not provide a clear benefit.

Based on the assumption that meetings give rise to robust debate while written consents do not, some practitioners believe that the 10-day waiting period in the Existing Statute was included to provide a window for the vigorous debate among shareholders that would otherwise occur at a meeting. A review of the statute reveals otherwise. The 10-day waiting period does not apply if the consents of all shareholders have been solicited in writing, regardless of whether a significant minority voting block opposes the transaction and regardless of whether they have had time to communicate with others about the transaction for which their consents were solicited. In cases where the consents of all shareholders have been solicited, "no additional

notice is required, as the solicitation itself serves as notice that the action has been proposed and will be accomplished if the requisite consents are obtained.” (Harold Marsh, Jr., Marsh’s California Corporation Law, Section 12.06 (2011)). In other words, as long as the corporation solicits consents from all shareholders, it may consummate the transaction, without notice, on the very day when the requisite consents are obtained.

In summary, corporations desiring speed and efficiency are left with the incongruous situation of a Reorganization with Dissenters’ Rights having been consummated, in accordance with the Existing Statute, by the time their shareholders open their solicitation envelopes, or subjecting the consummation of the reorganization to the risks associated with the 10-day waiting period. It simply seems wasteful to require California corporations to prepare solicitation materials and solicit consents from all shareholders to avoid a waiting period and the risks associated therewith when the requisite shareholder approval is a *fait accompli*.

D. The Proposed Statute Does Not Impair Existing Shareholder Protections.

Some practitioners believe that the 10-day waiting period was included to afford shareholders an opportunity to “take whatever action they deem appropriate to protect their interests.” (See Harold Marsh, Jr., Marsh’s California Corporation Law, Section 12.06 (2011)). However, Section 1312(a) expressly prohibits shareholders with dissenters’ rights from attacking the validity of the transaction. In addition, other available mechanisms safeguard the rights of shareholders.

The existence of dissenters’ rights, which permit a non-consenting shareholder to seek a fair market value determination with respect to its shares, eliminates any right at law or in equity to attack the validity of a Reorganization with Dissenters’ Rights: “[i]t is clear that Section 1312(a) was intended to and does prohibit any suit for an injunction to stop the merger, since its major purpose was to take away from the shareholder this “blackmail” threat to hold up the merger indefinitely while the suit was litigated.” (See Harold Marsh, Jr., Marsh’s California Corporation Law, Section 19.09[A] (2011)).

The time periods built into the dissenters’ rights statute, which provide dissatisfied shareholders with appropriate remedies, also remain unaffected by the Proposed Statute. After shareholder approval of a Reorganization with Dissenters’ Rights (including approvals by written consent), California corporations would continue to be subject to a 10-day period in which to notify shareholders of the approval and provide them with copies of the dissenters’ rights statutes, a description of the procedure to be followed and a statement of the price the corporation deems to be the fair value of the shares, including an offer to buy the shares at that price. (See Section 1301(a).) Dissenting shareholders would continue to have 30 days to demand appraisal without any impact from the Proposed Statute. (See Sections 1301(b) and 1302.) Finally, dissenting shareholders would continue to have six months in which to commence an appraisal action in Superior Court. (See Section 1304.)

In addition, the Proposed Statute would not affect fiduciary duties owed by the board of directors of a corporation to all shareholders and by majority shareholders to minority shareholders, each of which are recognized under California law. These fiduciary duties provide

direct recourse for aggrieved shareholders who disfavor an approved transaction. Thus, a minority shareholder whose written consent was not solicited retains the ability to sue members of the board or majority shareholder(s) for cash damages.

Additional minority shareholder protections are available and may be obtained by contract. Nothing prevents a shareholder or group of shareholders from requiring, as a condition to their investment in a corporation, that the corporation and other shareholders contractually agree to obtain the approval of the shareholder or a group of shareholders prior to specified corporate actions, including Reorganizations with Dissenters' Rights.

Finally, other waiting periods imposed by law or regulation for the protection of minority shareholders in other circumstances, when deemed necessary, would continue to be imposed notwithstanding enactment of the Proposed Statute. For example, Rule 14c-2 of the Securities and Exchange Commission's proxy rules imposes a waiting period that would remain unaffected by the Proposed Statute. Therefore, California corporations that are subject to Rule 14c-2, including those with concentrated shareholder voting blocks, would continue to be subject to more stringent Securities and Exchange Commission oversight. See also Section 1110(h), requiring uniform advance notification without regard to whether or not all shareholders were solicited, for specified types of transactions determined by the legislature to merit special treatment.

E. Corporations May Opt Out of Statutory Written Consent Rules.

Finally, the Proposed Statute preserves freedom of corporate choice. Section 603 is an "opt-out" statute. A corporation's founders or shareholders may eliminate the ability of shareholders to take action by written consent by so providing in the articles of incorporation. Alternatively, they may require that Reorganizations with Dissenters' Rights be approved by a percentage that is greater than a majority of the outstanding shares when such transactions are approved by written consent. A variety of permutations are possible. Many other jurisdictions, including Delaware and Nevada, do not impose a 10-day waiting period on any corporate action that is approved by written consent of shareholders. California should not have an additional layer of requirements, different from other states, that fundamentally are not justified by some important policy.

F. Conclusion.

Shareholder action taken by written consent is universally recognized as a valid approval by shareholders and this is expressly confirmed by California statute. The 10-day waiting period acts to delay the effectiveness of the action, which hinders a corporation's ability to act with speed and efficiency when necessary. Some practitioners believe that the 10-day waiting period was included to afford shareholders an opportunity to seek to enjoin a corporate action or take other action to protect their interests. However, the 10-day waiting period does not afford this opportunity with respect to Reorganizations with Dissenters' Rights. Section 1312(a) expressly prohibits shareholders with dissenters' rights from attacking the validity of the transaction (at law or in equity) and prohibits any suit for an injunction to stop the merger. Accordingly, the Existing Statute appears to foster unnecessary costs and places form over substance in its

encouragement of solicitations of all shareholders. The Committee respectfully submits that, because compliance with the Existing Statute unnecessarily increases corporate costs and the Proposed Statute would further the goals of the legislature when it authorized shareholder action by written consent, promoting efficiency and providing flexibility to corporations, without impairing shareholder protection afforded by other existing laws, the Proposed Statute be enacted.

APPLICATION

If enacted, the Proposed Statute 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 Statute would receive support from California corporations, shareholders and corporate law practitioners, with particularly strong support from closely-held corporations and their shareholders. Despite effective shareholder protection mechanisms that currently exist, opposition from shareholder rights advocates is possible.

FISCAL IMPACT

No negative fiscal impact is expected. The Proposed Statute may make California a more attractive location for companies to conduct business, which would increase tax revenues and create jobs.

GERMANENESS

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

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 603 of the Corporations Code is amended to read:

603. (a) Unless otherwise provided in the articles, any action that may be taken at any annual or special meeting of shareholders may be taken without a meeting and without prior notice, if a consent in writing, as specified in Section 195, setting forth the action so taken, shall be provided by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take that action at a meeting at which all shares entitled to vote thereon were present and voted.

(b) Unless the consents of all shareholders entitled to vote have been solicited in writing, both of the following shall apply:

(1) Notice of any shareholder approval pursuant to Section 310, 317, 1152, 1201 **(other than a reorganization as to which shareholders have the right under Chapter 13 to demand payment of cash for their shares)** or 2007 without a meeting by less than unanimous written consent shall be given at least 10 days before the consummation of the action authorized by that approval. Notice shall be given as provided in subdivision (b) of Section 601.

(2) Prompt notice shall be given of the taking of any other corporate action approved by shareholders without a meeting by less than unanimous written consent, to those shareholders entitled to vote who have not consented in writing. Notice shall be given as provided in subdivision (b) of Section 601.

(c) Any shareholder giving a written consent, or the shareholder's proxyholders, or a transferee of the shares or a personal representative of the shareholder or their respective proxyholders, may revoke the consent personally or by proxy by a writing received by the corporation prior to the time that written consents of the number of shares required to authorize the proposed action have been filed with the secretary of the corporation, but may not do so thereafter. The revocation is effective upon its receipt by the secretary of the corporation.

(d) Notwithstanding subdivision (a), directors may not be elected by written consent except by unanimous written consent of all shares entitled to vote for the election of directors; provided that the shareholders may elect a director to fill a vacancy, other than a vacancy created by removal, by the written consent of a majority of the outstanding shares entitled to vote.