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SILENCING THE SHAREHOLDERS' VOICE

THOMAS LEE HAZEN*

In this essay Professor Hazen discusses recent limitations on shareholders' participation in corporate governance. First, limiting shareholders' ability to convene a shareholder meeting deprives them of a significant corporate governance right. Second, permitting holders of a majority of the shares to act by consent in lieu of a meeting eliminates the opportunity for discourse and debate. Professor Hazen makes the point that an amendment to the articles of incorporation to permit shareholder action by majority consent triggers the statutory appraisal remedy for dissenting shareholders. Finally, Professor Hazen objects to the legislature's propensity to respond to certain private interests rather than balance the competing interests involved in corporate governance issues.

INTRODUCTION.....	1897
I. THE ROLE OF THE LEGISLATURE IN CORPORATE GOVERNANCE.....	1898
II. NORTH CAROLINA TRADITIONS.....	1903
III. THE EROSION OF SHAREHOLDERS' RIGHTS IN THE NORTH CAROLINA BUSINESS CORPORATION ACT.....	1908
A. <i>Eliminating Shareholder Initiative—Law for Sale</i>	1908
B. <i>Shareholder Action Without a Meeting</i>	1916
1. The Appraisal Remedy.....	1918
2. Basic Fairness.....	1922
CONCLUSION.....	1926

INTRODUCTION

This essay has a dual purpose. First, as a policy matter, I bemoan the decreasing role of shareholders in the governance of corporations organized under the North Carolina Business Corporation Act.¹

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1. N.C. GEN. STAT. § 55 (2001).

A long-standing rule in this country has been that the internal affairs of corporations are governed by the law of the state of incorporation, regardless of where the corporation does business. Accordingly, this essay discusses only those corporations that

Second, I criticize the North Carolina legislature² for enacting provisions of the North Carolina Business Corporation Act³ that, although perhaps beneficial in some particular instances, do not favor the best interests of most North Carolina companies and their shareholders. This is especially troubling because, as observed in the leading treatise on North Carolina corporate law, “[t]he North Carolina corporation law has been notable for its strong protection of shareholder rights.”⁴ This observation was made just one year before the legislature’s recent dilution of shareholder rights that prompted this essay. If the legislature continues on its current route, this and other parts of the rich tradition of North Carolina corporate law⁵ will have yielded to considerations of expediency to satisfy powerful lobbying efforts.

I. THE ROLE OF THE LEGISLATURE IN CORPORATE GOVERNANCE

The corporate form of doing business did not exist at common law; it is purely a creature of statute.⁶ The legislature defines the parameters of corporate existence. An important part of the legislature’s role is establishing a system of governance within the corporate enterprise. This entails defining the respective roles of the various constituencies—specifically shareholders and management.

Undoubtedly, the state’s economy is affected by corporate conduct⁷ and, therefore, the legislature has valid concerns in trying to protect the welfare of the state and its citizens. On the other hand,

are incorporated in North Carolina or under the laws of other states having substantially similar statutory provisions.

2. Strictly speaking, the Governor of North Carolina must share some of the blame for not vetoing the bill. However, to say the least, a veto would have been an unusual, albeit courageous, course to follow in light of the way in which the General Assembly passed the legislation.

3. North Carolina Business Corporation Act, ch. 1371, 1955 N.C. Sess. Laws 1432 (*superceded by* Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (codified as amended at N.C. GEN. STAT. §§ 55-17-05 (2001))).

4. RUSSELL M. ROBINSON II, ROBINSON ON NORTH CAROLINA CORPORATION LAW § 14.01(b), at 14-3 (6th ed. 2000).

5. See *infra* notes 24–48 and accompanying text (recounting the history of North Carolina’s corporate law).

6. See generally 1 JAMES D. COX, THOMAS LEE HAZEN & F. HODGE O’NEAL, CORPORATIONS §§ 2.2–2.4 (2002) (discussing the evolution of English and American corporate law).

7. Consider, for example, the effects of the departure of Piedmont Airlines and R.J. Reynolds corporate headquarters from Winston-Salem, North Carolina—both due to acquisitions. Any time a locality loses major corporate employers, the resulting layoffs adversely impact the local economy. Another adverse impact is the elimination of “big spenders” from the local economy.

maintaining a balanced state corporate law with integrity is another valid concern. Tens or even hundreds of thousands of businesses are incorporated under a state's corporate law. A state's corporate law regulates conduct affecting all of these business enterprises. In establishing corporate governance norms, the legislature should focus on the corporate community generally and also upon the public policies implicated in corporate governance. The corporate relation involves protection of investors as well as management. History⁸ reveals that legislatures design corporate law to regulate corporate power that otherwise might place the economic interests of a few ahead of the general welfare of the state and its citizens.⁹

Legislative intervention in corporate governance is not a new phenomenon. This intervention is especially visible when a corporation asks the legislature to intervene to prevent a corporate takeover that threatens jobs within the state.¹⁰ Although job retention in the state is an important goal, the legislature should not intervene at the expense of North Carolina's system of corporate governance. Such intervention should be avoided particularly at a time when legislatures have been embarking on the unfortunate course of silencing the shareholders' voice.

8. This history dates back to the 18th century and the infamous South Sea Bubble that resulted in significant corporate legislation in England. See ARMAND BUDINGTON DUBOIS, *THE ENGLISH BUSINESS COMPANY AFTER THE BUBBLE ACT 1720-1800* 1-3 (1938) (reciting the history of corporate legislation up to the Bubble Act); 7(2) HALSBURY'S LAWS OF ENGLAND, COMPANIES § 1739 (4th ed. 1973) (discussing the amendments made by the Insolvency Act).

9. See generally 1 COX, HAZEN & O'NEAL, *supra* note 6, §§ 2.2-2.5 (discussing the evolution of corporate law).

10. Recent North Carolina examples include the First Union amendments, as well as a threatened takeover of Burlington Industries in the 1980s. To repel the attempted takeover, the North Carolina legislature was asked to enact protective legislation. Since Burlington Industries was not a North Carolina corporation, the legislature could not simply amend the rules applicable to North Carolina corporations, as was done more recently in response to the SunTrust bid for Wachovia. Instead, legislation was introduced to amend the North Carolina takeover legislation to apply to any corporation having at least 50% of its assets in the state. Burlington Industries did not meet this threshold, however, so the proposal was rewritten and enacted with a 40% threshold. Shareholder Protection Act, N.C. GEN. STAT. §§ 55-9-01 to 55-9-05 (2001) (setting out North Carolina's version of a "fair price" statute which has the effect of preceding two tiered, front-end loaded tender offers); Control Share Acquisitions Act, N.C. GEN. STAT. §§ 55-9A-01 to 55-9A-09 (2001) (conditioning voting rights of a person acquiring a control block of shares upon approval by holders of a majority of the disinterested shares); Thomas Lee Hazen, *State Anti-Takeover Legislation: The Second and Third Generations*, 23 WAKE FOREST L. REV. 77, 85-88 (1988) [hereinafter Hazen, *State Anti-Takeover Legislation*] (discussing North Carolina's adoption of anti-takeover legislation in 1987 and the states that followed North Carolina's example).

Shareholders are the owners of the corporate enterprise. As the risk takers, they stand to gain from the success of the business. At the same time, they stand to lose their investment if the enterprise fails. Because of the shareholders' stake in the business, corporate law has vested ultimate control of the corporation in the shareholders. This essay examines two amendments to North Carolina's corporate law enacted in 2001 that unduly restrict the shareholders' role in determining the future of their corporation. First, the legislature enacted a provision permitting shareholder action without a shareholder meeting. In effect, this provision silences the shareholders' voice and destroys their opportunity to openly debate the issues before a vote is taken. Second, in response to an effort to defeat a hostile bid for control of Wachovia Corporation, the legislature restricted a shareholder's ability to call a shareholder meeting. Both amendments reflect a decision to defer to the lobbying efforts or other pressure by special interest promoting management control of corporations,¹¹ rather than an examination of the overriding corporate governance implications of these changes in the law.

Concerns over management control of corporations are not new. For example, in their classic analysis of American corporations,¹² Adolf Berle and Gardiner Means pointed out that "in the corporate system, the 'owner' of industrial wealth is left with a mere symbol of ownership while the power, the responsibility and the substance which have been an integral part of ownership in the past are being transferred to a separate group in whose hands lies control."¹³ While

11. Traditional corporate governance structure and its separation of powers between shareholders, directors, and managers creates a system of checks and balances. Managers are permitted to run the day-to-day affairs of the corporation under the supervision and direction of the board of directors. The directors are elected by, and are therefore accountable to, the shareholders. Even beyond this electoral system, shareholder votes are required for various actions, including most fundamental changes in the corporate entity such as a merger with another corporation or dissolution. Shareholders are also permitted to vote on substantive amendments to the articles of incorporation. The amendments to the North Carolina Business Corporation Act, discussed herein, lessen the shareholders' influence and thus expand management control of corporate activities.

12. ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932) (discussing the separation of corporate ownership from control of the enterprise).

13. *Id.* at 68. For more recent attacks on corporate concentration in America, see, for example, JOHN KENNETH GALBRAITH, *THE AGE OF UNCERTAINTY* 257-279 (1977); RALPH NADER ET AL., *TAMING THE GIANT CORPORATION* 15-32 (1976); and CHRISTOPHER D. STONE, *WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR* 74-121 (1975). See also John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and*

corporate management needs the flexibility to make business decisions to manage effectively, this does not mean that shareholders should be divested of the residual control of the corporate enterprise.

Even though modern corporate statutes have increased management control, they still recognize the importance of shareholder voting. As a result of the long-held tradition of corporate law in this country, major matters of corporate governance must be put to a shareholder vote. The shareholders, for example, have control over the corporate charter¹⁴ except for ministerial amendments, such as a corporate name change.¹⁵ The procedure for amending the articles of incorporation requires that the board of

Control, 111 YALE L.J. 1, 24-59 (2001) (discussing the propriety of regulating the separation of shareholder ownership and actual control of the corporation).

Other commentators have applauded this separation of control from ownership. See generally THE ATTACK ON CORPORATE AMERICA: THE CORPORATE ISSUES SOURCEBOOK (M. Bruce Johnson ed., 1978) (compiling essays on such topics as the corporate social role, management, state and federal chartering and the economic market); Daniel J.H. Greenwood, *Fictional Shareholders: For Whom are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021 (1996) (analyzing shareholders' role in corporate governance and arguing against separation of ownership from control); Henry G. Manne, *The "Higher Criticism" of the Modern Corporation*, 62 COLUM. L. REV. 399 (1962) (criticizing various schools of thought relating to the separation of ownership from control); Bayless Manning, *Corporate Power and Individual Freedom: Some General Analysis and Particular Reservations*, 55 NW. U. L. REV. 38 (1960) (arguing that the practice of corporate control and individual ownership is not as problematic as others have claimed).

For a general discussion of corporate social responsibility, see, for example, Phillip I. Blumberg, *Selected Materials on Corporate Social Responsibility*, 27 BUS. LAW. 1275 (1972) (providing a bibliography of sources). See also Cary Jones, Note, *The Modern Corporation Looks Homeward: The Berle and Means Revolution and the Corporate Paradigm*, 1975 UTAH L. REV. 471, 477-82 (discussing the relevance of the ideas of Berle and Means in today's society). See generally David L. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1 (1979) (addressing the theory of corporate social responsibility as a backdrop of political philosophy); Edwin M. Epstein, *Societal, Managerial, and Legal Perspectives on Corporate Social Responsibility—Product and Process*, 30 HASTINGS L.J. 1287 (1979) (providing a framework for the social responsibility concept); Thomas L. Hazen & Bren L. Buckley, *Models of Corporate Conduct: From the Government Dominated Corporation to the Corporate Dominated Government*, 58 NEB. L. REV. 100 (1978) (examining corporate regulation through the views of various corporate commentators); Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265 (1998) (criticizing the "law-as-price theory" and its lack of consideration for social responsibility).

14. E.g., DEL. CODE ANN. tit. 8, § 242 (2001); N.C. GEN. STAT. §§ 55-10-03, 55-10-04 (2001); MODEL BUS. CORP. ACT §§ 10.03, 10.04 (1999).

15. Under the law of many states, the board of directors may amend the articles of incorporation to extend the duration of a limited existence corporation, delete the names and addresses of the initial directors, delete the name and address of the original registered agent if a successor agent has been duly selected, authorize a stock split if the corporation has only one class of shares outstanding and change the corporate name. E.g., N.C. GEN. STAT. § 55-10-02 (2001); MODEL BUS. CORP. ACT § 10.05 (1999).

directors adopt a proposed amendment, which is then presented to the shareholders at a shareholder meeting for approval by a majority of the shares entitled to vote.¹⁶ Other organic changes, such as mergers,¹⁷ sales of substantially all of the assets other than those in the regular course of business,¹⁸ and dissolutions,¹⁹ similarly require that a majority of the shares entitled to vote approve the proposed change. In addition, shareholders are vested with control over the board of directors by virtue of having the power to elect²⁰ and remove²¹ directors. Shareholder democracy not only has been a benchmark of state corporate law,²² it has been further strengthened by federal securities law in the case of public corporations.²³

The basic rules of corporate governance, thus, are found in the laws of a company's state of incorporation. Over time, state legislatures have struggled to strike the proper balance between the often competing interests of shareholders and management. North Carolina's tradition is filled with a rich history of safeguarding the shareholders' role in corporate governance. In 2001, however, the North Carolina General Assembly departed from this important tradition for the sake of expediency and, in doing so, undermined two important concepts of shareholder rights.

16. *E.g.*, DEL. CODE ANN. tit. 8, § 242 (2001); N.C. GEN. STAT. §§ 55-10-03, 55-10-04 (2001); MODEL BUS. CORP. ACT §§ 10.03 (1999).

17. N.C. GEN. STAT. §§ 55-11-01, 55-11-03 (2001); MODEL BUS. CORP. ACT §§ 11.01, 11.03 (1999).

18. N.C. GEN. STAT. § 55-12-02 (2001); MODEL BUS. CORP. ACT § 12.02 (1999).

19. N.C. GEN. STAT. § 55-14-02 (2001); MODEL BUS. CORP. ACT § 14.02 (1999).

20. N.C. GEN. STAT. § 55-8-03 (2001); MODEL BUS. CORP. ACT § 8.03(d) (1999).

21. N.C. GEN. STAT. § 55-8-08 (2001); MODEL BUS. CORP. ACT § 8.08 (1999).

22. The law of the state of incorporation governs the internal affairs of the corporation, including its governance rules. *See, e.g.*, 1 COX, HAZEN & O'NEAL, *supra* note 6, §§ 2.5, 2.6 (discussing the "internal affairs" doctrine); Stephen J. Choi & Andrew T. Guzman, *Choice and Federal Intervention in Corporate Law*, 87 VA. L. REV. 961, 961-62 (2001) (noting the corporation's ability to choose the applicable law by incorporating in a given state).

Federal securities law supplements state law with investor protection rules. *See, e.g.*, 1 THOMAS LEE HAZEN, *TREATISE ON THE LAW OF SECURITIES REGULATION* §§ 1.2(2)-1.3(C) (4th ed. 2002) [hereinafter HAZEN, *SECURITIES REGULATION*] (recounting the development of the federal securities laws).

23. *See, e.g.*, Thomas L. Hazen, *Corporate Chartering and the Securities Markets: Shareholder Suffrage, Corporate Responsibility and Managerial Accountability*, 1978 WIS. L. REV. 391, 397-40 (1978) [hereinafter Hazen, *Corporate Chartering*] (discussing the relationship of state and federal law affecting shareholder voting rights and procedures); Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 LAW & CONTEMP. PROBS. 215, 218-25 (1999) (discussing federal preemption of state corporate law).

II. NORTH CAROLINA TRADITIONS

Since the adoption of its modernized corporation act in 1955,²⁴ North Carolina was in the vanguard of protecting shareholder rights.²⁵ In 1986, however, the North Carolina legislature began cutting back piecemeal on shareholder rights.²⁶ As discussed herein, this unfortunate trend has continued.

In 1986, the legislature limited the right of shareholders of a public corporation to mandate a special meeting of shareholders to

24. Although adopted in 1955, the act was not effective until 1957. Therefore, it is referred to as the Business Corporation Act of 1957. See ROBINSON, *supra* note 4, § 1.02(a), at 1-4.

25. See, e.g., Ernest L. Folk III, *Revisiting the North Carolina Corporation Law: The Robinson Treatise Reviewed and the Statute Reconsidered*, 43 N.C. L. REV. 768, 805-33 (1965). In addition, see Thomas Lee Hazen, *Book Review of North Carolina Corporation Law and Practice Revised Third Edition by Russell M. Robinson II*, 61 N.C. L. REV. 1256, 1259 (1983), which relies on RUSSELL M. ROBINSON II, NORTH CAROLINA CORPORATION LAW AND PRACTICE § 2-3 (rev. 3d ed. 1983) to set forth the following protectionist provisions of the North Carolina statute:

1. statutory requirement that one-third of the corporate earnings be paid out in dividends upon demand by the holders of at least twenty percent of the shares . . . ;
2. mandatory cumulative voting;
3. extensive mandatory voting rights to nonvoting shares;
4. extensive class voting rights and rights of appraisal given to preferred shareholders upon any recapitalization designed to eliminate dividend arrearages or effect other prejudicial changes;
5. other unusual rights of appraisal . . . ;
6. strict nonfinancial limitations on a corporation's purchase of its own shares;
7. prohibition against shares redeemable at holder's option and against convertibility into a senior security;
8. strict limitations on increases and decreases in number of directors;
9. limitations on employee compensation by stock and options;
10. relatively tight watered stock liability, particularly for promoters;
11. nonresident directors subject to the jurisdiction of local courts;
12. no security-for-expenses provision in derivative actions.

26. For example, in 1986, the legislature eliminated mandatory cumulative voting rights and limited the shareholders' power to call special meetings. Act of June 26, 1986, ch. 801, § 45, 1986 N.C. Sess. Laws 30, 41 (codified as amended at N.C. GEN. STAT. § 55-7-28 (2001)); ROBINSON, *supra* note 4, § 1.02(a), at 1-5. In 1987, the legislature authorized a provision in the articles of incorporation to excuse directors from liability in terms of monetary damages for duty of care violations. Act of July 22, 1987, ch. 626, 1987 N.C. Sess. Laws 1113 (codified as amended at N.C. GEN. STAT. § 55-2-02(b)(3) (2001)). The legislature also adopted two anti-takeover statutes—the Shareholder Protection Act, ch. 88, 1987 N.C. Sess. Laws 84, amended by Act of May 1, 1987, ch. 124, 1987 N.C. Sess. Laws 122 (codified as amended at N.C. GEN. STAT. §§ 55-9-01 to 55-9-05 (2001)), and the Control Share Acquisition Act, ch. 182, 1987 N.C. Sess. Laws 205 (codified as amended at N.C. GEN. STAT. §§ 55-9A-01 to 55-9A-09 (2001)). For further discussion of these legislative actions, see ROBINSON, *supra* note 4, § 1.02(a), at 1-6. See also Thomas Lee Hazen, *Corporate Directors' Accountability: The Race to the Bottom—The Second Lap*, 66 N.C. L. REV. 171, 180-81 (1987) [hereinafter Hazen, *Race to the Bottom*].

vote upon matters put forth in the call for the meeting.²⁷ Until 1986, the North Carolina statute provided that holders of ten percent of a class of shares entitled to vote on a matter could mandate that a special meeting of the shareholders be called. In 1986, the General Assembly amended that provision, depriving shareholders of a public corporation the right to mandate the call of a shareholder meeting unless an enabling provision is included in the public company's articles of incorporation or bylaws.²⁸ In the spring of 2001, pursuant to the existing statute, SunTrust, the hostile bidder²⁹ in the battle over Wachovia, planned to introduce an amendment to Wachovia's bylaws that would have given the right to call a special meeting to the owners of ten percent of the shares entitled to vote.³⁰ To thwart this initiative, Wachovia and First Union convinced the North Carolina General Assembly to change the corporate law to permit a provision enabling the shareholders to call a special meeting only if authorized by a public company's articles of incorporation, not by its bylaws, as was formerly the case.³¹ The significance of this amendment to the North Carolina Business Corporation Act is that it effectively prevented the shareholders of a public corporation from enacting an enabling provision to permit shareholders to mandate a special shareholders' meeting. This dilution of shareholder power was the consequence of the legislative change because shareholders only have

27. N.C. GEN. STAT. § 55-7-02(a) (2001) (amended 2002). For example, the 1986 legislation rearranged existing shareholder rights by limiting the shareholders' initiative. For, as of that date, shareholders no longer automatically had the right to mandate a shareholder meeting; it became necessary to first amend the bylaws. § 55-10-20. Presumably the bylaw amendment would have to await the next annual shareholder meeting or one called by the company's management. Although no such attack on the 1986 amendment has yet been made, it can be argued that, as applied to corporations incorporated prior to the statute's amendment, the new limitation is an unconstitutional interference with existing contract rights. Nelson Ferebee Taylor, *Evolution of Corporate Combination Law: Policy Issues and Constitutional Questions*, 76 N.C. L. REV. 687, 992-1010 (1998).

28. Act of June 26, 1986, ch. 801, § 44, 1986 N.C. Sess. Laws 30, 40 (codified as amended at N.C. GEN. STAT. § 55-2-02(b)(3) (2001)).

29. A hostile bidder bids for corporate control without the blessing of the target company's management. Thus, SunTrust was a hostile bidder in the context of the Wachovia merger, while First Union was a friendly suitor.

30. This plan was revealed in a filing that SunTrust made with the Securities and Exchange Commission. See Tom Shean, *New N.C. Law Tilts Merger War Against Suntrust*, THE VIRGINIAN-PILOT (Norfolk, Va.), June 15, 2001, at D-1, available at 2001 WL 9721991.

31. Act of June 14, 2001, ch. ___, § 15, 2001 N.C. Sess. Laws ___, ___ (codified at N.C. GEN. STAT. § 55-7-02(a) (2001)), available at http://www.ncleg.net/SessionLaws/2001_sl20010201/default.htm (on file with the North Carolina Law Review).

the ability to propose amendments to the bylaws,³² not the articles of incorporation.³³ In the wake of the 2001 legislation, SunTrust was disabled from introducing the proposed bylaw amendment, which, as a result of the new law, could only be introduced as an amendment to the articles requiring the imprimatur of Wachovia's board of directors.³⁴

The legislation was patently geared to the SunTrust takeover.³⁵ Although other unrelated amendments to the North Carolina Business Corporation Act were to become effective on October 1, 2001, the provision relating to the shareholders' ability to mandate a special meeting was immediately effective,³⁶ thus precluding SunTrust's initiative. The effect of this hurried amendment, though, went beyond the particular takeover battle for which it was crafted. Consider, for example, a public corporation which, through its bylaws, adopted such an enabling provision prior to the 2001 amendment to give the shareholders initiative to call a special meeting. As enacted, the 2001 amendment to section 55-7-02(a) would appear to void such a bylaw. The new legislation, if upheld³⁷ as applied to an existing corporation, would be an unwarranted interference with existing corporate governance structures.³⁸

32. N.C. GEN. STAT. § 55-10-20 (2001) (providing for the amendment of bylaws by directors or shareholders). This provision follows MODEL BUS. CORP. ACT § 10.20 (1999).

33. Section 55-10-03 (2001) of the General Statutes of North Carolina provides that when the articles are to be amended by shareholder action, the amendment must come in the form of a recommendation from the board of directors before it is submitted to the shareholders.

34. See, e.g., David Boraks, *Battle for Wachovia: One Day Wonder: N.C. Gov Signs 1st Union's Law*, AM. BANKER, June 15, 2001, at 2, available at 2001 WL 3912258 (discussing the effect of the new legislation); Chris Serres, *House Deals Blow to Bid by SunTrust*, NEWS & OBSERVER (Raleigh, N.C.), June 14, 2001, at D1, available at 2001 WL 3469487 (same); David Rice, *Banks' Merger Gets a Boost; State Pre-empt's SunTrust Strategy*, WINSTON-SALEM J., June 15, 2001, at 1, available at 2001 WL 19803835 (same); David Rice, *First Union Asks for Legislative Aid in Takeover: Bank Says SunTrust has Unfair Advantage, Wants to Change the Rules*, WINSTON-SALEM J., June 13, 2001, at 1, available at 2001 WL 19803740 (same).

35. Thus, one observer referred to it as "1st Union's Law." See Boraks, *supra* note 34.

36. Act of June 14, 2001, ch. ____, § 17, 2001 N.C. Sess. Laws ____, ____, available at http://www.ncleg.net/SessionLaws/2001_/sl20010201/default.htm (on file with the North Carolina Law Review).

37. There are limits on a legislature's ability to ipso facto amend existing contract rights, including voting rights. Trustees of Dartmouth Coll. v. Woodward, 17 U.S. 518, 558 (1819). Professor Taylor's fine article amply demonstrates that retroactive application of this provision, in the absence of a right of appraisal for dissenters, would likely be unconstitutional as an interference with existing contract rights among the shareholders. See Taylor, *supra* note 27, at 992-1010.

38. To the extent that limitations of shareholder rights can be justified on policy

Prior to the special First Union legislation described above, the legislature enacted a provision permitting corporate articles of incorporation to authorize shareholder action by a majority of the shares entitled to vote without a formal meeting.³⁹ Permitting the majority of the shares to act outside the presence of the remaining shareholders is troublesome in that it stifles the remaining shareholders' voice. Also, for the reasons discussed below, the majority consent provision further reflects the North Carolina legislature's adherence to political expediency rather than thoughtful consideration of corporate governance issues.⁴⁰

In contrast to the recent actions of the North Carolina General Assembly, the North Carolina Supreme Court has long been committed to safeguarding the rights of shareholders. For example, one of the nation's leading cases on shareholder rights in closely held corporations is the North Carolina decision in *Meiselman v. Meiselman*.⁴¹ Most recently, in *First Union Corp. v. SunTrust Banks, Inc.*,⁴² Judge Tennille recognized the importance of shareholders in

grounds, the usual argument is based on a contractarian analysis—namely, that the various constituencies in the corporation should be free to provide contractually for the relative rights and duties, even if that means dispensing with fiduciary obligations that traditionally apply within the corporation. See generally Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856, 857–71 (1997) (reviewing LAWRENCE E. MITCHELL, *PROGRESSIVE CORPORATE LAW* (1995) and criticizing the contractarian paradigm); Lucian Arye Bebchuk, Foreword, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989) (discussing the extent to which corporations should be allowed to opt out of corporate law by adopting charter provisions); Fred S. McChesney, Comment, *Economics, Law, and Science in the Corporate Field: A Critique of Eisenberg*, 89 COLUM. L. REV. 1530 (1989) (arguing that the contractarian paradigm preserves freedom of choice while the fiduciary paradigm is “coercionist”).

Because the 2001 amendments to section 55-7-02 of the General Statutes of North Carolina unilaterally rearrange those existing contractual allocations of voting rights and shareholder suffrage, they run counter to the argument that is generally used to support backing corporate managers in control battles and other areas of corporate law.

39. N.C. GEN. STAT. § 55-7-04 (2001) (appearing as amended).

40. I say this because the North Carolina statute applies only to nonpublic corporations where the damage of such a provision is most likely to be recognized.

41. 309 N.C. 279, 307 S.E.2d 551 (1983) (protecting the reasonable expectations of minority shareholders). For earlier treatment of duties in closely held corporations, see generally Allen B. Afterman, *Statutory Protection for Oppressed Minority Shareholders: A Model For Reform*, 55 VA. L. REV. 1043 (1969), discussing the plight of minority shareholders; and F. Hodge O'Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW. 873, 875–78 (1978), advocating legislative reform regarding closely held corporations.

42. 2001 WL 1885686 (N.C. Bus. Ct. Aug. 10, 2001). The North Carolina Business Court was created to allow parties to have their complex business disputes resolved by a court with particular expertise in business law. For the history and evaluations of the Business Court see Carrie A. O'Brien, Note, *The North Carolina Business Court: North*

corporate governance by invalidating defensive takeover maneuvers that would have had a coercive effect on a shareholder vote necessary to approve the proposed transaction.⁴³ The merger agreement between First Union and Wachovia contained a number of provisions designed to make a bid by a competing would-be acquirer unlikely to succeed. Namely, the merger agreement contained a non-termination clause that, in the court's words, would have "hobbled" Wachovia's board in any attempt to combine with someone other than First Union.⁴⁴ The North Carolina Business Court ruled that this clause was unduly coercive in pushing the Wachovia shareholders to vote in favor of the merger with First Union. In so ruling, unlike the unfortunate recent actions of the North Carolina legislature, the opinion upheld the supremacy of shareholder rights over the possible self-interest⁴⁵ of corporate managers.

In protecting the integrity of shareholders' voting rights, the court in *First Union* noted the strong tradition of North Carolina's corporate law,⁴⁶ which includes the long-standing commitment to shareholder rights.⁴⁷ Fortunately, the North Carolina legislature's

Carolina's Special Superior Court for Complex Business Cases, 6 N.C. BANKING INST. 367, 368-78 (2002).

43. Judge Tennille's opinion thoroughly analyzes all of the relevant Delaware cases.

44. *First Union Corp.*, 2001 WL 1885686, at *38 ("In this case, if there had been a proxy fight over seats on the Wachovia Board at the same time the merger proposal was submitted, and SunTrust had elected a majority of directors, those new directors would have been contractually hobbled . . .").

45. The possible self-interest in the *First Union* litigation arose out of the situation in which Wachovia had agreed to be acquired in a friendly merger with First Union and then was faced with an uninvited counter-offer by SunTrust Banks. The First Union/Wachovia merger agreement submitted to the Wachovia shareholders for approval contained a "lock out" provision under which there would have been a moratorium on mergers should the shareholders reject the First Union proposal. The court found that this provision was coercive in that it might encourage a shareholder to vote for the First Union deal on a basis other than the merits or fairness of the transaction.

46. In a footnote commenting on the North Carolina legislature's decision to amend section 55-8-30(d) to provide that "[t]he duties of a director weighing a change of control situation shall not be any different, nor the standard of care any higher, than otherwise provided in this section" (emphasis added), Judge Tennille observed:

Neither, the wisdom of that decision [to amend the statute] nor the legal and economic debate over the nature of the corporation are within the purview of this opinion. That North Carolina would adopt this social entity concept is not surprising. The state's economic roots are sunk deep in the soil of textile, furniture and tobacco companies that were historically run like families.

First Union Corp., 2001 WL 1885686, at *20 n.112 (citations omitted). See generally Lijun K. Yang, Note, *First Union v. Sun Trust Banks: The Fight for Wachovia and its Impact on North Carolina Corporate Law*, 6 N.C. BANKING INST. 334 (2002) (providing an extensive discussion of the *First Union* decision and the events leading up to it).

47. See *supra* note 25 and accompanying text.

actions have not affected the ruling in the *First Union* case. The business court's ruling thus reaffirms the long-held view that the shareholder's right to vote is a "fundamental" right⁴⁸ under the law generally, and under the law of North Carolina in particular. Unfortunately, as discussed below, recent legislation passed in response to pro-management lobbying efforts has unduly weakened this fundamental right.

III. THE EROSION OF SHAREHOLDERS' RIGHTS IN THE NORTH CAROLINA BUSINESS CORPORATION ACT

As mentioned above, in 2001 the North Carolina General Assembly continued eroding shareholder rights in the governance of North Carolina corporations. The legislature hastily enacted the First Union amendments that undermined the shareholders' ability to mandate a special meeting of shareholders. It gave into the fierce lobbying efforts from First Union to facilitate the merger with Wachovia.⁴⁹ The General Assembly derogated its responsibility to maintain a more balanced corporate law. This legislation followed on the heels of a measure permitting shareholder action without a meeting for non-public North Carolina corporations.

A. *Eliminating Shareholder Initiative—Law for Sale*⁵⁰

In 2001, in the midst of a battle for control of Wachovia, the North Carolina General Assembly rewrote the rules regarding the convening of shareholder meetings. In the spring of 2001, First Union and SunTrust were vying for control of Wachovia. Although Wachovia and First Union had agreed on a plan of merger, SunTrust wanted to present a counter-offer to the Wachovia shareholders. As the battle unfolded, SunTrust, which had already acquired a stake in Wachovia, planned to invoke its right under the general corporate law to amend the bylaws to enable the holders of ten percent of a class of voting shares to call a special meeting of shareholders. SunTrust's plan was to give the Wachovia shareholders a chance to express their preference for the SunTrust offer. The ability of ten percent of the shares to call a special meeting is a long-standing

48. ROBINSON, *supra* note 4, § 7.01, at 7-1 to 7-3.

49. See Boraks, *supra* note 34.

50. Cf. 1 COX, HAZEN & O'NEAL, *supra* note 6, at § 2.6 (discussing the race of laxity); Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861, 862 (1969) (discussing the phenomenon of forum shopping for the state of incorporation).

bastion of shareholder democracy. As described above,⁵¹ in 1986 the North Carolina General Assembly initially diluted that right for shareholders of public corporations and further diluted it in 2001⁵² to block SunTrust's attempt to communicate with Wachovia's shareholders. This act was such a blatant partisan legislative intervention that it has been dubbed "1st Union's Law."⁵³

The First Union amendment goes to the very core of corporate democracy. Voting is an essential component of the package of shareholder rights.⁵⁴ Corporate statutes generally precondition many important corporate acts upon approval by a majority of the shares entitled to vote.⁵⁵ Additionally, shareholders have long been given the right to air their views to management, even if the power to act on the matter in question is solely vested in the board of directors.⁵⁶ For example, when shareholders have the ability to call a special meeting, courts have held that informing the board of whom the shareholders would recommend as president is a proper purpose for calling a meeting, even though the power to select the president ultimately lies within the purview of the board.⁵⁷ The shareholders, thus, have a right to have their concerns heard by corporate directors and managers.

The shareholder role, however, extends beyond voting on specified matters and having the ability to voice their concerns to others. In many states, the ability to mandate a special meeting is among the various rights of shareholder suffrage. For example, this

51. See *supra* notes 26–28 and accompanying text.

52. Act of June 14, 2001, ch. ___, § 15, 2001 N.C. Sess. Laws ___, ___ (codified at N.C. GEN. STAT. § 55-7-02(a) (2001)), available at http://www.ncleg.net/SessionLaws/2001_sl20010201/default.htm (on file with the North Carolina Law Review).

53. See Boraks, *supra* note 34 (discussing the process by which the legislation was passed).

54. See generally Hazen, *Corporate Chartering, supra* note 23 (detailing the effect of the federal securities laws on corporate charters and shareholder suffrage); Kimble C. Kannon & Patrick J. Tangney, *Protection of Minority Shareholder Rights Under Delaware Law: Reinforcing Shareholders as Residual Claimants and Maximizing Long-Term Share Value by Restricting Directorial Discretion*, 1995 COLUM. BUS. L. REV. 725, 755 (1995) (noting that voting rights should receive special protection); Wesley G. Nissen, *The Constitutionality of the 1983 Illinois Business Corporation Act's Voting Provisions*, 1985 U. ILL. L. REV. 647, 672 (1985) (recognizing that courts have characterized shareholder voting rights as vested property rights).

55. See DEL. CODE ANN. tit. 8, §§ 109, 144, 253 (2001); N.C. GEN. STAT. §§ 55-10-03, 55-10-22, 55-14-02 (2001); N.Y. BUS. CORP. LAW §§ 601, 903 (McKinney Supp. 2001–2002); MODEL BUS. CORP. ACT §§ 10.03, 10.06, 11.04, 11.06, 12.02, 14.02 (1999).

56. See, e.g., *Auer v. Dressel*, 118 N.E.2d 590, 593 (N.Y. 1954) (recognizing that shareholders can express approval of officers' conduct even though they cannot directly remove officers).

57. *Id.*

statutory enabling provision for shareholder initiative is found in the Model Business Corporation Act.⁵⁸ This provision predated the 1980 revision to the Model Act and is firmly entrenched in American corporate law.⁵⁹ The important right it secures was recognized in the English Companies Act⁶⁰ and, by the late 1950s, many of the United States adopted similar provisions.⁶¹

As of 2001, many states continued to statutorily grant the holders of a stated percentage of the shares the right to call a special meeting even in the absence of a bylaw conferring such a right.⁶² Other states, including Delaware and New York, confer no such right without a bylaw provision.⁶³ Although the majority of statutes enable shareholders to mandate a special meeting, obviously there is disagreement as to whether this is a wise policy. While the evidence points in the other direction, the North Carolina statute, as amended in the spring of 2001, arguably may be a reasonable balance.⁶⁴

58. MODEL BUS. CORP. ACT § 7.02 (1999).

59. See COLO. REV. STAT. § 31-4-11(3) (1963); FLA. STAT. ANN. § 608.10 to 608.12 (West 1975); GA. CODE ANN. § 14-2-702 (1981); IDAHO CODE § 29-132.2 (Michie 1932); ILL. COMP. STAT. ANN. § 742(a) (West 1970); MODEL BUS. CORP. ACT ANN. § 28 (2d ed. 1971).

60. Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 132 (Eng.); see, e.g., RALPH J. BAKER & WILLIAM L. CARY, CASES AND MATERIALS ON CORPORATIONS 178 (3d unabridged ed. 1959). (noting the English Companies Act).

61. CAL. CORP. CODE § 2202 (Deering 1948); N.C. GEN. STAT. § 55-61(c) (1959) (current version at § 55-7-02); TEX. BUS. CORP. ACT CODE ANN. § 2.24(c) (Vernon 1980); see BAKER & CARY, *supra* note 60, at 179. Delaware has continued to adhere to the former American view that "special meetings of the stockholders may be called by the board of directors or by such person or persons as may be authorized by the certificate of incorporation or by the bylaws." DEL. CODE ANN. tit. 8, § 211(d) (2001). There is no mention of the shareholders' ability to mandate that a special meeting be called. Of course, shareholders could be given this right in the certificate of incorporation or bylaws.

62. ARIZ. REV. STAT. § 33-1248 (2001) (25% of a class of the votes); D.C. CODE ANN. § 29-101.25(c) (2001) (20% of all outstanding shares entitled to vote); GA. CODE ANN. § 14-2-702(d) (2001) (at least 25% of the voting power); HAW. REV. STAT. § 414-122(a)(2) (2000) (amended 2002) (at least 10% of the votes entitled to be cast on any issue proposed); IDAHO CODE § 30-1-702 (Michie 2001) (20% of the votes entitled to be cast on any issue); IND. CODE ANN. § 23-1-29-2 (Michie 2001) (for corporations with fifty or fewer shareholders, 25% of the shares entitled to vote on an issue); KY. REV. STAT. ANN. § 271B.7-020 (Michie 2001) (33 1/3% of the votes entitled to be cast on an issue); LA. REV. STAT. ANN. § 12:73 (West 1994) (20% of the total voting power); MO. REV. STAT. § 362.044 (1997) (majority of the shares); VA. CODE ANN. § 13.1-655 (Michie 2001) (corporations of thirty-five or fewer shareholders, 20% of all votes entitled to be cast on any issue); WASH. REV. CODE § 24.06.100 (2001) ("persons having one-twentieth of the votes entitled to be cast").

63. DEL. CODE ANN. tit. 8, § 211(d); N.Y. BUS. CORP. LAW § 602(c) (McKinney 1986); OKLA. STAT. tit. 18, § 1056 (2002).

64. See, e.g., Chris Serres, *New Law Hurts SunTrust / But It Limits Options for Shareholders*, NEWS & OBSERVER (Raleigh, N.C.), June 15, 2001, at D1. (discussing the process by which the legislation was passed).

Although I disagree with the narrowing of shareholders' ability to mandate a special meeting, this article does not elaborate on the wisdom of the change. Rather, this article deals with the way in which it was made.

The amendment was not designed to address shareholder voting rights generally, but rather was clearly designed as an anti-takeover maneuver.⁶⁵ Although this essay was prompted by the action of the North Carolina legislature, the problem is by no means unique to North Carolina. A number of state legislatures similarly have blindly acquiesced⁶⁶ in the desires of corporate management, rather than balance the interests of shareholders.⁶⁷ Although I do not agree that the principles of fiduciary duty should yield to freedom of contract in corporate law,⁶⁸ I do not take on that battle in this essay. Assuming *arguendo* that the contractarians⁶⁹ are correct in their view that fiduciary principles are outmoded and should be replaced by the freedom of contract to define shareholder rights, lobbying the legislature is not the means by which to accomplish that goal. In fact, lobbying the legislature circumvents the shareholders' freedom of contract by taking away their choice. The legislature's unilateral rewriting of the governance rights embodied in a corporation's charter not only violates freedom of contract principles, but it also may be invalid under the Contract Clause of the United States Constitution.⁷⁰

65. The new law was designed "to protect [North Carolina companies] against abusive tactics in unsolicited takeover attempts." Christine Van Dusen, *SunTrust Wins One, Loses One in Fight for Wachovia in North Carolina*, ATLANTA J. & CONST., June 15, 2001, at 1G (quoting First Union CEO Ken Thompson).

66. There are legitimate arguments that corporate statutes should give more leeway to management and hence less protection to shareholders. See Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 921-23 (1982); *supra* note 11.

67. For discussion of the politics underlying corporate legislative reform, see, for example, Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 122-23 (1987); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 721-22 (1987).

68. See, e.g., Stephen J. Choi & Andrew T. Guzman, *Choice and Federal Intervention in Corporate Law*, 87 VA. L. REV. 961 (2001) (advocating the move to freedom of choice); Thomas L. Hazen, *The Corporate Persona, Contract (And Market) Failure, and Moral Values*, 69 N.C. L. REV. 273, 293-95 (1991) [hereinafter Hazen, *Corporate Persona*] (arguing that corporate contract and fiduciary duties are not incompatible); Hazen, *Corporate Chartering*, *supra* note 23, at 397-440 (stating that too much regulation of corporate conduct is unwise).

69. See *supra* note 13.

70. U.S. CONST. art I, § 10. See generally Taylor, *supra* note 27 (noting that statutory amendments that have the effect of rearranging rights within existing corporations are problematic at best and, if applied without appraisal rights being accorded to dissenters,

The constitutional concern, however, is not the sole problem with the new rules for shareholders' convening of meetings. There is a substantive incoherence to the new provision. The substantive incoherence is that shareholders of a publicly held company still can mandate a special meeting if they cross the twenty percent share ownership threshold.⁷¹ This provision is part of the Control Share Acquisition Act that the General Assembly adopted in 1986 as an anti-takeover device.⁷² This epitomizes irony, considering that the only remaining guaranteed initiative for shareholders of a publicly-held North Carolina company is found in a statute designed to disenfranchise shareholders acquiring a substantial percentage of a company's shares.

The 2001 change to the special shareholder meeting provisions of the North Carolina statute was not made in response to a reasoned debate over the wisdom of shareholder initiative, nor was it made upon the recommendation of the General Statutes Commission⁷³ or the North Carolina Bar Association, which have both been active in initiating corporate law reform over the past two decades. The change was a direct result of First Union's lobbying efforts to help defeat SunTrust's hostile offer. First Union asserted that its proposal to acquire Wachovia would serve the state of North Carolina by keeping the corporate headquarters at home and by preserving the Wachovia name.⁷⁴ First Union contended that, based on SunTrust's past record of acquisitions, a similar result could not be expected to follow a SunTrust takeover of Wachovia.⁷⁵ The First Union amendment was proposed to the legislature as a good faith attempt to

likely to be unconstitutional).

71. N.C. GEN. STAT. §§ 55-9A-01(b)(2), 55-9A-03 (2001). This right to trigger a special meeting is pointed out, for example, in ROBINSON, *supra* note 4, § 8.02, at 8-2 to 8-3.

72. See *supra* notes 27-28; see also Hazen, *State Anti-Takeover Legislation*, *supra* note 10, at 85-88 (discussing the background of the North Carolina Control Share Acquisition Act).

73. The General Statutes Commission periodically reviews and recommends legislation to be adopted. The Commission is a division within the North Carolina Department of Justice designed to work with state officials and the legislature in reviewing and drafting legislation. N.C. GEN. STAT. § 114-9 (2001). The members of the General Statutes Commission decide which legislation they want to review. The Commission, which works with the Attorney General's office from time to time, appoints drafting committees when the Commission members believe legislation is warranted. The North Carolina Business Corporation Act that was adopted in 1990 was drafted by such a committee. I served as a member of this drafting committee. See *infra* note 90.

74. For a more complete description of the machinations behind this legislation, see Yang, *supra* note 46, at 348-52.

75. Yang, *supra* note 46, at 348-52.

thwart a threatened hostile bid that the drafters believed would be contrary to the best interests of Wachovia shareholders and the state of North Carolina.⁷⁶ I do not question the legitimacy of the concern that First Union's bid may have been in the state's best interests. I do, however, condemn the way in which the North Carolina legislature tipped the balance in the takeover contest by amending its corporate law. I am also concerned about state legislatures' propensity, in general, to react favorably to management's concerns and to unduly devalue the rights of shareholders.⁷⁷

76. Section 55-7-02 as it existed prior to the First Union amendment, would have permitted First Union to amend Wachovia's bylaws to permit the call of a special meeting by a delay of thirty days before the call for a special shareholder meeting and the convening of the meeting. The resulting delay would have been a serious threat to First Union's merger plans. As explained by Russell Robinson, a leading authority on North Carolina Corporate law:

SunTrust took unfair advantage of these circumstances by putting on the agenda a proposal to add a 30-day special meeting provision to Wachovia's bylaws, with the promise of demanding such a meeting to elect directors who would negotiate a SunTrust merger if the First Union merger was defeated. This was a snare and delusion. It threatened to add to the proxy material a confusing distraction calculated to draw the shareholders' attention away from the relative merits of a First Union merger vs. [sic] a possible later SunTrust bid and to capture anti-merger votes on a misleading basis. On its face, a proposal that appears to broaden shareholder rights is "motherhood and apple pie." Thus, a significant number of shareholders who would favor the merger would nevertheless be likely simply to sign the SunTrust proxy as a vote for the special meeting proposal, without knowing how, or taking the trouble, to split their vote and without realizing the inappropriateness of the 30-day provision and the false hope of the SunTrust board-packing proposal. (Incidentally, a Wall Street Journal article at that very time explored the usually disastrous consequences of such board-packing attempts.)

Letter from Russell M. Robinson II, Attorney, Robinson Bradshaw & Hinson, to Thomas L. Hazen, Cary C. Boshamer Distinguished Professor of Law, University of North Carolina School of Law 3 (July 9, 2002) (on file with the North Carolina Law Review).

In order to avoid this problem, at First Union's behest, a bill was introduced and eventually enacted so as to eliminate Sun Trust's ability to amend the bylaws and call a special meeting. *See supra* notes 29-40 and accompanying text.

In 2002, the legislature again amended section 55-7-02 to eliminate the thirty-day delay and further fix the problems created by the hasty First Union amendments that had been added. *See Act of Aug. 1, 2002, ch. ___, § 1, 2001 N.C. Sess. Laws ___, ___* (now available in leaflet form as Session Law 2002-58) (on file with the North Carolina Law Review); *infra* notes 78-80. While the thirty-day delay may have been an unwise provision in the statute, it was wrong to let First Union avoid this provision by special legislation rather than wait for better thought-out remedial legislation such as that which was introduced in 2002.

77. In the 1980s, the North Carolina legislature overturned years of forward-looking corporate regulation when it overreacted to management's concerns of liability exposure to shareholders for corporate mismanagement. *See Hazen, Race to the Bottom, supra* note 25, at 180-83 (discussing the changes to the North Carolina Corporation Act).

The haste with which the General Assembly enacted the First Union amendments is further demonstrated by the fact that in 2002 an amendment was enacted to reinject more balance into the law.⁷⁸ The most recent change to section 55-7-02 eliminated the substance of the First Union Amendments and reinstated the ability of public corporations to provide for shareholder initiative in their bylaws as well as in the articles of incorporation. Section 55-7-02 as amended provides that the right of shareholders to call a special meeting is limited to corporations that are not public corporations.⁷⁹ Section 55-7-02(a)(1) as amended, however, also permits the call of a special meeting by “the person or persons authorized to do so by the articles of incorporation or *bylaws*.”⁸⁰ This would be accomplished by allowing all corporations (public and nonpublic) to name in its bylaws or articles of incorporation the persons entitled to call a special meeting. Thus, for example, even a public corporation could amend its bylaws to permit the call of a special meeting upon a petition of the holders of a stated percentage of the shares. With the adoption of the 2002 amendments, the 2001 First Union amendment is in essence eliminated from the laws of North Carolina. This episode, however, leaves the indelible imprint of a short-lived statute that served its intended goal—defeating SunTrust’s challenge to the First Union/Wachovia merger.

The method by which the legislature adopted the First Union amendments presents two issues. A first concern is whether a state legislature should intervene in a contest for corporate control to favor one side and thus take the decision away from the owners of the corporation—its shareholders. A second concern is whether, even assuming that intervention in a particular corporate control battle is appropriate, a wholesale amendment of the corporate statute is the proper way to proceed. Instead, the legislation should specifically target the acquisition in question.

With respect to the first issue, a major tenet of corporate law in this country since its inception has been that the state should not intervene in the management of private corporations. This policy has

78. H.R. 1503, 2001 Gen. Assem., Reg. Sess. (N.C. 2002) (legislative proposal to amend N.C. GEN. STAT. § 55-7-02). The amendment was passed on June 18, 2002, and became law on August 1, 2002. Act of Aug. 1, 2002, ch. ___, § 1, 2001 N.C. Sess. Laws ___, ___ (to be codified at N.C. GEN. STAT. § 55-7-02) (now available in leaflet form as Session Law 2002-58) (on file with the North Carolina Law Review)

79. Act of Aug. 1, 2002, ch. ___, § 1, 2001 N.C. Sess. Laws ___, ___ (now available in leaflet form as Session Law 2002-58) (on file with the North Carolina Law Review)

80. *Id.*

appeared in various forms. Although the state of incorporation through its corporation laws sets various management norms and governance procedures, these norms are general ground rules rather than directives for specific corporate decisions. Under the universally recognized business judgment rule,⁸¹ which is nearly two centuries old,⁸² courts defer to corporate managers' business judgment. Courts will defer to corporate decisions even if those judgments are not economically in the best interests of the corporation.⁸³ Thus, courts do not put themselves in the position of making business decisions. This sound doctrine strongly militates against the state—whether through its legislature or through its courts—from interfering in business decisions of corporate management and shareholders. Prior to the SunTrust bid, North Carolina's long-declared legislative policy was to grant to ten percent of the shares entitled to vote on an issue the right to compel a special meeting of the shareholders.⁸⁴ By amending the statute, the legislature disenfranchised the shareholders of Wachovia and deprived them of the right to decide what was best for themselves and their company. The legislature made this move merely to favor one company, without any disengaged consideration of the wisdom of reversing this long-held public policy of refraining from intervening in management. . These events illustrate the old adage that "hard facts make bad law."⁸⁵ Unfortunately, this episode is not the first time that the North Carolina legislature has embarked on this misguided journey.⁸⁶

81. See generally DENNIS J. BLOCK ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* (5th ed. 1998) (discussing in part the application of the business judgment rule to corporate takeovers, shareholder derivative suits, and indemnification and insurance of corporate officials); 1 COX, HAZEN & O'NEAL, *supra* note 6, at § 10.2 (discussing the business judgement rule); HARRY G. HENN & JOHN R. ALEXANDER, *LAWS OF CORPORATIONS* § 242 (3d ed. 1983) (stating the general rule and citing cases from various jurisdictions).

The failure to make an adequate investigation has been held to preclude the applicability of the business judgment rule. *Smith v. Van Gorkom*, 488 A.2d 858, 893 (Del. 1985).

82. See *Percy v. Millaudon*, 8 Mart. (n.s.) 68 (La. 1829).

83. The classic example of this is *Shlensky v. Wrigley*, 237 N.E.2d 776 (Ill. App. Ct. 1968), where the management of the Chicago Cubs decided to remain the only major league baseball team not to have night baseball games. Night baseball games produced demonstrably higher revenues than daytime games. *Id.* at 780. Although the court noted that most reasonable directors acted differently, it nevertheless deferred to the decision of the Cub's directors. *Id.* at 781.

84. N.C. GEN. STAT. § 55-7-02 (1999) (amended 2001 & 2002).

85. *Northern Securities Co. v. United States*, 193 U.S. 197, 400 (1904) (Holmes, J., dissenting) ("Great cases like hard cases make bad law.").

86. In the mid-1980s, a Canadian national made a takeover bid for Burlington Industries, which, although incorporated in Delaware, had a substantial presence in North

Notably, relatively few public corporations are organized under the North Carolina Business Corporation Act. As such, this most recent limitation on shareholder initiative will have limited practical impact, unless there is a significant increase in the number of North Carolina public corporations. This amendment may in fact inhibit growth in the number of public corporations in North Carolina, as the absence of shareholder initiative may make North Carolina less attractive as a state of incorporation. Institutional investors throughout the country have become increasingly proactive in corporate governance.⁸⁷ The shareholders' ability to initiate a bylaw amendment to grant shareholders the right to call a special meeting may make the corporation more attractive to institutional investors. Though the 2001 amendments to the statute may have only limited impact in the future, this does not change the reality that the legislation was ill-advised and should be reconsidered. In fact, the leading treatise on North Carolina Corporate Law suggested that further amendment of the North Carolina statute was needed to accord shareholders of a public corporation "a reasonable right to call a special meeting."⁸⁸

B. Shareholder Action Without a Meeting

The earlier change in shareholder voting is the new provision permitting corporations to opt into a system of shareholder action by consent, thus dispensing with shareholders' meetings.⁸⁹ The drafting

Carolina. To defeat this bid, a bill was introduced in the North Carolina legislature to create takeover barriers for corporations, which, although incorporated elsewhere, had more than 50% of their assets and employees within the state. While the bill was progressing to passage, it was discovered that Burlington did not meet this threshold and the threshold was lowered to 40% in the state before the bill was enacted into law. See Hazen, *State Anti-Takeover Legislation*, *supra* note 10, at 85. The history of this legislation made it patently clear that it was geared to defeat a particular takeover bid. For my previous criticism of the legislature's knee-jerk response to management-based lobbying efforts, see Hazen, *Race to the Bottom*, *supra* note 26, at 84-88.

87. Bernard S. Black, *Shareholder Activism and Corporate Governance in the United States*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 459 (Peter Newman ed., 1998); Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 827-29 (1992); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor As Corporate Monitor*, 91 COLUM. L. REV. 1277, 1291 (1991); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 447 (1991); Roberta Romano, *Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174, 175 (2001); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 799 (1993).

88. RUSSELL M. ROBINSON II, ROBINSON ON NORTH CAROLINA CORPORATION LAW § 8.3 (Supp. 2002).

89. N.C. GEN. STAT. § 55-7-04 (2001).

committee⁹⁰ for the 1990 North Carolina Business Corporation Act considered but rejected the Delaware approach of permitting shareholder action by majority consent.⁹¹ Then, in 2001, the North Carolina legislature reversed this position by permitting nonpublic companies to adopt a majority consent provision through an amendment to the articles of incorporation approved by the shareholders.⁹²

A corporation cannot dispense with a shareholder meeting under the majority consent provision with respect to the election of directors at the annual shareholders meeting.⁹³ Majority consent, however, can be invoked to avoid meeting for all other important shareholder action, including amendments to the articles of incorporation, mergers, and dissolution—all of which can take place at a special shareholders meeting.⁹⁴ Furthermore, since there is no mention of the vacancy having to be filled at an annual shareholder meeting⁹⁵ the majority consent provision can also be used to fill director vacancies at a special shareholder meeting. With an enabling provision in the corporation's articles of incorporation, a majority consent provision may thus be used for virtually any significant corporate action requiring shareholder approval.

The legislative amendment that introduced the majority consent provision to North Carolina was drafted by the Business Section of

90. The drafting committee, established by the North Carolina General Statutes Commission, was chaired by Russell M. Robinson II and included Micheal R. Abel, Doris R. Bray, Clarence W. Walker, Professor James D. Cox, and me. See ROBINSON, *supra* note 4, § 1.02(b), at 1–6 to 1–7.

91. See ROBINSON, *supra* note 4, § 8.12, at 8–18 to 8–20 (discussing shareholder action without a meeting).

92. N.C. GEN. STAT. § 55-7-04 (2001).

93. N.C. GEN. STAT. § 55-7-04(a1) (2001) provides that unanimous consent is required to dispense with election of directors at the annual stockholders meeting.

In *Hoschett v. TSI Int'l Software, Ltd.*, 683 A.2d 43 (Del. Ch. 1996), the Chancery Court held that, given the importance of the annual meeting to corporate governance, action by written consent is not the equivalent of an annual meeting and ordered an annual meeting to be held. Delaware subsequently amended section 211 of the Delaware General Corporation Law to provide that an annual meeting need not be held if action is taken without a meeting by less than unanimous consent. all directorships to which directors could be elected at the annual meeting are vacant and all of those directorships are filled by such action. DEL. CODE ANN. tit. 8, § 211 (2001). This is in contrast to the North Carolina statute which takes the better view that the annual meeting is sacrosanct and cannot be avoided by majority consent. N.C. GEN. STAT. § 55-7-04(a1) (2001).

94. N.C. GEN. STAT. § 55-8-10(a)(1) (2001).

95. *Id.* Director vacancies include those resulting from newly created director positions. *Id.* This permits a majority of the shareholders to change the board's composition by consent rather than waiting for the next annual meeting of shareholders.

the North Carolina Bar Association⁹⁶ and was supported by the Business Section and the Bar Association as a whole.⁹⁷ The Bar Association's amendment was the result of the concern that venture capital firms find such a provision attractive and that enabling North Carolina corporations to adopt majority consent provisions would encourage these companies to remain incorporated in North Carolina rather than reincorporate in Delaware which permits shareholder action by majority consent.⁹⁸ The Business Section of the Bar Association believed that amending the North Carolina Business Corporation Act would benefit the state by preventing reincorporation in Delaware. As well intentioned as this may have been, the amendment was inspired by and focused on only a very small percentage of North Carolina corporations—those seeking venture capital financing. At the same time the majority consent provision operated to the detriment of minority shareholders⁹⁹ in all other nonpublic companies by permitting the elimination of shareholder meetings for most important shareholder action.

The new North Carolina law on shareholder action by consent raises two problems for existing corporations: (1) the prospect of having to offer appraisal rights to dissenting shareholders; and (2) the wisdom and fairness of permitting action by majority consent.

1. The Appraisal Remedy

As a result of the 2001 amendment to section 55-7-04 of the North Carolina Business Corporation Act, any existing corporation seeking to permit shareholder action by majority consent must submit the matter to a shareholder vote at a duly convened meeting, as this is the only way to amend the articles.¹⁰⁰ Such an amendment should trigger statutory appraisal rights in the hands of dissenting shareholders.

96. See Letter from Russell M. Robinson II, *supra* note 76; Letter from Stephen M. Lynch, Attorney, Robinson Bradshaw & Hinson, to Thomas L. Hazen, Cary C. Boshamer Distinguished Professor of Law, University of North Carolina School of Law (July 10, 2002) (on file with the North Carolina Law Review).

97. Email from Stephen M. Lynch, Attorney, Robinson Bradshaw & Hinson, to Thomas L. Hazen, Cary C. Boshamer Distinguished Professor of Law, University of North Carolina School of Law (July 29, 2002, 09:29:50 EST) (on file with the North Carolina Law Review).

98. See Letter from Stephen M. Lynch, *supra* note 96.

99. See *infra* notes 106–07 and accompanying text.

100. See N.C. GEN. STAT. §§ 55-10-03 to 55-10-04 (2001) (setting forth the procedure for amending the articles).

Statutory appraisal rights provide an exit for shareholders who are dissatisfied with major corporate actions, including mergers and specified important changes to the corporation's articles of incorporation.¹⁰¹ Every state has adopted statutory appraisal rights for some corporate actions.¹⁰² In essence, the statutory appraisal

101. The North Carolina appraisal remedy statute reads:

(a) In addition to any rights granted under Article 9, a shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:

(1) Consummation of a plan of merger to which the corporation (other than a parent corporation in a merger whose shares are not affected under G.S. 55-11-04) is a party unless (i) approval by the shareholders of that corporation is not required under G.S. 55-11-03(g) or (ii) such shares are then redeemable by the corporation at a price not greater than the cash to be received in exchange for such shares;

(2) Consummation of a plan of share exchange to which the corporation is a party as the corporation whose shares will be acquired, unless such shares are then redeemable by the corporation at a price not greater than the cash to be received in exchange for such shares;

(2a) Consummation of a plan of conversion pursuant to Part 2 of Article 11A of this Chapter;

(3) Consummation of a sale or exchange of all, or substantially all, of the property of the corporation other than as permitted by G.S. 55-12-01, including a sale in dissolution, but not including a sale pursuant to court order or a sale pursuant to a plan by which all or substantially all of the net proceeds of the sale will be distributed in cash to the shareholders within one year after the date of sale;

(4) An amendment of the articles of incorporation that materially and adversely affects rights in respect of a dissenter's shares because it (i) alters or abolishes a preferential right of the shares; (ii) creates, alters, or abolishes a right in respect of redemption, including a provision respecting a sinking fund for the redemption or repurchase, of the shares; (iii) alters or abolishes a preemptive right of the holder of the shares to acquire shares or other securities; (iv) excludes or limits the right of the shares to vote on any matter, or to cumulate votes; (v) reduces the number of shares owned by the shareholder to a fraction of a share if the fractional share so created is to be acquired for cash under G.S. 55-6-04; or (vi) changes the corporation into a nonprofit corporation or cooperative organization; or

(5) Any corporate action taken pursuant to a shareholder vote to the extent the articles of incorporation, bylaws, or a resolution of the board of directors provides that voting or nonvoting shareholders are entitled to dissent and obtain payment for their shares.

N.C. GEN. STAT. § 55-13-02 (2001). There are exceptions to the appraisal remedy for mergers and other business combinations, as well as for corporations whose shares are listed on a national securities exchange or traded in Nasdaq's over-the-counter market, where there are at least 2000 record shareholders. § 55-13-02(c) (listing the exceptions to the appraisal remedy).

102. See 3 COX, HAZEN & O'NEAL, *supra* note 6, at § 22.24 (discussing state law appraisal remedies).

remedy gives dissenting shareholders a right to demand payment of the fair value of their shares.¹⁰³

Corporations that amend their articles of incorporation to permit shareholders to act by majority consent deprive existing shareholders of an important aspect of their voting rights.¹⁰⁴ The right of appraisal provides minority shareholders, especially in closely held corporations, with the opportunity to exit from what might otherwise be an illiquid position.¹⁰⁵

The appraisal statute applies, among other things, to an amendment to the articles of incorporation that "limits the right of the shares to vote on any matter."¹⁰⁶ Permitting shareholder action by majority consent eradicates the need for a shareholder meeting and removes a shareholder's opportunity to vote and enjoy the other rights that attach to voting rights, such as appraisal rights. Although statutory appraisal rights are afforded to shareholders who cast a dissenting vote, simply withholding consent is not the equivalent of casting a positive vote.

103. See generally ABA Committee on Corporate Laws, *Changes in the Model Business Corporation Act Affecting Dissenters' Rights*, 32 BUS. LAW. 1855 (1977) (discussing dissenting shareholders' rights); ABA Committee on Corporate Laws, *Proposed Changes in the Model Business Corporation Act—Appraisal Rights*, 54 BUS. LAW. 209 (1998) (same); Richard M. Buxbaum, *The Dissenter's Appraisal Remedy*, 23 UCLA L. REV. 1229 (1976) (same); Alfred F. Conard, *Amendments of Model Business Corporation Act Affecting Dissenters' Rights (Sections 73, 74, 80, and 81)*, 33 BUS. LAW. 2587 (1978) (same); Norman D. Lattin, *Minority and Dissenting Shareholders' Rights in Fundamental Changes*, 23 LAW & CONTEMP. PROBS. 307 (1958) (same); Norman D. Lattin, *Remedies of Dissenting Stockholders Under Appraisal Statutes*, 45 HARV. L. REV. 233, 234-44 (1931) (same); Peter V. Letsou, *The Role of Appraisal in Corporate Law*, 39 B.C. L. REV. 1121 (1998) (same); Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223 (1962) (same); Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1 (1995) (same); Joseph L. Weiner, *Payment of Dissenting Stockholders*, 27 COLUM. L. REV. 547 (1927) (same); Angie Woo, Note, *Appraisal Rights in Mergers of Publicly-Held Delaware Corporations: Something Old, Something New, Something Borrowed, and Something B.L.U.E.*, 68 S. CAL. L. REV. 719 (1995) (same).

104. N.C. GEN. STAT. § 55-13-02(a)(4)(iv) grants the appraisal remedy to shareholders dissenting from an amendment to the articles of incorporation that "excludes or limits the right of the shares to vote on any matter, or to cumulate votes . . ."

105. As the North Carolina Supreme Court observed in a leading case, "the illiquidity of a minority shareholder's interest in a close corporation renders him vulnerable to exploitation by the majority shareholders." *Meiselman v. Meiselman*, 309 N.C. 279, 291, 307 S.E.2d 551, 559 (1983). For discussion of the general problem, see generally J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1 (1977) (analyzing the vulnerability of shareholders in closely held corporations).

106. N.C. GEN. STAT. § 55-13-02(a)(4)(iv) (2001); MODEL BUS. CORP. ACT § 13-02(a)(4)(iv) (1998) (amended 1999).

Attendance at a meeting provides the opportunity not only to debate issues, but also to propose amendments to agenda items and thereby vote on the amendments. The action by consent procedure bypasses this process, thus effectively denying minority shareholders the right to vote.¹⁰⁷ The importance of the right to vote and dissent extends beyond the right to participate in the debate that may take place at the meeting.

While the appraisal right provides protection to shareholders in corporations existing at the time the 2001 amendments were adopted, appraisal rights do not apply to corporations formed after that date that opt into the majority consent procedure in the corporation's initial articles of incorporation. In a newly formed corporation, the organizers can avoid appraisal rights by adopting action by majority consent in their initial articles of incorporation. The articles of incorporation are on file with the secretary of state and thus are readily available to anyone buying into an existing corporation. Those shareholders, therefore, take with notice of the consent procedure and, as such, can be deemed to have consented to it.

Even the sponsors of the majority consent provision recognize that there is an issue concerning the availability of statutory appraisal rights for an article amendment opting in to majority consent for existing North Carolina corporations. In July 2002, representatives of the Business Section Council of the North Carolina Bar Association¹⁰⁸ submitted to the North Carolina General Assembly's Senate Judiciary Committee a proposed amendment to section 55-13-02¹⁰⁹ that would have had the effect of eliminating shareholder appraisal rights for an amendment to the articles of incorporation implementing majority consent without a meeting pursuant to 55-7-04(a).¹¹⁰ Recognizing that this would not simply be a technical

107. In the event that N.C. GEN. STAT. § 55-13-02(a)(4)(iv) is interpreted not to grant appraisal rights to an article's amendment implementing the majority consent provisions of § 55-7-04, the appraisal remedy would nevertheless be required for all corporations incorporated prior to 2001, when § 55-7-04 was adopted. *See* Taylor, *supra* note 27, at 991-1010 (analyzing the Constitutional implications of post-incorporation changes in a state's corporate law concerning statutory appraisal rights).

108. The 2001 amendments to § 55-7-04 were drafted by members of the Business Section of the North Carolina Bar Association and submitted to the North Carolina General Assembly with the support of the Bar Association. *See supra* note 96.

109. N.C. GEN. STAT. § 55-13-02 (2001).

110. *See* Email from Stephen M. Lynch, Attorney, Robinson Bradshaw & Hinson, to Thomas L. Hazen, Cary C. Boshamer Distinguished Professor of Law, University of North Carolina School of Law (Aug. 10, 2002, 13:13:19 EST) (on file with the North Carolina Law Review).

correction, the proposal was withdrawn.¹¹¹ It thus remains to be the case that the language of the appraisal rights statute¹¹² calls for statutory appraisal rights upon the amendment of a corporation's articles of incorporation to adopt a majority consent provision.¹¹³

2. Basic Fairness

My concern over the majority consent provision goes beyond the appraisal remedy. Traditionally, corporate law required that all shareholder action had to take place at duly convened shareholder meetings.¹¹⁴ The only exception, which continues to be the case in many states, was that holders of all of the shares entitled to vote may act unanimously by written consent without a meeting.¹¹⁵ An increasing number of states led by Delaware, however, permit shareholder action without a meeting by consent of a mere majority of the shares entitled to vote.¹¹⁶ This may be desirable for many corporations where a shareholder meeting would be just a formality. This is the case for most public corporations, where the need for a meeting is further diminished in light of SEC mandated disclosure requirements designed to keep investors informed.¹¹⁷

Permitting action without a meeting in a closely-held context, however, is not a desirable outcome. The rationale underlying the requirement of a formal meeting is that it allows even minority shareholders to voice their concerns and to have the opportunity to influence the votes of their fellow shareholders.¹¹⁸ A majority consent

111. *Id.*

112. N.C. GEN. STAT. § 55-13-02 (2001).

113. *See supra* notes 104–05 and accompanying text.

114. *E.g.*, N.C. GEN. STAT. § 55-7-01 (2001) (annual meeting); *id.* § 55-7-02 (special meeting); MODEL BUS. CORP. ACT § 7.01 (1999) (annual meeting); *id.* § 7.02 (special meeting).

115. *E.g.*, ALA. CODE § 10-2B-7.04 (1999); ALASKA STAT. § 10.06.423 (Michie 2000); ARIZ. REV. STAT. § 10-704 (1996); COLO. REV. STAT. § 7-56-302 (2001); N.C. GEN. STAT. § 55-7-04 (1999) (amended 2001); MODEL BUS. CORP. ACT § 7.04 (1999).

116. DEL. CODE ANN. tit. 8, § 228 (2001); *see, e.g.*, CAL. CORP. CODE § 603 (West Supp. 2002); ARK. CODE ANN. § 4-27-704 (Michie 2001); CONN. GEN. STAT. ANN. § 33-698 (West Supp. 2002); FLA. STAT. ANN. § 617.0701 (West 2001); 805 ILL. COMP. STAT. ANN. 5/7.10 (West 1993); N.J. STAT. ANN. § 14A:5-6 (West Supp. 2002); TEX. BUS. CORP. ACT CODE ANN. § 9.10 (Vernon Supp. 2002).

117. SEC Rule 14a-3 provides that when management solicits shareholder consent, it must provide detailed information about the proposals being submitted. Even if the company does not solicit consent, it must nevertheless provide shareholders with the same type of information via an information statement that must be distributed in advance of the date on which the action by consent is to be taken. *See* 17 C.F.R. § 240.14a-3.

118. *See generally* HAZEN, SECURITIES REGULATION, *supra* note 22, § 10.8, at 136 (discussing the SEC shareholder proposal rule); Daniel E. Lazaroff, *Promoting Corporate Democracy and Social Responsibility: The Need to Reform the Federal Proxy Rules on*

provision eliminates minority owners' access to the decision-making process. It is a relatively minor inconvenience and expense to solicit minority shareholder proxies to permit a quorum without physical attendance at a meeting.¹¹⁹ At the same time, the formal meeting leaves minority shareholders the option of attending in person. It is difficult to see a valid reason for denying this option to minority shareholders; after all, the shareholders' money has been used in forming the business. Although a minority shareholder may not have an effective voice, the ability to attend meetings gives shareholders access to information that, as owners, they should have. The shareholders' voice has been silenced and their right to information derogated by the increasing number of states permitting shareholder action by majority consent.

An additional problem with the majority consent provision, from the perspective of minority shareholders, is that they will not be informed of shareholder action by consent until after the action has taken place.¹²⁰ The lack of timely information opens the door for all sorts of mischief. For example, dominant shareholders, although alone they may lack a majority of the votes, can achieve working control by soliciting the consent of the more malleable shareholders. Dominant shareholders could therefore secure a majority without consulting all of the remaining shareholders or giving them the chance to speak to their fellow shareholders to make their case against the position urged. It is not sufficient to say that the course of events can be altered once the action by consent is announced. Claiming that the course of events can be altered is insufficient. If the corporation has already begun to implement the action in question, it may be too late to turn back the clock and rescind the action approved by majority consent without a meeting. Thus, for example,

Shareholder Proposals, 50 RUTGERS L. REV. 33 (1997) (discussing the SEC's shareholder proposal rule and proposing reform that would preserve shareholder democracy); Eric A. Welter, Note, *The Shareholder Proposal Rule: A Change to Certainty*, 60 GEO. WASH. L. REV. 1980 (1992) (calling for federal legislation to clarify shareholders' access to the proxy process in public issue corporations).

119. In the absence of a shareholder consent statute, the corporation must send shareholders notice of a meeting. If corporations or shareholders want to solicit proxies, they can do so by phone or other simple communication. The inconvenience and cost of having a meeting thus is quite minor.

120. N.C. GEN. STAT. § 55-7-04(d) (2001) requires advance notice of mergers and certain other shareholder action before the action by consent is taken. However, the articles can be amended to eliminate such prior consent. *Id.* It is reasonable to assume that a corporation adopting a majority consent enabling provision may also dispense with the prior notice requirement of section 55-7-04(d).

this process would effectively eliminate the availability of injunctive relief to stop the transaction from taking place.

The majority consent provision cannot totally preclude shareholder meetings in nonpublic companies, because ten percent of the shares entitled to vote can mandate a special meeting of the shareholders under section 55-7-02 of the North Carolina Business Corporation Act.¹²¹ This does not adequately address the concern raised above, however, because once the action by consent is taken, the only possible relief at a subsequent special meeting would be to try to undo the action. As a practical matter, this may not be effective as, under the terms of section 55-7-02(b) as enacted in 2001, the corporation can delay the meeting for up to thirty days following the written demand for a special meeting.¹²² Furthermore, there may be a time lag from the date the action by majority consent is taken and the time that the action is disclosed to the non-consenting shareholders. Although section 55-7-04(e) provides that nonconsenting shareholders should receive notice of the action taken by consent within ten days following the action taken, failure to give the notice does not invalidate the action.¹²³ As a result, the majority can delay any shareholder meeting for a significant period of time¹²⁴ following the action by consent, and, as a practical matter, the delay could be

121. N.C. GEN. STAT. § 55-7-02 (2001) (amended 2002); *see supra* notes 27–28 and accompanying text.

122. N.C. GEN. STAT. § 55-7-02(a)(2) (2001) (amended 2002).

123. The statute states that:

If action is taken without a meeting by fewer than all shareholders entitled to vote on the action, the corporation shall give written notice to all shareholders who have not consented to the action and who, if the action had been taken at a meeting, would have been entitled to notice of the meeting with the same record date as the action taken without a meeting, within 10 days after the action is taken. The notice shall describe the action and indicate that the action has been taken without a meeting of shareholders. Failure to comply with the requirements of this subsection shall not invalidate any action taken that otherwise complies with this section.

§ 55-7-04(e). *See supra* note 120.

In the case of action by consent regarding a merger, share exchange, article amendment, dissolution or other action that could trigger the statutory appraisal remedy, the notice of the action by consent will have to include the notice required for statutory appraisal rights. *See* § 55-7-04(d).

124. The forty day period is based on taking advantage of the ten day delay before giving notice of the action and then, assuming there is an immediate demand for a special meeting by the required ten percent of the shares, there would be an additional thirty days under N.C. GEN. STAT. § 55-7-02(a)(2) (2001). In all likelihood the period would be longer, since it would probably take some time for the non-consenting shareholders to digest the information in the notice and then prepare and deliver the written demand for a special meeting.

extended for a considerably longer period.¹²⁵ Therefore, by the time a special meeting is called, it may be too late to “unscramble the eggs.”

The North Carolina legislature’s proclivity to respond to lobbying efforts rather than engage in thoughtful analysis was reflected in the 2001 amendment that defeated shareholder initiative in public corporations.¹²⁶ It is also reflected in the majority consent provision of section 55-7-04. While I question the wisdom of such a choice by closely held entities, the statute does make it something that the corporation has to opt into, thus requiring at least constructive consent of all of the shareholders. Applying principles of freedom of contract to corporate law, although of questionable wisdom,¹²⁷ is consistent with the current trend of corporate law throughout the country. Ironically, the North Carolina legislature has not left this option open to existing public corporations.¹²⁸ By its terms, section 55-7-04 applies to “a corporation that is not a public corporation at the time the action is taken” Thus, unlike Delaware,¹²⁹ public corporations incorporated in North Carolina cannot take advantage of majority shareholder consent, unless it was provided for in the initial articles or adopted as an amendment to the articles before the corporation became public. Why make such a distinction? Presumably the distinction exists because the legislature wanted to insulate the few existing public North Carolina corporations from having a hostile takeover attempt aided by the shareholder consent provision contained in their articles of incorporation.¹³⁰

125. In addition to the likelihood that the permissible period would extend beyond forty days, there could be a delay in giving notice of the action beyond the ten-day statutory period that would not invalidate the action taken. N.C. GEN. STAT. § 55-7-04(e) (2001).

126. See *supra* notes 29–40 and accompanying text.

127. See generally Hazen, *Corporate Persona*, *supra* note 68 (arguing against the application of contract principles to destroy fiduciary obligations in corporate governance).

128. “‘Public corporation’ means any corporation that has a class of shares registered under Section 12 of the Securities Exchange Act of 1934, as amended (15 U.S.C. § 78l).” N.C. GEN. STAT. § 55-1-40(18a) (2001). Presumably a non-public company could adopt the article amendment and then become a public company with the amendment remaining in force.

129. DEL. CODE ANN. tit. 8, § 228 (2001).

130. Years ago Martin Marietta Corp. and Bendix Corp. were engaged in a takeover involving the Pac-Man defense—an acquisition of an aggressor as a response to a hostile bid. Cf. *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982) (refusing to enjoin defensive tactic). See generally Deborah A. De Mott, Comment, *Pac-Man Tender Offers*, 1983 DUKE L.J. 116 (1983) (discussing the Pac-Man defense). Once the competing suitors’ purchases stopped, each company owned a majority of the other’s shares. The corporation that was not incorporated in Delaware won the battle. The

CONCLUSION

In 2001, the North Carolina legislature took two unfortunate steps towards silencing the shareholders' voice in the management of corporations. This legislative action, however, was contrary to the traditions of corporate law in this country and particularly in North Carolina. The legislature should reconsider its decision to succumb to the political lobbies of corporate managers at the expense of the shareholders and investors who put up their capital to finance these corporate entities. Even if the legislature does not take corrective action, the courts should continue to interpret the North Carolina corporate law in light of the state's rich tradition of protecting shareholder rights against management's possible self-interest. More than thirty-five years ago, a preeminent authority on corporate law identified the North Carolina corporate statute as "the most advanced statute of its time."¹³¹ The North Carolina legislature's recent actions may cause the North Carolina Business Corporation Act to be described as the most politically-motivated statute of its time.¹³² It would be in the interest of the citizens of North Carolina to restore our corporate law to the revered stature it formerly held. Let us hope that the courts do not find themselves on the same slippery slope as the legislature.

Delaware shareholder consent statute was partly responsible because it permitted immediate shareholder action, whereas shareholders of the victorious corporation would have had to call a special meeting, a process that takes weeks due to state law notice requirements and the federal proxy requirements. The SEC disclosure requirements did not slow the process since the controlling shareholder did not have to solicit other shareholders' consent. The Delaware statute thus worked to the advantage of the acquiring corporation. See Harry Anderson & Hope Lampert, *Bendix Bites the Dust*, NEWSWEEK, Oct. 4, 1982, at 67.

131. Folk, *supra* note 25, at 769. Professor Folk further explained that the 1955 North Carolina Corporation Act "was the forerunner of significant developments in corporation laws elsewhere in the United States." *Id.*

132. As pointed out earlier, this is due not only to the current amendments but also to a trend that was started a little more than ten years ago. See generally Hazen, *Race to the Bottom*, *supra* note 26 (lamenting the state's derogation of corporate responsibility); Hazen, *State Anti-Takeover Legislation*, *supra* note 10 (discussing changes in state anti-takeover legislation). These changes and others were incorporated into the 1990 Business Corporation Act, which adopted a variation of the Revised Model Business Corporation Act. See ROBINSON, *supra* note 4, § 1.02(b), at 1-6 to 1-7. As part of this legislation, the legislature adopted the Model Act formula and eliminated an express reference to fiduciary obligations in describing the duties of corporate directors. See Taylor, *supra* note 27, at 982-83. The North Carolina statute also permits a charter provision eliminating director liability for certain breaches of fiduciary duty. N.C. GEN. STAT. § 55-2-02(b)(3) (2001). It has been suggested, however, that there may be constitutional barriers to implementing such a provision. See Taylor, *supra* note 27, at 982-84.