

SENATE BILL REPORT

HB 1052

As of March 17, 2011

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: Passed House: 3/01/11, 98-0.

Committee Activity: Judiciary: 3/16/11.

SENATE COMMITTEE ON JUDICIARY

Staff: Kim Johnson (786-7472)

Background: The Washington Business Corporations Act (WBCA) provides requirements for the creation, organization, and operation of corporations and the relationship between shareholders, board of directors (board), and officers of the corporation.

All corporate powers must be exercised by or under the authority of the board, and the business and affairs of the corporation must be managed under the direction of the board, except as limited by the articles of incorporation. The bylaws of a corporation may contain any provision that is not in conflict with the law or the articles of incorporation. The board 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. Shareholders also have concurrent authority to amend or repeal bylaws, or adopt new bylaws. Currently, shareholders also may enter unanimous shareholder agreements that eliminate or restrict the power of the board.

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.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

A "force the vote" agreement is a provision in an agreement regarding a proposed corporate action that requires the board to submit the proposed corporate action to a vote of the shareholders even if the board determines later that it no longer recommends the action. "Force the Vote" agreements are often used as deal protection devices in merger agreements. The American Bar Association Section on Business Law has 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 only upon approval of the shareholders. These include (1) amendments to some provisions of the articles of incorporation; (2) mergers or share exchanges; (3) the sale of assets of the corporation other than in the regular course of business; and (4) dissolution of the corporation. Currently, it is unclear whether "force the vote" agreements are valid under the WBCA.

Summary of Bill: The authority of the board of directors is revised to explicitly state that the board 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 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 to make substantive decisions concerning the management of the corporation's affairs; and
- reference the right of shareholders to alter these rules through unanimous shareholder agreements.

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.

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 to reflect a corporation's ability to enter into such agreements.

Appropriation: None.

Fiscal Note: Not requested.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony: PRO: This bill comes to us by way of recommendations made by the Corporate Act Revisions Committee of the Bar Association. Our role is to try to keep track of the state's corporate laws, and most of our recommendations are for the purpose of clarification and to keep our statutes competitive with Delaware and other states so that we can attract businesses to Washington. Also we are a Model Act state and really try to keep up with the developments.

Regarding the balance of power provisions (between the board of directors and stakeholders), the provisions are designed actually to protect minority shareholder rights. Typically, the board of directors manages the operation of the corporation. Currently, shareholders may amend the bylaws. What we're saying in this bill is, if you want to limit the board's powers, you should either put that shift in the balance of power in the articles of incorporation at the outset, or have a unanimous agreement of the shareholders to change the balance of power in the bylaws. There is another mechanism in place in statute that shareholders may use to change the substantive authority of the board. Under current law, with a two-thirds vote, shareholders can amend the articles of incorporation to change the powers of the board. This bill does not change the power of shareholders to amend the articles of incorporation, and this will remain a way in which shareholders may take action.

Regarding the indemnification provisions, imagine a situation where you are in a car accident and the insurance company can cancel your insurance after the accident and before the claim is actually filed. This same situation happened to a board member in Delaware where the indemnity was removed after the incident giving rise to the need for indemnification occurred. We want to prevent that situation from occurring in Washington.

Finally, the force the vote provision is a mechanism to allow the board to put the matter before the shareholders, even if it later may have to withdraw its support. We believe that these types of agreements are allowed under Washington law, but want to make the authority explicit.

Persons Testifying: PRO: Representative Pedersen, prime sponsor; John Reed, WSBA Corporate Act Review Committee.