



BUSINESS LAW SECTION

THE STATE BAR OF CALIFORNIA

BLS – 2005 - 06

TO: Larry Doyle, Chief Legislative Counsel, State Bar of California

FROM: Business Law Section-Corporations Committee
Jerome A. Grossman, Vice Chair-Legislation--Executive Committee

DATE: August 2, 2004

RE: Proposal to amend Sections 307(b), 5211(b), 7211(b), 9211(b) and 12351(b) of the Corporations Code of the State of California

SECTION ACTION AND CONTACTS:

Section: Business Law Section
Committee: Corporations Committee

Dates of Approval:

Section Executive Committee -July 16, 2004
Corporations Committee -April 2, 2004

Approval Vote:

Section Executive Committee: For: 15 Against: 0
Corporations Committee: For: 20 Against: 0

SECTION CONTACTS:

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HISTORY, DIGEST AND PURPOSE

The mission statement of the Corporations Committee provides that it shall study, consider, take a position on and advocate that position with respect to, among other things, “statutory changes that would promote efficiency or effectiveness in practice.” The Corporations Committee has concluded that amending Section 307(b) to the Corporations Code (the “Code”) will promote such efficiency and effectiveness by harmonizing the approaches of the interested director and board consent statutes. The Corporations Committee recommends that the Code be amended to permit unanimous written consent of directors to board actions to be taken without the participation of “interested directors” as that term is described in Section 310 of the Code. The Nonprofit Organizations Committee also is in support of this proposal with respect to the relevant provisions in Sections 5211, 7211, 9211 and 12351 of the Code as described below.

1. Background. Section 307(b) of the Code permits directors to approve actions without the formal calling and convening of a meeting of the board of directors so long as all directors sign the written consent approving such action. The requirement for unanimity evidences the fact that all directors agree on the action to be taken, and therefore removes the need to hold a board meeting where differing views could be discussed.

Section 310 of the Code provides a mechanism for approval of potential self-dealing transactions involving interested directors, as that term is described in Section 310, which provides certain protections for approval of the transaction (the “Section 310 Approval”). In particular, Section 310 provides that a transaction is not voidable simply because a director is an interested party so long as (i) the material facts as to the interested director’s participation are disclosed to, and approved by, the disinterested directors (not counting the vote of the interested director(s)) and (ii) the transaction is just and reasonable as to the corporation.

Although it is preferable for a board of directors, when approving a transaction involving an interested director, to meet and discuss the transaction and the interested director’s interest, there are times when that is not possible. For example, a company unable to meet payroll on Friday may wish to accept a loan from a director, or an investment fund affiliated with a director, in a transaction that has arisen (due to necessity) in the same week. However, it may not be possible to convene the board on short notice due to conflicts in schedules. In this instance, a written consent is a convenient mechanism for obtaining board approval and meeting payroll. It is generally the position of corporate practitioners that the Section 310 Approval is not defective because it was signed by the interested director. Under Section 310, the interested director’s vote, or consent to the action, is not counted for purposes of determining whether a disinterested approval was obtained.

However, with increasing frequency in recent years due to a heightened sensitivity to litigation, interested directors are being advised by counsel not to sign written consents that would otherwise be valid to approve the transaction in accordance with Sections 307(b) and 310 of the Code. There is concern that an interested director who signs such a consent is providing plaintiff’s counsel with what may appear to be a bad fact (i.e., approval of the transaction by the interested director) and thereby taking on greater risk of liability to the extent that a claim is brought by other constituencies of the company, be it shareholders, employees or creditors, in connection with the transaction. As a result, the ability to quickly obtain a unanimous written

consent approving a transaction that provides a lifeline for a company has become more uncertain.

This conflict was addressed for nonprofit public benefit corporations in a prior amendment that added to Code Section 5211(b) the stipulation that “interested directors” need not be counted in determining whether a written consent was unanimous. Again, while this amendment was not necessary to permit interested directors to sign the written consent, “leaving those directors out of the written consent process does harmonize the approaches of the written-consent and self-dealing transactions provisions of the law.”¹ It is recommended that a similar approach be taken with Section 307(b) as it relates to Section 310 Approvals.

In addition, if Section 307(b) permits action by unanimous written consent of the board, some practitioners have wondered how many directors must be in office for such approval to be effective, i.e., do the quorum requirements of Section 307(a)(7) still apply? While the language would seem to lead to the conclusion that Section 307(b) cannot be used to circumvent quorum requirements, concerns have been raised that the language is not clear. This proposal therefore recommends that clarifying language be added to this effect. We believe this revision reflects the current state of the law and practice.

2. Amendment of Code Section 307.² Existing Code Section 307 governs board meetings and actions. Section 307(b) is amended to provide that a written consent by all the members of the Board may include the abstention of “interested directors” as described in Section 310 in order to eliminate any conflict between Sections 307(b) and 310 of the Code when boards take an action subject to Section 310 by written consent. In addition, Section 307(b) is amended to clarify that such written consents of the board are still subject to quorum requirements. Finally, it is proposed that the last sentence of Section 307(b) be deleted because under the current statute, it does not add anything operative, and under the amended statute, deeming the consent to be a “unanimous vote of the directors” could be construed to suggest that the interested director is deemed to have approved the transaction, which would undercut the purpose of the amendment.

APPLICATION

If adopted, the proposed amendment would be effective January 1, 2006.

PENDING LITIGATION

None to our knowledge.

LIKELY SUPPORT AND OPPOSITION

Support from corporations, partnerships, limited liability companies and professionals providing services to such companies. No opposition expected.

¹ Ballantine and Sterling, § 405.03.

² Analogous amendments to §§ 5211 (nonprofit public benefit corporations), 7211 (nonprofit mutual benefit corporations), 9211 (nonprofit religious corporations) and 12351 (consumer cooperative corporations) are included in this proposal and have been reviewed by the Nonprofit and Unincorporated Organizations committee.

FISCAL IMPACT

None expected.

GERMANENESS

The subject matter of the proposal is one in which the members of the Business Law Section (and, in particular, the members of the Corporations Committee) have special experience, since corporate governance issues are major areas of concern for these members. The subject matter requires the special knowledge, training, experience and technical expertise of the Business Law Section. In addition, the proposed statute will promote clarity, consistency and comprehensiveness in the law.

TEXT OF PROPOSAL

Section 1. Legislative Intent.

It is the intent of the Legislature in enacting this act that (i) the addition of the language “and if the number of members of the board serving at the time constitutes a quorum” does not constitute a change of law but is meant as a clarification to guide directors in using the respective subdivisions, and (ii) the deletion of the sentence “The action by written consent shall have the same force and effect as a unanimous vote of the directors” does not constitute a change of law but is only a deletion of superfluous language that is covered by the initial sentence of the respective subdivisions.

Section 2 Section 307 of the Corporations Code.

§ 307. Board meetings; notice; participation; use of electronic equipment; quorum; waiver of meeting requirement

(b) An action required or permitted to be taken by the board may be taken without a meeting, if all members of the board shall individually or collectively consent in writing to that action **and if the number of members of the board serving at the time constitutes a quorum.** The written consent or consents shall be filed with the minutes of the proceedings of the board. ~~The action by written consent shall have the same force and effect as a unanimous vote of the directors.~~ **For purposes of this subdivision only, (i) “consent” shall include the abstention of an interested director as described in Section 310 where such board action by written consent approves a transaction described in subdivisions (a)(2) or (b)(1) of Section 310 and recites his or her status as an interested director, and (ii) a director who has signed a consent that recites his or her status as an interested director in respect of a transaction shall be deemed to be an interested director.**

Section 3. Section 5211 of the Corporations Code.

§ 5211. Board meetings; notice; participation; conference telephone communication equipment; quorum; waiver of meeting requirement

(b) An action required or permitted to be taken by the board may be taken without a meeting, if all members of the board shall individually or collectively consent in writing to that action **and if the number of members of the board serving at the time constitutes a quorum**. The written consent or consents shall be filed with the minutes of the proceedings of the board. ~~The action by written consent shall have the same force and effect as the unanimous vote of the directors.~~ For the purposes of this section only, "all members of the board" does not include an "interested director" as defined in Section 5233 **subdivision only, (i) "consent" shall include the abstention of an interested director as defined in Section 5233 where such board action by written consent approves a transaction described in subdivisions (d)(2)(C) or (d)(3)(C) of Section 5233 and recites his or her status as an interested director, and (ii) a director who has signed a consent that recites his or her status as an interested director in respect of a transaction shall be deemed to be an interested director.**

Section 4. Section 7211 of the Corporations Code.

§ 7211. Board meetings; notice; participation; conference telephone communication equipment; quorum; waiver of meeting requirement

(b) An action required or permitted to be taken by the board may be taken without a meeting, if all members of the board shall individually or collectively consent in writing to that action **and if the number of members of the board serving at the time constitutes a quorum**. The written consent or consents shall be filed with the minutes of the proceedings of the board. ~~The action by written consent shall have the same force and effect as a unanimous vote of the directors.~~ For the purposes of this section only, "all members of the board" does not include an "interested director" as defined in Section 5233, insofar as it is made applicable pursuant to Section 7238 **subdivision only, (i) "consent" shall include the abstention of an interested director as defined in Section 7233 where such board action by written consent approves a transaction described in subdivisions (a)(2) or (b)(1) of Section 7233 and recites his or her status as an interested director, and (ii) a director who has signed a consent that recites his or her status as an interested director in respect of a transaction shall be deemed to be an interested director.**

Section 5. Section 9211 of the Corporations Code.

§ 9211. Board meetings; notice; participation; conference telephone communication equipment; quorum; waiver of meeting requirement

(b) An action required or permitted to be taken by the board may be taken without a meeting, if all members of the board shall individually or collectively consent in writing to that action **and if the number of members of the board serving at the time constitutes a quorum**. The written consent or consents shall be filed with the minutes of the proceedings of the board. ~~The action by written consent shall have the same force and effect as the unanimous vote of the directors.~~ **For the purposes of this subdivision only, (i) "consent" shall include the abstention of an interested director as defined in Section 9243 where such board action by written consent approves a transaction described in subdivisions (d)(3)(C) or (d)(4)(C) of**

Section 9243 and recites his or her status as an interested director, and (ii) a director who has signed a consent that recites his or her status as an interested director in respect of a transaction shall be deemed to be an interested director.

Section 6. Section 12351 of the Corporations Code.

§ 12351. Board meetings

(b) Any action required or permitted to be taken by the board may be taken without a meeting, if all members of the board shall individually or collectively consent in writing to such action **and if the number of members of the board serving at the time constitutes a quorum.** Such written consent or consents shall be filed with the minutes of the proceedings of the board. ~~Such action by written consent shall have the same force and effect as a unanimous vote of such directors.~~ **For the purposes of this subdivision only, (i) “consent” shall include the abstention of an interested director as described in Section 12373 where such board action by written consent approves a transaction described in subdivisions (a)(2) or (b)(1) of Section 12373 and recites his or her status as an interested director, and (ii) a director who has signed a consent that recites his or her status as an interested director in respect of a transaction shall be deemed to be an interested director.**