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The New Illinois Business Corporation Act Needs More Work

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THE NEW ILLINOIS BUSINESS CORPORATION ACT NEEDS
MORE WORK

JAMES M. VAN VLIET, JR.*

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I. INTRODUCTION

The Illinois Business Corporation Act of 1983¹ (the "New BCA") became effective July 1, 1984, replacing The Business Corporation Act² (the "Old BCA").³ This represents the first comprehensive revision of the Illinois general business corporation statutory law since the Old BCA

1. ILL. REV. STAT. ch. 32, §§ 1.01-16.10 (Supp. 1984)[hereinafter cited as New BCA, §§ 1.01-16.10].

2. ILL. REV. STAT. ch. 32, §§ 157.1-157.166 (1983)[hereinafter cited as Old BCA, §§ 1-166].

3. The anomaly of a "1983" suffix to the name of an act that became effective in mid-1984 appears to be due to the expectation of a 1983 effective date when House Bill 2281, providing for the creation of the New BCA and the repeal of the Old BCA, was introduced in the Illinois General Assembly on April 20, 1983. The press of other matters delayed passage of the bill. *Business Act on Hold; Other Bills Win Passage*, CHI. B. A. COMMUNICATOR, Aug. 1983, at 8 [hereinafter cited as

became effective in 1933. Such action by a major commercial-industrial state is important not only for the large number of corporations that are subject to the Illinois law and their attorneys, but also for other states that may consider the Illinois law as a possible pattern for their general business corporation statutes.

Drafted by the Illinois Secretary of State's specially-appointed Advisory Committee to Revise the Illinois Business Corporation Act (the "Advisory Committee"), the New BCA changes an estimated 80% of the sections of the Old BCA.⁴ Given the extent of the changes, a definitive evaluation of the New BCA will require a long period of broad public exposure to its provisions. Even at this early stage, however, certain positive and negative aspects of the change-over to the New BCA are apparent, as is the need for more work on the New BCA.

II. SOME POSITIVE AND NEGATIVE ASPECTS OF THE NEW BCA

On the positive side, some substantive changes in the Old BCA that were needed—in many cases for a long time—have been made. Counted as examples of this are provisions (i) allowing refunds of fees and franchise taxes erroneously paid (New BCA section 1.17); (ii) increasing to 60 days (from 40) the maximum notice period for shareholders' meetings (New BCA section 7.15); (iii) eliminating the requirement in Old BCA section 37 for recording meetings of a board or committee attended by means of conference telephone (New BCA section 8.15(d)); (iv) allowing boards of directors to have any number of committees (New BCA section 8.40) instead of the Old BCA allowance of only an executive committee; (v) providing for "cash-out" mergers and otherwise broadening the types of consideration that may be exchanged for shares in a merger (New BCA section 11.05(c)); and (vi) more forcefully forbidding the application of Illinois law to the internal affairs of foreign corporations qualified in the state (New BCA section 13.10) in an effort to overcome case precedent to the contrary under the Old BCA.

Also on the positive side are a number of other changes which, while not properly labelled as "needed," are useful in that they make the New BCA more flexible than the Old BCA. Examples of such changes are provisions (i) permitting correction of errors in documents filed with the Illinois Secretary of State (New BCA section 1.15); (ii) eliminating the

Business Act on Hold]. The bill ultimately was passed by the General Assembly in November, 1983, and signed into law by the governor on January 4, 1984, to become effective on July 1, 1984.

4. Advisory Committee, *Overview of the Illinois Business Corporation Act of 1983*, 64 CHI. B. REC. 344, 346 (1983)[hereinafter cited as Advisory Committee, *Overview*].

requirement that there be at least one class or series of shares with voting rights on all matters (New BCA section 6.05); (iii) broadening the powers of boards of directors to determine the types and amounts of consideration that will be full payment for shares to be issued (New BCA sections 6.25 and 6.30); (iv) permitting uncertificated shares (New BCA section 6.35); (v) eliminating the unanimity requirement for action taken by shareholders by written consent (New BCA section 7.10); (vi) permitting classified boards of directors, although limited to boards of six or more members (New BCA section 8.10(e)); and (vii) creating a mandatory share exchange, with an approving vote by shareholders, as a method of corporate acquisition (New BCA section 11.10).

More questionable is the benefit that may result from the changes in format employed in the New BCA. To some extent the choice of format is always arbitrary because any format sacrifices some advantages to gain others.⁵ In this case, intertwining numerous substantive changes with extensive changes in format makes it more difficult to identify, and gain an accurate and complete understanding of, the substantive changes that have been made. The near-term consequence is to substantially increase the cost and other burdens of the transition to the new law.⁶

While cost and other burdens of transition may be a necessary part of any major change, the following are several negative aspects of the changeover to the New BCA that could have been avoided:

First, the July 1, 1984 effective date allowed too little lead time.

There was no pressing public need that made the New BCA an urgent matter.⁷ A January 1, 1985 effective date, for example, would have

5. One of the format changes is to combine in a single section or series of sections the treatment of particular topics for both domestic and foreign corporations instead of using separate but parallel sections for domestic and foreign corporations as was done in the Old BCA. For example, matters relating to corporate and assumed names for domestic and foreign corporations are dealt with on a combined basis in New BCA §§ 4.05 - 4.20, avoiding the redundancy of language required by the separate but parallel provisions used in the Old BCA. Lost, however, is a certain convenience of finding most of the provisions relating to foreign corporations in a segregated portion of the Old BCA, rather than scattered as is true of the New BCA.

6. The true cost of the changeover to the New BCA probably cannot be measured. However, if the cost of time spent by corporate personnel and the practicing bar to educate themselves about the New BCA averages only \$100 for each of the approximately 185,000 corporations that were subject to the Old BCA, that time component of the transition cost alone would total \$18,500,000.

7. The belief that an early effective date was needed may be derived from the claim that the New BCA "should enhance economic development in Illinois by making incorporation in Illinois and remaining an Illinois corporation more attractive." See Kjellenberg, *1983 Illinois Business Corporation Act Nears Completion*, 28 ILL. ST. B. A. CORP. & SEC. 1, 2 (Oct. 1982) [hereinafter cited as Kjellenberg, *Act Nears Completion*]; see also *Thompson Signs Corp. Bill at CBA Lunch*, CHI. B. A. COMMUNICATOR, Feb. 1984, at 7. However, it is more reasonable to expect that business considerations, rather than the choice of domiciliary law, will dictate the extent of economic development, *i.e.*, the location and retention of business in Illinois. Businesses desiring an Illinois location which do not prefer the Illinois corporate law have always had the choice of incorporating under another state's law, usually the General Corporation Law of the State of Delaware (DEL. CODE ANN. tit. 8,

allowed more time for a thorough advance education for those affected, thereby smoothing the transition. The longer period of general public exposure prior to the effective date also would have provided more time to verify that there are no serious deficiencies in the New BCA adversely affecting the some 185,000 corporations that mandatorily became subject to its provisions when it took effect.⁸

Second, certainty as to the meaning of the provisions of the New BCA is important to the public interest, and the need for improvement in that regard is obvious in various instances. To promote understanding of the new provisions and to minimize the need for judicial interpretation, as extensive a background commentary as is reasonably possible should be made publicly available. The Advisory Committee's February 1984 Official Comments on the New BCA⁹ (the "*Official Comments*") are helpful but not sufficiently detailed or thorough. Particularly needed is a comprehensive attribution of the sources from which the New BCA changes were derived. Depending upon their quality, the minutes of the meetings of the Advisory Committee might be published as an alternative to the preparation of a more extensive official commentary although it probably would be helpful to the public, in any event, to publish those minutes as an additional reference source.

Third, even though the Advisory Committee devoted substantial time to the preparation of the New BCA¹⁰ and "[t]he 175-member Corporation Law Committee [of The Chicago Bar Association] painstakingly examined and approved each revision,"¹¹ the blunt fact is that in splicing provisions taken from different sources into a comprehensive act, certain errors and peculiarities resulted that deserve further attention. An example of this, discussed subsequently herein, is the change in the corporate capital concept which has the incidental (and no doubt unintended) consequence of allowing at least some corporations to reduce their Illinois franchise tax obligations.¹²

§§ 101-398 (1983)) [hereinafter the "Delaware General Corporation Law"], and qualifying to do business in Illinois, at a relatively modest additional total cost. Further, those making a careful analysis of the factors affecting the choice will conclude that most businesses that would have chosen the Delaware General Corporation Law as the domiciliary law while the Old BCA was in effect still have compelling reasons to do so with the New BCA in effect.

8. A period of general public exposure was provided by the procedure for the comprehensive revision of the Model Business Corporation Act, tentatively entitled *1983 Revised Model Business Corporation Act*, undertaken by the Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association. A March 1983 Exposure Draft was published "for the sole purpose of study, criticism, and comment." MODEL BUSINESS CORP. ACT (Tent. Draft, March 1983)[hereinafter cited as *ABA Exposure Draft*]. The Committee on Corporate Laws committed to review all comments received before August 31, 1983, and, to the extent possible, all comments received thereafter, in preparing its final draft.

9. 2 ILL. BUSINESS CORP. ACT ANN. app. F (Supp. 1984)[hereinafter cited as *Official Comments*].

10. See Advisory Committee, *Overview*, *supra* note 4, at 344-46; Kjellenberg, *Act Nears Completion*, *supra* note 7, at 1.

11. *Business Act on Hold*, *supra* note 3, at 8.

12. Another example is the failure to properly interrelate New BCA §§ 8.65(a)(2) and 12.75. New BCA § 8.65(a)(2) provides that directors of a dissolved corporation may be held liable for failure "to take reasonable steps to cause the notice *required* by [New BCA] Section 12.75 . . . to be

Fourth, the New BCA contains some important public policy changes that deserved to be singled out for broad public exposure and comment before enactment. For example, New BCA section 8.60 concerning directors' conflicts of interest reverses, without explanation, a policy only recently adopted in the 1981 amendments to the Old BCA. This reversal, moreover, has possible adverse consequences for the indemnification by corporations of their directors under New BCA section 8.75.¹³

Fifth, assuming that the purpose of the New BCA is to modernize and streamline the Illinois general business corporation statutory law,¹⁴ the effort in that regard falls short in various instances. The New BCA does make a number of improvements suited to that purpose, but given the cost and other burdens of transition to the New BCA, it is disappointing that a more comprehensive modernization and streamlining has not been achieved.

III. SOME EXAMPLES WHERE MORE WORK IS NEEDED

The foregoing five points are illustrated in the analysis of the New BCA which follows. The primary purpose of the analysis is to point out examples where it is apparent that more work is needed.

A. GENERAL PROVISIONS

1. *Execution, Filing and Recording*

New BCA section 1.10 places in one section a uniform standard for most of the execution, filing and recording requirements for documents to be filed with the Illinois Secretary of State. Although this is a major

given to any known creditor of such corporation" (emphasis added). New BCA § 8.65(a)(2) in effect carries forward, with minor substantive changes, the provisions of Old BCA § 42.6. However, Old BCA § 42.6 related to Old BCA § 79(a) which required a corporation to notify its known creditors in the case of a voluntary dissolution. Unlike Old BCA § 79(a), New BCA § 12.75 *permits*, but does not *require*, any notice to be given to known creditors of a dissolved corporation. Does this render New BCA § 8.65(a)(2) meaningless? If not, in what situation does New BCA § 8.65(a)(2) apply?

13. See *infra* pp. 36-38 ("Director Conflicts of Interest").

14. While the New BCA reasonably should be analyzed in terms of its overall purpose, the task is made difficult by the published descriptions of that purpose. For example, one reason for the New BCA advanced by the Advisory Committee in its *Introduction to Illinois Business Corporation Act of 1983* which accompanies the copy of the New BCA published by the Secretary of State [hereinafter cited as *Advisory Committee's Introduction*] is that the Old BCA "has hindered economic development in Illinois." As already indicated, "economic development" is not a plausible purpose. See *supra* note 7. Another reason for the New BCA is described in the *Advisory Committee's Introduction* as follows:

The need to modernize the [Old BCA] is also the result of a number of significant developments during the past 50 years, such as substantial revisions of the Internal Revenue Code and the taxation of corporations, the development of a "federal corporate law," and recent developments by the Securities and Exchange Commission and the American Law Institute in the area of corporate governance.

However, few of the changes made by the New BCA relate to those developments. The most likely reason for the New BCA appears to be simply to make the Illinois statutory law more flexible and accommodating to the wide range of circumstances encountered in modern corporate practice.

change in format from the Old BCA, in which many of those requirements were separately stated in different sections for each of the documents to be filed, only minor substantive changes are made. On the substantive side, for example, is the change that requires only the original to be manually signed when documents are to be filed in duplicate or triplicate. The copies may be carbon or photo copies of the signed original, rather than having all copies manually signed as was required by the Old BCA.

Overall, New BCA section 1.10 falls short of the modernizing and streamlining objectives. The typical, outdated execution requirement in the Old BCA¹⁵ that a filed document be signed by the president or a vice-president and the secretary or an assistant secretary has been made the standard in the New BCA. New BCA section 1.10(b)(2)(i) does add an alternative for signatures “by such officers as may be duly authorized to exercise the duties, respectively, ordinarily exercised by the president or vice-president and by the secretary or assistant secretary.” The apparent purpose of this alternative is not to add flexibility but to correlate with New BCA section 8.50 which allows a corporation to have such officers, with such titles, as it may determine, instead of the Old BCA section 43 requirement that a corporation had to have at least certain specified officers, including a president and a secretary. Taken literally, New BCA section 1.10(b)(2)(i) will permit execution by a chairman or vice chairman of the board only if those officers are authorized to carry out the overall functions of a president, and not just the president’s duties of executing documents. This is far more restrictive than Delaware General Corporation Law section 103(a) (from which New BCA section 1.10(b) appears to be derived) which specifically authorizes, without any limitation, execution by a chairman or vice chairman.¹⁶

A more flexible and modern execution provision is contained in the American Bar Association’s March 1983 Exposure Draft of the *1983 Revised Model Business Corporation Act*¹⁷ (the “*ABA Exposure Draft*”),

15. See, e.g., Old BCA, §§ 12, 15, 55, 58, 58a, 59 & 60a.

16. The signature formula in New BCA § 1.10(b)(1) and (2) is basically a copy of Delaware General Corporation Law § 103(a)(1) and (2) except that the authority granted by the Delaware law for a chairman or vice chairman of the board to sign is eliminated in the New BCA version. Another variation from the Delaware Law occurs in clauses (iii) and (iv) of New BCA § 1.10(b)(2) which provide for execution of filed documents by shareholders. Clause (iii) tracks Delaware Law § 103(a)(2)(iii) precisely, allowing “holders of record, or such of them as may be designated by the holders of record of a majority of all outstanding shares” (emphasis added) to sign when there are no directors or officers. But clause (iv) of New BCA § 1.10(b)(2), addressing the case where there are directors or officers, varies from Delaware Law § 103(a)(2)(iv) by omitting the phrase “of record” so that it simply permits a document to be signed “[b]y the holders of all outstanding shares.” Was a different meaning intended in clause (iv) by failing to require that the holders be *of record*?

17. See *supra* note 8.

section 1.20(f), which permits execution by any officer, leaving it to the filing corporation to determine which officers are authorized to sign. The *ABA Exposure Draft* also eliminates, while the New BCA continues, the archaic requirement that two officers sign a filed document. In addition, the New BCA does not eliminate the requirement that copies of filed documents and certificates issued by the Secretary of State be recorded in the county where a corporation maintains its registered office. If any present-day need is served by such recording, isn't it time that an alternative be developed so that the burden and expense of recording can be eliminated?

2. *Correction of Errors*

Unlike the Old BCA, which had no such procedure, New BCA section 1.15 allows correction of errors in documents *filed under the New BCA* with the Secretary of State. Correction may be made at any time and will be effective retroactively to the date the document being corrected was filed. Of course, rights and liabilities arising from reliance on the error prior to the corrective filing cannot be extinguished by the correction (New BCA section 1.15(e)(3)).

Delaware for some time has had a procedure for correcting errors in filed documents.¹⁸ *ABA Exposure Draft* section 1.24, contains a similar provision. Both allow correction only of mechanical errors—factual misstatements and faulty execution.

New BCA section 1.15(a) allows the same corrections, but goes further by permitting correction of “any other error or defect.” Exactly what is intended by the added language in the New BCA is not clear. A detailed explanation by the Advisory Committee might have provided needed guidance, but no such explanation appears in the Advisory Committee's *Official Comments*. In the absence of such explanation, the literal meaning appears to be to permit retroactive amendments of documents to correct errors of judgment.¹⁹

A literal interpretation leads to some interesting possibilities. For example, can the election by a corporation in its articles of incorporation filed under the New BCA to have the Illinois franchise tax based on all,

18. See DEL. CODE ANN. tit. 8, § 103(f) (1983).

19. The argument that retroactive amendment is permitted is further supported by the provision in New BCA § 1.15(e)(1) that a statement of correction may not make “any change or *amendment* of articles” that could not have been lawfully made “at the time of filing the instrument being corrected” (emphasis added). An argument against retroactive amendment likely would be based on New BCA § 1.15(e)(2), which says that a statement of correction may not “[t]ake the place of any document . . . otherwise required to be filed.” It would have been helpful if the *Official Comments* had explained the meaning of New BCA § 1.15(e)(2) which is not fully apparent from its text.

or a certain portion, of its paid-in capital be retroactively changed to reduce the basis for such tax if subsequent events prove the initial judgment to have been unwise? If a corporation reports in its articles of incorporation filed under the New BCA that it will raise, say, \$100,000 of paid-in capital without further report and subsequently fails to raise that amount, can it file a statement of correction to retroactively reduce that figure, thereby establishing grounds for a refund of at least a part of its initial Illinois franchise tax payment? If such errors of judgment, determined from postfiling events, can be corrected under section 1.15, it is not clear what provision of the New BCA prevents retroactive organic changes from also being made under the section. For example, may a corporation which initially had authorized 10,000 shares and subsequently finds it could use 100,000, file under section 1.15 to make that change, rather than resort to the procedure for amending its articles of incorporation which requires shareholders' approval?

3. Refunds

In the case of illegal or erroneous assessments or overpayments of the Illinois license fee, franchise tax,²⁰ penalties or other charges, New BCA section 1.17 provides for correction of the assessments and refunds of the overpayments if a petition therefor is filed within a three year limitation period. There was no counterpart to this provision in the Old BCA.

Does the right to a refund apply to overpayments under the Old BCA as well as the New BCA? In the absence of guidance by the Advisory Committee as to what was intended, an argument can be made that refunds should be available in some instances for overpayments under the Old BCA if applied for within the three year limitation period. The refund right under New BCA section 1.17 is not expressly limited to overpayments made under the New BCA, while in contrast the right to correct an error in a filed document is limited by New BCA section 1.15(a) to documents filed under the New BCA. However, under New BCA section 1.17(a)(3), a refund due because of an error in a filed document is conditioned upon a statement of correction of that error being filed under New BCA section 1.15. Consequently, at most a refund of an overpayment under the Old BCA could be claimed only if it is not based on an error in a document filed under the Old BCA. Even then, the

20. New BCA § 1.17 refers simply to "tax" which is not a defined term and which literally would not be limited to the Illinois corporate franchise tax. However, because the only tax administered by the Illinois Secretary of State is the state's corporate franchise tax, the word "tax" in section 1.17 reasonably should be construed to mean only that tax.

argument against refund no doubt would claim an intent (not expressed in New BCA section 1.17) to bar such refunds because payments under the Old BCA were final and no refunds should be permitted when the law in effect at the time of overpayment did not permit refunds.

4. *Definitions*

Most of the changes in defined terms in New BCA section 1.80 were made to correlate with changes elsewhere in the Act. An example is the replacement of the definitions of "stated capital" and "paid-in surplus" in Old BCA sections 2.11 and 2.12 with a single definition of "paid-in capital" in New BCA section 1.80(j). This is tied to changes elsewhere in the New BCA section 1.80(j). This is tied to changes elsewhere in the New BCA which eliminate the par value concept and the restrictions that existed in the Old BCA on the use of stated capital and paid-in surplus for dividends and purchases by an issuer of its shares.²¹

However, one peculiarity arises from the continued use in New BCA section 1.80(a) of the Old BCA definition of "corporation" to refer only to a domestic corporation. Due no doubt to the format change in the New BCA which combines into a single section or series of sections the treatment of each topic common to both domestic and foreign corporations, the New BCA lapses in at least one instance (New BCA section 4.20 concerning change or cancellation of an assumed name) into the use of "corporation" as if the word means a foreign as well as a domestic corporation. The courts and those using the New BCA will have to interpret "corporation" to include a foreign corporation where the assigned definition would produce an apparently unintended result.

B. FORMATION OF CORPORATIONS

1. *Incorporators*

New BCA section 2.05 changes Old BCA section 46 only by reducing to 18 (from 21) the minimum age at which a natural person may act as an incorporator. Thus, the restrictive rule in Old BCA section 46 that only natural persons and corporations may act as incorporators is continued in New BCA section 2.05. This stands in contrast to the more flexible, modern provisions for incorporators in Delaware General Corporation Law section 101 ("[a]ny person, partnership, association or corporation") and in the *ABA Exposure Draft*, sections 1.40(9), 1.40(15) and 2.01 (any "individual" or "entity").

21. See *infra* pp. 38-42 ("Distributions").

2. *Organization of Corporation*

In contrast to Old BCA section 51, which provided only one set of steps for corporate action to complete the organization of a corporation after its incorporation, the New BCA provides three alternatives. Which New BCA alternative applies turns primarily on whether the initial directors are named in the articles of incorporation (as permitted by New BCA section 2.10(b)(1)) and, secondarily, on whether there are preorganization subscribers, as follows:

1. If the initial directors *are* named in the articles of incorporation, the board of directors attends to organizational matters, electing officers, adopting by-laws and taking other necessary action (New BCA section 2.20(c)). However, this alternative is compatible with a provision in the articles of incorporation reserving the by-law power exclusively to the shareholders (as permitted by New BCA section 2.25) only if there are preorganization subscribers. Because preorganization subscribers are deemed to be shareholders under New BCA section 6.20 (as was true under Old BCA section 16), they can adopt by-laws under such circumstances, saving the corporation from the problems of having no by-laws.²²

2. If the initial directors are *not* named in the articles of incorporation and if there *are* preorganization subscribers, the procedure is the same as under Old BCA section 51. In such event, the preorganization subscribers elect the initial directors and may (or must, if the by-law power is reserved exclusively to the shareholders in the articles of incorporation) adopt by-laws, after which the board of directors elects officers and takes the remaining action needed to complete the organization of the corporation (New BCA section 2.20(b)).

3. If the initial directors are *not* named in the articles of incorporation and if there are *no* preorganization subscribers, the incorporators elect the initial directors, who then take the remaining action needed to complete the organization of the corporation (New BCA section 2.20(a)). This alternative is not compatible with a reservation of the by-law power exclusively to the shareholders in the articles of incorporation.

Although the New BCA makes the alternatives for completing the organization of a corporation more like those under the Delaware General Corporation Law, the evolution falls short of being finished. The New BCA still lacks some of the Delaware Law's flexibility. As a minor nuisance, the New BCA has no provision comparable to Delaware General Corporation Law section 108(c) for incorporators to act by written consent in lieu of holding a meeting. Also, under Delaware General Corporation Law section 107, until the initial directors are named, the cor-

22. Without by-laws, for example, a corporation apparently could not have officers because under New BCA § 8.50 "[a] corporation shall have such officers as shall be provided in the by-laws."

poration nevertheless has a governing body because the incorporators may "manage the affairs of the corporation" in addition to doing "whatever is necessary and proper to perfect the organization of the corporation, including the adoption of the original by-laws . . . and the election of directors." Under the New BCA, the incorporators may do no more than elect the initial directors and then only if there are no preorganization subscribers. Finally, Delaware General Corporation Law section 109 avoids the need for preorganization subscribers that exists under the New BCA when the articles of incorporation reserve the by-law power exclusively to the shareholders. The by-law power is reserved to the shareholders under the Delaware Law, but that reservation is not operative until the corporation has received some payment for at least some of its stock; prior to that time the directors or incorporators have the power to adopt by-laws.

3. *By-Laws*

New BCA section 2.25 makes a major substantive change in the power to adopt and amend by-laws. Old BCA section 25 vested that power in the directors unless reserved to the shareholders in the articles of incorporation. Under New BCA section 2.25, the power is vested in the shareholders as well as the board of directors, unless reserved solely to the shareholders in the articles of incorporation. In other words, shareholders always have by-law power which cannot be denied, while the board of directors also will have by-law power if not denied that power by the articles of incorporation. Such sharing of the by-law power is similar to the result usually achieved under Delaware General Corporation Law section 109. However, New BCA section 2.25 goes further by specifying that if the by-laws so provide, by-law provisions adopted by the shareholders may not be amended or repealed by the board. Consequently, shareholders may reserve to themselves exclusive by-law power at any time, even when not so provided in the articles of incorporation.

Corporations concerned with defense against hostile takeover bids obviously will be concerned about the substantive change made by New BCA section 2.25, since it gives a bidder a powerful tool in a fight for corporate control. New BCA section 2.25, coupled with the changes made elsewhere in the New BCA allowing shareholders to act by majority written consent in the absence of a contrary provision in the articles of incorporation, is particularly severe for public corporations in existence prior to July 1, 1984. Such pre-existing corporations likely will not have a provision in their articles of incorporation restricting action by

shareholders by majority written consent because the Old BCA required unanimous written consent. Suddenly, by virtue of the New BCA becoming effective, by-laws of these corporations can be amended and the by-law power of their boards of directors can be eliminated, both by written consent of a majority shareholder. New BCA section 2.25 is an example of an important policy change (and, incidentally, a reduction rather than an increase in corporate flexibility), imposed on existing as well as new corporations, that deserved but did not receive broad public exposure and comment prior to its adoption.

C. CORPORATE POWERS

The Old BCA section 5 provisions are modified somewhat in New BCA section 3.10 to broaden and improve the statement of general corporate powers. For example, the power of a corporation under Old BCA section 5(d) to own and deal in property as “appropriate to enable it to accomplish any or all of its purposes” is broadened in New BCA section 3.10(d) by omission of the quoted limitation; the power to make loans to employees is expanded in New BCA section 3.10(f) by eliminating the Old BCA section 5(f) limitation that permitted such loans only to enable employees to acquire, own and improve homes; and the power of a corporation under Old BCA section 5(p) to indemnify its directors, officers, employees and agents by “appropriate provisions in the by-laws” is improved in New BCA section 3.10(p) by eliminating the “by-laws” limitation.

Although the statement of powers is improved, New BCA section 3.10 falls short of overall modernization. For example, the New BCA has no counterpart to the 1983 amendment to Delaware General Corporation Law section 122(13) which expressly empowers Delaware corporations to guarantee obligations of their parent corporations and of sibling corporations—an amendment which aids businesses conducted through a holding company-subsidiary form of organization. Another example of insufficient modernization is found in New BCA section 3.10(m). That section broadens the power “to lend money to the State or Federal government” and to transact “business in aid of the United States” by eliminating the limitation in Old BCA section 5(m) that allowed such power to be exercised only to support a war effort. However, New BCA section 3.10(m) still does not empower transaction of business in aid of any government other than the federal government. In contrast, Delaware General Corporation Law section 122(12) empowers any lawful business in aid of *any* “governmental authority,” as does *ABA Expo-*

sure *Draft* section 3.02(15) which simply provides for "any lawful business that will aid governmental policy."

D. CORPORATE AND ASSUMED NAMES

New BCA Article 4, which combines into one location the name provisions in the Old BCA for both domestic and foreign corporations, makes three substantive changes: (1) the standard for determining the availability of a corporate or assumed name is changed; (2) the assumed name provisions in the Old BCA are expanded to allow the use of more than one such name; and (3) provision is made for the reservation of a name, with an unlimited number of annual renewal rights, by a foreign corporation which has no existing plans to qualify in Illinois. Of the three changes, the first is a basic public policy change which eliminates some protection that had been provided by the Old BCA, the second change is one of questionable merit, and the third change is of minor importance and is not discussed below.

1. *Availability Of Names*

Under New BCA section 4.05(a)(3), a corporate or assumed name is available for use by a domestic or foreign corporation if it is "distinguishable upon the records" of the Illinois Secretary of State from other names on file. In contrast is the requirement in Old BCA sections 9(c), 9a, 104(a) and 104a that made a name unavailable if it was "the same as, or deceptively similar to," another name on file.

"Distinguishable upon the records" is the standard in both Delaware General Corporation Law section 102(a)(1) and the *ABA Exposure Draft* section 4.01(b). As explained in the official commentary on the *ABA Exposure Draft* section 4.01, the standard is intended to require only such difference in names as will allow the Secretary of State to distinguish among corporations for administrative purposes. This stands in contrast to the "deceptively similar" standard in the Old BCA, which was intended to serve the additional purpose of protecting against unfair competition and deception of the public.²³ Under the New BCA, issues as to unfair competition and deception are left to the statutory and common law dealing with such matters, such as the Uniform Deceptive Trade Practices Act.²⁴

The "distinguishable upon the records" standard clearly is the modern trend and should reduce the administrative burden on the Secretary

23. 1 ILL. BUS. CORP. ACT ANN. at 94-95 (3rd ed. 1975).

24. ILL. REV. STAT. ch. 121-½, ¶¶ 311-317 (1983).

of State's office. The offsetting disadvantage is that under the New BCA, corporations and counsel no longer will have the benefit which they had under the "deceptively similar" standard of the Secretary of State's pre-screening of names, and thus will have a greater burden of determining whether the use of a selected name may result in unfair competition or deception of the public. Because the screening for deceptive similarity needs to be done in all events, the choice as to the appropriate public policy concerning availability of names might better have been based upon a determination as to what method is most cost effective—central screening by the Secretary of State or individual screening by each corporation with whatever resources it has available.

2. *Assumed Names*

Of dubious merit is the revision in the New BCA of the assumed name provisions, which were first introduced into the Old BCA in 1980, to greatly expand the permitted corporate use of assumed names.

The most common corporate use of assumed names involves division and trade names. The use of such names has been legally permissible when coupled with disclosure of the true corporate name. Under New BCA section 4.15(b) (as was also true under Old BCA section 9(e)), that practice is expressly permitted to continue without compliance with the statutory assumed name provisions.

With the use of division and trade names accommodated, the need for corporate authority to use other assumed names relates to the limited situation in which a foreign corporation cannot gain admission to a state under its true name due to a conflict with a name already on file. *ABA Exposure Draft* section 15.06 confines its assumed name provisions to that limited situation. The New BCA (as did the Old BCA) permits admission of a foreign corporation under an assumed name in such circumstances, but goes further by allowing foreign corporations admitted, or seeking admission, to do business in Illinois to adopt assumed names even when their true names are available for use, and by also allowing Illinois corporations to adopt assumed names, in each case without requiring the use of the assumed names to be coupled with a disclosure of the true corporate name.

The difference between the New BCA and the Old BCA is essentially one of degree. New BCA section 4.15 permits a corporation to register more than one assumed name while Old BCA sections 9a and 104a permitted only one per corporation. Further, while an assumed

name had to have a corporate suffix under the Old BCA, such a suffix is not required under New BCA section 4.15(a).

The Advisory Committee's *Official Comments* offer no explanation of the reason for expanding the assumed name provisions in the New BCA. However, the Draft Comments submitted by the Illinois Secretary of State to the General Assembly (the "*Draft Comments*") indicate that the principal purpose is "to provide a central registration at the state level of divisional names or other assumed names of corporations" and that "[t]he public will benefit from such a registry" because "[b]usinesses and consumers will be able to quickly determine the true name of the party with whom they are dealing by calling or writing the Secretary of State." If such a practice develops, the fees charged for assumed name registration (\$20 filing fee plus \$150 for five years) will fall far short of covering the administrative costs. Furthermore, the reasoning is circuitous in that there would be no public need to inquire of a central registry if the New BCA did not authorize the general use by corporations of assumed names without disclosure of their true corporate names. Finally, such a purpose for the central registry would be valid only if the registry were made comprehensive so that it covered assumed names of all entities rather than just assumed names of corporations.

What purpose, then, is served by the expanded assumed name provisions? Except for foreign corporations needing to qualify under assumed names due to name conflict problems, there appears to be little, if any, need for the assumed name provisions. An assumed name filing cannot be used solely as a name-holding device because that is prevented by the New BCA section 4.15(c)(3) requirement of a declared intention to transact business under the assumed name. Although the New BCA makes a corporate suffix to an assumed name unnecessary, utilization of that provision likely will be deterred by the risk of losing corporate limited liability. To avoid that risk, an assumed name with no corporate suffix should be used only in conjunction with disclosure of the true corporate name, but in that case, by the terms of the New BCA, no assumed name filing is required.

Use of an assumed name with a corporate suffix for an active corporation will be constrained by the fact that corporations conducting business on a multi-state basis typically make a large investment in developing good will under a given name. Without comparable assumed name provisions throughout the United States—and the *ABA Exposure Draft* indicates that the trend may be in the opposite direction—a corporation engaged in a multi-state business is unlikely to invest in promoting an assumed name.

An assumed name with a corporate suffix might be useful for a local business, but such a business could accomplish the same end result, with less public confusion, by changing its true corporate name. An assumed name with a corporate suffix might be useful for a multi-state, as well as a local, business during a temporary transition period, such as following an acquisition. However, the use of a division name coupled with disclosure of the true corporate name, which requires no filing, or the use of a name-holding subsidiary are adequate alternatives.

E. SERVICE OF PROCESS ON NONADMITTED FOREIGN CORPORATIONS

In addition to various changes intended to make technical improvements in the Old BCA's registered office and register agent provisions, New BCA Article 5 adds an important new provision relating to service of process on foreign corporations. Specifically, New BCA section 5.30 appoints the Illinois Secretary of State as agent for service of process of any foreign corporation that transacts business in Illinois without having obtained a certificate of authority to do so. The Advisory Committee's *Official Comments* to New BCA section 5.30 explain the purpose of the section as follows:

It fills a gap in the present statutory scheme. The Advisory Committee believed that failure to comply with the provisions . . . on qualification to do business should not benefit a foreign corporation by making service upon it in Illinois difficult or impossible.

Section 5.30 presumably was written with the knowledge that the Illinois "long-arm" statute²⁵ already permits personal service on any defendant *outside* Illinois as to any cause of action arising from the "transaction of any business within" Illinois. Thus the statutory "gap" referred to in the *Official Comments* must be one or both of two possibilities. *First*, literally applied, New BCA section 5.30 expands the jurisdiction of courts in Illinois by providing for service of process on a foreign corporation as to a cause of action unrelated to the business done in Illinois, while under the "long-arm" statute that relationship must exist. *Second*, service of process may be more immediately achieved under New BCA section 5.30 by serving the Illinois Secretary of State, rather than by serving the defendant outside the state under the "long-arm" statute.

However, were either of these "gaps" really a problem that needed to be corrected? If so, should the changes have been made instead in the

25. ILL. REV. STAT. ch. 110, ¶ 2-209 (1983).

“long-arm” statute or at least cross-referenced in that statute since New BCA section 5.30 in effect expands the substance of that statute?

F. SHARES

New BCA Article 6 makes a number of changes pertaining to shares of Illinois corporations. The overall result is increased flexibility, although one of the changes—the elimination of the par value concept—decreases flexibility or at least makes flexibility more cumbersome to achieve. The elimination of the par value concept, being part of a larger change imposed without choice on pre-existing Illinois corporations that may have substantive importance for at least some of those corporations, is further discussed below, under “Distributions.”

Another change—the elimination in the New BCA of the Old BCA’s express prohibition against the use of future services as consideration for the issuance of shares—is less than it might seem at first blush, since the New BCA is actually intended to continue that prohibition. Under New BCA section 6.30, as was true under Old BCA section 18, the types of consideration for which shares may be issued are to be determined by the board of directors. However, the express prohibitions in Old BCA section 18 against paying for issued shares with promissory notes or promises of future services are dropped in New BCA section 6.30. While the deletion is intended to *end* the prohibition against using promissory notes to pay for issued shares that existed under the Old BCA, according to the *Official Comments* to New BCA section 6.30 the deletion is intended to *continue* the prohibition against accepting a promise of future services as a payment for shares. The continued ban against promises of future services is intended to derive from the retained statutory language that states that the “consideration for the issuance of shares may be paid . . . in labor or services *actually performed* for the corporation.”²⁶ For the uninitiated to read that language as a prohibition with respect to promises of future services, they must read “may be paid” as meaning “must only be paid.” To avoid a trap for the unwary, the better method of retaining the prohibition with respect to promises of future services would have been to express it in the statute as was done in the Old BCA.

G. SHAREHOLDERS

New BCA Article 7 contains provisions relating to shareholders’

26. New BCA, § 6.30 (emphasis added).

meetings, voting, rights to inspect corporate records and derivative actions. These provisions make numerous changes from the Old BCA which, overall, constitute an improvement, but repeatedly fall short of the current "state of the art" on the subjects covered.

1. Shareholders' Meetings

Old BCA section 26 required annual meetings of shareholders to be held "at such time as may be provided in the by-laws." New BCA section 7.05 adds, as an alternative, that the by-laws may permit the board of directors, by resolution, to fix the time for holding the annual meeting each year. This approaches, but does not fully achieve, the flexibility of Delaware General Corporation Law section 211(b) which requires an annual meeting to be held "on a date and at a time designated by or *in the manner provided in the by-laws.*"²⁷ The Delaware provisions allow someone other than the board to fix the date and time of the meeting. Similarly, *ABA Exposure Draft* section 7.01(a) simply requires an annual meeting to be held "at a time stated in or *fixed in accordance with the bylaws.*"²⁸

The Old BCA provided no remedy for failure to hold an annual meeting of shareholders. New BCA section 7.05 repairs this omission by allowing a shareholder who would be entitled to vote at the annual meeting to apply for a court order directing the holding of such meeting if it is not held within a prescribed time. Unfortunately, the draftsmanship leaves a great deal to be desired.

First, the provision borrows the time period formula (but not the text) used in *ABA Exposure Draft* section 7.03(a)(1) by allowing application to be made for a court-ordered meeting if the annual meeting is not held by the earlier of (i) six months after the end of the corporation's fiscal year or (ii) 15 months after the last annual meeting. Unlike the *ABA Exposure Draft*, New BCA section 7.05 also conditions the right to apply for the court order upon the corporation's failure to give notice of the annual meeting within 60 days after the shareholder's written request for such a notice to be given is directed to the corporation's president. It is unclear whether such a written request may be made before the period resulting from the "six months/15 months" formula has expired or may be made only after that period has expired, and the *Official Comments* provide no guidance.

Second, the provision is ineptly worded in that it provides that a

27. DEL. CODE ANN. tit. 8, § 211(b) (1983)(emphasis added).

28. *ABA Exposure Draft*, *supra* note 8, § 7.01(a)(emphasis added).

shareholder may apply for a court order directing that a meeting be held, but fails to state that a court has authority to grant the order. Section 7.05 goes on to state that “[t]he court may issue such *additional* orders as may be necessary or appropriate for the holding of the meeting.”²⁹ Thus, the court’s authority to order an annual meeting is implied, rather than expressly granted. In contrast, *ABA Exposure Draft* section 7.03(a) expressly grants authority for a court to “order a meeting to be held,” as does Delaware General Corporation Law section 211(c).

Third, New BCA section 7.05 says that “[t]he court may issue such additional orders as may be necessary or appropriate for the holding of the meeting”—a vague formula to be defined in future litigation. In contrast, both *ABA Exposure Draft* section 7.03(b) and Delaware General Corporation law section 211(c) supplement similar wording with a specification of the court’s authority to fix the time, place, record date and form of notice for the meeting, and an authorization of special quorum requirements for court-ordered meetings.³⁰ With no counterpart in New BCA section 7.05 for special quorum requirements, it seems unlikely that a court could issue an order overriding the general quorum requirements contained in New BCA section 7.60. Thus, a court-ordered meeting could not transact business if such general quorum requirements are not met.

2. *Informal Action By Shareholders*

Old BCA section 147 permitted shareholders, in lieu of voting at a meeting, to take action by unanimous written consent. New BCA section 7.10 adds an alternative, modeled on Delaware General Corporation Law section 228, which permits, in the absence of anything to the contrary in the articles of incorporation, action by written consent by shareholders having not less than the minimum number of votes that would be necessary to take the action at a meeting at which the holders of all shares entitled to vote are present. However, New BCA section 7.10 has a requirement, not found in its Delaware counterpart, that five days prior written notice of the proposed action must be given to all shareholders. Unfortunately, the notice requirement is inartfully drafted, leaving it un-

29. New BCA, § 7.05 (emphasis added).

30. *ABA Exposure Draft*, *supra* note 8, § 7.03(b), describes the court’s authority as follows: The court may fix the time and place of the meeting, specify a record date for determining shareholders entitled to notice of and to vote at the meeting, prescribe the form and content of the meeting notice, fix the quorum required for the meeting (or direct that the votes represented at the meeting constitute a quorum for the meeting), and enter other orders necessary to accomplish the purpose or purposes of the meeting.

Delaware’s provision is just as explicit. See DEL. CODE ANN. tit. 8, § 211(c) (1983).

clear whether the notice must precede the signing of the consent by five days or merely precede the effectiveness of the action taken by five days. The sentence structure favors the former interpretation which, in any event, is the interpretation that should be followed to avoid the risk of invalid action.

Obviously, the requirement for advance notice gives those opposed an opportunity to challenge the action before it is taken. But the advance notice requirement is in addition to the New BCA section 7.10(b) requirement, copied from Delaware General Corporation Law section 228(c), that notice of the action taken by written consent be promptly given to those who did not consent. While the consent procedure is intended to be an efficient method of taking shareholder action,³¹ the Illinois requirement of two notices—before and after action is taken—runs counter to any notion of efficiency.

3. *Waiver Of Notice*

New BCA section 7.20 copies the general waiver of notice provision from Old BCA section 145 and adds a provision, not found in the Old BCA, that attendance at a meeting constitutes a waiver of notice unless the person attending “objects to the holding of the meeting because proper notice was not given.”

As drafted, New BCA section 7.20 has two peculiarities. The first derives from the fact that Old BCA section 145 authorized written waivers of notice by directors as well as shareholders. Because Old BCA section 145 is copied verbatim into New BCA section 7.20, the wording (“person or persons entitled to such notice”) continues to be broad enough to cover written waivers of notice by directors as well as by shareholders. However, placing this language in Article 7, which by its title relates only to shareholders, suggests that section 7.20 should be construed to apply only to written waivers of notice by shareholders. Given the source of the text, the better (and literal) interpretation would apply New BCA section 7.20 to written waivers by directors as well as shareholders, despite its placement.³² Those using the New BCA simply

31. See *Official Comments*, *supra* note 9, § 7.10.

32. Other language in New BCA § 7.20, which deems attendance at a meeting to be a waiver of notice in the absence of an objection that proper notice was not given, also is broad enough to apply to directors as well as shareholders, even though placed in Article 7 which by its title relates only to shareholders. However, New BCA § 8.25 covers the same subject (waiver of notice by attendance) for directors only. Arguably, this indicates an intent to have all of New BCA § 7.20 apply only to shareholders, but that would leave the New BCA without a provision for written waivers of notice by directors.

will have to remember that written waivers of notice by directors are provided for in the shareholders' provisions in Article 7.

The second peculiarity of New BCA section 7.20 relates to the provision that attendance of a meeting constitutes waiver of notice unless the person at the meeting objects to the holding of the meeting on the grounds that proper notice was not given. The language used does not specify when such an objection must be raised at the meeting, leaving that question to be decided in future litigation. The better approach, avoiding the need for judicial interpretation, is to require the objection to be raised at the beginning of the meeting, as Delaware General Corporation Law section 229 and *ABA Exposure Draft* section 7.06(b) do.

4. *Record Dates*

New BCA section 7.25 makes three changes in Old BCA section 29 by (1) eliminating as outmoded provisions for closing the share transfer books as an alternative to fixing record dates; (2) making changes concerning record dates to correlate with changes in the minimum notice required under New BCA section 7.15 for certain shareholders' meetings³³; and (3) allowing the by-laws to "establish a mechanism for determining record dates" in lieu of having them established by the board of directors. These are appropriate improvements, but one needed improvement was not made. Old BCA section 29 statutorily fixed the record date, when none was otherwise fixed, only for payments of dividends and meetings of shareholders, leaving uncovered any other instance for which a record date is needed, such as the record date for action by written consent. That deficiency is not corrected in New BCA section 7.25. Delaware General Corporation Law section 213(b), in contrast, comprehensively fixes record dates which are not fixed by the board of directors.³⁴

5. *Voting Lists*

New BCA section 7.30 makes a seemingly purposeless technical change as well as an important policy change concerning the list of shareholders entitled to vote that must be made available by a corporation in connection with a meeting of its shareholders.

33. New BCA § 7.15 requires 20 days minimum notice of meetings at which a merger, consolidation, share exchange, dissolution, or sale, lease or exchange of assets is to be acted upon, whereas Old BCA § 27 required 20 days minimum notice only for a merger or consolidation. The record date provisions in New BCA § 7.25 require a record date at least 20 days prior to the meeting in each instance in which 20 days minimum notice is required under New BCA § 7.15.

34. The *ABA Exposure Draft*, *supra* note 8, also has a comprehensive record date scheme, although the applicable provisions are scattered in that Act, such as in sections 6.40(b), 7.02(b), 7.04(b), 7.05(d) and 7.07.

Under Old BCA section 32, the list had to be prepared and made available for inspection by shareholders at least 10 days prior to the meeting. Under New BCA section 7.30, the list must be *prepared* by the *earlier* of (i) 20 days after the record date for the meeting or (ii) 10 days prior to the meeting. The change in this requirement seems to have no purpose because the list still need not be made available for inspection under New BCA section 7.30 until 10 days prior to the meeting.³⁵

The important policy change made in New BCA section 7.30 is that shareholders are expressly permitted to copy the list of shareholders without any showing of proper purpose as would be required if a copy were requested under New BCA section 7.75(b), pertaining to shareholders' rights to inspect corporate records. Publicly-held corporations likely will find objectionable the right to copy the list of shareholders without a showing of proper purpose. The Advisory Committee's *Official Comments* offer no justification for this exception to the New BCA section 7.75(b) safeguards.

6. *Voting Of Shares*

New BCA section 7.40 basically carries forward the Old BCA section 28 requirement that, unless otherwise provided in the articles of incorporation, each outstanding share of a corporation is entitled to one vote on each matter submitted to shareholders and has cumulative voting rights in elections of directors. The 1981 amendments to Old BCA section 28 allowed a corporation incorporated prior to January 1, 1982 to amend its articles of incorporation to eliminate voting rights for any class or series of shares, or to eliminate cumulative voting in the election of directors, but only if the amendment was unanimously approved by the shareholders. New BCA section 7.40(c) dispenses with the unanimous approval requirement. Consequently, such amendments for pre-1982 corporations require only the vote needed for other charter amendments. However, any limitation or elimination of cumulative voting rights by such corporations apparently gives rise to dissenters' rights under New

35. Peculiarly, the penalty for failure to prepare the list, or to make it available, as required by law, was copied from Old BCA § 32 into New BCA § 7.30, without adjustment for the difference between the New BCA and the Old BCA, even though under the Old BCA the deadlines for preparing the list and making it available fell on the same day, which is not always true under the New BCA. Thus, failure to prepare the list within 20 days after the record date as required by the New BCA (if the twentieth day is more than 10 days prior to the meeting) makes the responsible officer liable for damages suffered by the complaining shareholder. Given that the list need not be made available for inspection until 10 days prior to the meeting, what damages would a shareholder suffer from the officer's failure to prepare the list by an earlier date?

BCA section 11.65(a)(3)(iii).³⁶

The provisions of New BCA section 7.40(c) may in fact be overridden in part by the decision in *Roanoke Agency, Inc. v. Edgar*.³⁷ The Illinois Constitution of 1870 in effect required cumulative voting rights for all shares of an Illinois corporation. A similar requirement was not included in the Illinois Constitution of 1970, which became effective on July 1, 1971, but Section 8 of the Transition Schedule therein provides that “[s]hareholders of all corporations heretofore organized under any law of this State which requires cumulative voting . . . shall retain their right to vote cumulatively.” Despite the constitutional change which became effective in 1971, cumulative voting rights for all shares continued to be statutorily required until the change made by the 1981 amendments to the Old BCA discussed above. *Roanoke Agency, Inc.* had been incorporated in 1963 while the Illinois Constitution of 1870 was in effect. Proceeding under the 1981 amendments to the Old BCA, the corporation, with the unanimous approval of its shareholders, sought to amend its articles of incorporation to provide for the issuance of a class of non-voting shares. The Illinois Supreme Court upheld its right to do so, holding, on constitutional grounds, that a corporation in existence prior to July 1, 1971 may authorize nonvoting shares (*i.e.*, eliminate cumulative voting), provided that the unanimous approval of its existing shareholders is obtained. Although the Illinois Supreme Court expressly refused to say that its decision would be the same under the provisions in New BCA section 7.40(c),³⁸ until a different interpretation is indicated to be appropriate by the Illinois courts, it seems prudent to view section 7.40(c) as if the *Roanoke* decision applies. That view would mean that a pre-July 1, 1971 corporation may eliminate cumulative voting rights only by the unanimous approval of its shareholders, and until that is done, it cannot eliminate or limit voting rights in the election of directors for any class or series of shares without the same unanimous vote.

7. *Voting Of Shares By Certain Persons*

New BCA section 7.45 combines into one section certain provisions from Old BCA sections 28 and 30. These provisions permit a corporation to vote those of its own shares which it holds in a fiduciary capacity

36. New BCA § 11.65(a) does not expressly provide for dissenters' rights if a pre-1982 corporation simply eliminates the voting rights of a particular class or series of shares. However, any such amendment that prevents a class or series from voting in an election of directors in effect eliminates cumulative voting rights as well, so that dissenters' rights should apply to such an amendment.

37. 101 Ill. 2d 315, 461 N.E.2d 1365 (1984).

38. *Id.* at 328, 461 N.E.2d at 1371-72.

and also specify who may vote pledged shares, shares controlled by a receiver and shares registered in the name of another corporation, a deceased person, a minor ward or a person under legal disability.

As written, New BCA section 7.45 is disappointing. Desirable improvements were not attempted. Instead, what the *Official Comments* call “stylistic changes” were made in the Old BCA provisions. Notwithstanding that disclaimer, in one instance—pertaining to voting of shares held by another corporation—substantive changes were in fact made, but unfortunately their effect is only to add needless complications.

Under Old BCA section 30, a corporate shareholder had to show who had the authority to vote the shares which it owned, by means of an appropriate provision in the corporate shareholder’s by-laws or a resolution of the corporate shareholder’s board. New BCA section 7.45, with far more complicated language, comes to the same result.

New BCA section 7.45 then adds a feature not found in Old BCA section 30, namely, that the person or office entitled to vote the shares of a corporate shareholder must be “registered” on the share transfer books and “included in” the list of shareholders that must be made available under New BCA section 7.30 for any meeting of shareholders. Particularly for large, publicly-held corporations, this requirement likely will be a burden, without any apparent benefit. Remember that under New BCA section 7.30, the list of shareholders must be prepared within 20 days after the record date. The demonstration of authority to vote shares held by a corporate shareholder of a publicly-owned corporation ordinarily will accompany its proxy sent *after* the list of shareholders is required to be prepared under New BCA section 7.30. Must that list be revised when such evidence of authority is received? If not, what value (purpose) can there be in having outdated (last year’s) information in the list?

New BCA section 7.45 also fails to make an improvement that experience shows is needed, namely, a provision as to how to treat a vote cast by only one of two or more persons who share the power to vote, such as shares held by joint tenants or co-trustees. Both Delaware General Corporation Law section 217(b) and *ABA Exposure Draft* section 7.24(b)(5) provide for that situation, but New BCA section 7.45 does not.

8. Proxies

Old BCA section 28 permitted voting by proxy, but provided that no proxy would be valid after 11 months from the date of its execution unless otherwise specified in the proxy. New BCA section 7.50 continues

the substance of Old BCA section 28 and adds provisions governing revocation of proxies as well as extensive provisions for irrevocable proxies.

New BCA section 7.50(b), for which there was no counterpart in the Old BCA, prescribes how a proxy may be revoked. One provision that may prove controversial states that the dates on contradictory proxies "presumptively determine the order of execution, regardless of the postmark dates on the envelopes in which they are mailed." Resort to postmarks is a typical method of choosing between contradictory proxies of the same date from the same shareholder. Does the presumption established by section 7.50(b) bar that practice? The presumption may also generate other problems. For example, it seems to encourage, in a contested situation, the solicitation of postdated proxies or undated proxies to be dated at the last minute by the proxy holder. Also, the text of New BCA section 7.50(b) seems to say that a proxy is presumed valid even if dated after the date of the postmark on the envelope in which it is mailed, although the presumption as thus applied obviously is unjustified.

New BCA section 7.50(c)-(g) contain extensive provisions governing irrevocable proxies and other proxy questions. These provisions are taken from New York Business Corporation Law section 609 and *ABA Exposure Draft* section 7.22. Unfortunately, the New BCA paraphrases its sources inartfully. For example, in New BCA section 7.50(e) the situation in which "the creditor's debt is paid" is listed as an instance in which an irrevocable proxy becomes revocable, when in fact it is not the debt of the creditor that is involved. The correct description of the situation should be "when the debt owed the creditor is paid."

9. *Proxy Solicitation*

New BCA section 7.55, for which there was no counterpart in the Old BCA, prohibits the solicitation of a proxy:

by means of any communication containing a statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order that the statements made not be false and misleading.

This disclosure standard is taken from Rule 14a-9,³⁹ promulgated by the

39. 17 C.F.R. § 240.14a-9 (1984). New BCA § 7.55 borrows only part of the disclosure formula in SEC Rule 14a-9. Omitted is the part which forbids the omission from a communication of any material fact "necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934.

The Advisory Committee clearly did not view section 7.55 as a significant change, stating in the *Official Comments* that it "is probably declarative of existing case law." Notwithstanding that comment, New BCA section 7.55 establishes, rather than codifies, the Illinois disclosure standards for proxy solicitations. The incorrect assumption that existing case law was being codified may also explain why section 7.55 was so written as to leave open some important questions as to its application.

It long has been uncertain whether the federal disclosure standard is the same as or stricter than the state common law disclosure requirement and, if there is a difference, whether the difference has any practical significance.⁴⁰ To resolve those issues, there have been suggestions that the states should apply the federal standard.⁴¹ This has been done in some instances. The federal standard was applied, for example, in *Brown v. Ward*,⁴² in which the Alaska Supreme Court simply assumed that there was no substantive difference between the state common law rule and SEC Rule 14a-9. However, the dissenting opinion in that case, after a review of the authorities, concluded that the common law requirement was "a compromise position between the federal standard and the common law tort of misrepresentation."⁴³

New BCA section 7.55 moots the question as to what the Illinois common law standard is by statutorily adopting the federal standard. Presumably, this adoption brings with it the extensive, complex and still evolving interpretations of SEC Rule 14a-9.

In the federal scheme of regulation, SEC Rule 14a-9 is coupled with SEC Rule 14a-3⁴⁴ which requires a proxy statement containing specified information to be used for proxy solicitations. In the New BCA, the disclosure standard in section 7.55 is *not* coupled with a requirement similar to SEC Rule 14a-3. Nevertheless, both SEC Rule 14a-9 and New BCA section 7.55 key on some disclosure being made that is false or misleading. Inasmuch as the New BCA does not require any disclosure, may New BCA section 7.55 be avoided by making no disclosure? Will a simple request for a proxy, without any express disclosure relating to the matters to be voted upon, be construed as an implied disclosure recom-

40. See 2 L. Loss, *SECURITIES REGULATION* 917 (2d ed. 1961).

41. See Comment, *Standards of Disclosure in Proxy Solicitation of Unlisted Securities*, 1960 DUKE L.J. 623, 636; Loss, *The SEC Proxy Rules and State Law*, 73 HARV. L. REV. 1249, 1264 (1960).

42. 593 P.2d 247 (Alaska 1979).

43. *Id.* at 255.

44. 17 C.F.R. § 240.14a-3 (1984).

mending that a proxy be given, so that an omission of disclosures weighing against the giving of the proxy will violate New BCA section 7.55? The same question would exist even if New BCA section 7.55 had not been adopted, but when the state legislates the disclosure standard, one objective, not achieved in this instance, should be to provide more certainty as to the application of the rule than would be possible if the rule were left to be developed by court decisions.

A second question left unanswered by New BCA section 7.55 and the *Official Comments* is whether the requirements of section 7.55 also apply to the solicitation of a written shareholder's consent. SEC Rule 14a-1(d)⁴⁵ defines "proxy" to include such a consent. The New BCA does not contain a similar definition. There is no policy reason why the solicitation of a consent should be treated differently than a solicitation of a proxy. Consequently, it seems likely that the courts will correct the draftsmen's omission by allowing New BCA section 7.55 to be applied to a solicitation of a written shareholder's consent, either by construing "proxy" to have the same meaning as it does in SEC Rule 14a-9 or by construing section 7.55 as a declaration of public policy to be applied as a matter of common law to solicitations of such consents.

10. *Shareholders' Quorum And Voting*

New BCA section 7.60 defines what constitutes a quorum and the vote required for shareholders' action when a different requirement is not specified in the articles of incorporation. The section in effect changes Old BCA section 31 to provide for instances in which a corporation has nonvoting shares—a correction that should have been made when the 1981 amendments to the Old BCA first authorized nonvoting shares.

Unfortunately, New BCA section 7.60 inadequately accommodates a corporation that has shares with more or less than one full vote per share. Although section 7.60 allows the articles of incorporation to define the voting power that must be present to constitute a quorum and the vote needed to take shareholders' action, a quorum requirement thus fixed may not be "less than one-third of the outstanding *shares* entitled so to vote" and the vote required to take action may not be less than "the affirmative vote of the majority of the *shares* represented at the meeting and entitled to vote on a matter."⁴⁶ An adequate accommodation would have added to section 7.60 (or possibly to section 7.40) a counterpart to Delaware General Corporation Law section 212(a), which automatically

45. 17 C.F.R. § 240.14a-1(d) (1984).

46. New BCA, § 7.60 (emphasis added).

converts into “votes” statutory voting requirements expressed in terms of “shares” when a corporation has voting shares with more or less than one full vote per share.

Without a provision similar to the one in Delaware General Corporation Law section 212(a), shares given more or less than one full vote per share by the articles of incorporation will nevertheless have only one vote per share for various other purposes under the New BCA. For example, an amendment to the articles of incorporation is adopted under New BCA section 10.20(c) “upon receiving the affirmative vote of the holders of at least two-thirds of the outstanding *shares* entitled to vote on such amendment.”⁴⁷ For a corporation with, say, two classes of voting shares—Class A with one vote per share and Class B with five votes per share—voting without class distinction on an amendment, Class B shares will be treated by New BCA section 10.20(c) as if they have only one vote per share. Attempts to cure the problem by appropriate provisions in the articles of incorporation will be limited by New BCA section 10.20(d) which forbids a voting requirement of “less than a majority of the outstanding *shares* entitled to vote.”⁴⁸ The New BCA’s one vote per share requirement also applies to voting on other transactions, such as share exchanges, mergers and consolidations (New BCA section 11.20), dissolutions (New BCA section 12.15(c)), and dispositions of all or substantially all assets not in the usual course of business (New BCA section 11.60(c)).

11. *Voting Trust and Voting Agreements*

New BCA section 7.65 carries forward, with minor rephrasing, the voting trust provisions in Old BCA section 30a. However, the New BCA goes on to add section 7.70, for which there was no counterpart in the Old BCA. New BCA section 7.70 validates agreements made by shareholders for the voting of their shares, with express provision that such agreements are *not* subject to the voting trust provisions in New BCA section 7.65.⁴⁹ While New BCA section 7.70 attempts to resolve some uncertainties in the Illinois law about shareholders’ agreements, it also, in some respects, contradicts the public policy expressed for voting trusts in New BCA section 7.65.

The decision in *Galler v. Galler*⁵⁰ is generally considered to have left

47. *Id.* at § 10.20(c) (emphasis added).

48. *Id.* (emphasis added).

49. The *Draft Comments* indicate that New BCA § 7.70 “is modeled after similar provisions in other states, such as Delaware.” It is also similar to *ABA Exposure Draft* § 7.31.

50. 32 Ill. 2d 16, 203 N.E.2d 577 (1964).

uncertainty as to the validity of shareholders' agreements under Illinois law when less than all shareholders are parties to the agreement or when other interests are affected, such as the rights of creditors. In 1977, Illinois adopted The Close Corporation Act⁵¹ which authorizes shareholders' agreements for the conduct of the affairs of corporations qualifying as close corporations under that Act.⁵² That statutory provision is consistent with *Galler* in that the statutorily-authorized agreement must be between *all* shareholders of the close corporation and the statutory grant of validity applies only "as between the parties" to the agreement, without purporting to deal with the question of validity when third-party rights are involved.

In contrast, New BCA section 7.70 seeks to overcome rather than conform to *Galler*, insofar as shareholders' voting agreements are concerned. The objective, according to the Advisory Committee's *Official Comments*, is as follows:

Section 7.70 seeks to remove any doubt of the validity and specific enforceability of shareholder agreements by providing that such agreements "for the voting of shares" may be made without apparent statutory reservations, limitations, or restrictions, and without electing statutory close corporation status.⁵³

That should assure the enforcement of voting agreements, even when made by less than all of the shareholders. However, New BCA section 7.70 is limited to voting agreement; agreements covering other matters remain subject to *Galler*.

The validation of shareholders' voting agreements in New BCA section 7.70 in some respects is contradictory of the voting trust provisions in New BCA section 7.65. The voting trust provisions require that such voting arrangements not be secret (*i.e.*, the trust agreement must be in writing and filed with the corporation, where it must be made available for inspection by shareholders and voting trust beneficiaries), and the duration of a voting trust must be limited to 10 years. In contrast, under New BCA section 7.70 a voting agreement dealing with the same subject—shareholder voting—may be secret and of unlimited duration. Also, New BCA section 7.50(c)(5) permits an irrevocable proxy to be given to a party to a section 7.70 voting agreement, thereby providing a mechanism for accomplishing the same result as a voting trust, free of the requirements applicable to voting trusts under New BCA section

51. ILL. REV. STAT. ch. 32, §§ 1201-1216 (1983).

52. *Id.* at § 1211.

53. See *Official Comments*, *supra* note 9, § 7.70.

7.65. The *Official Comments* offer no explanation for this contradictory result.

12. *Rights Of Shareholders To Examine Corporate Records*

New BCA section 7.75 makes several modifications in the provisions of Old BCA section 45 concerning shareholders' rights to examine and copy records of a corporation. According to the Secretary of State's *Draft Comments*, several of the changes are intended to make the provisions parallel those in Delaware General Corporation Law section 220. The need for improvement or further explanation for certain of the changes is illustrated by the following examples.

1. The right granted by Old BCA section 45 to holders of voting trust certificates to examine and copy corporate records has been eliminated. As changed, holders of voting trust certificates have the right under New BCA section 7.65 to examine the voting trust agreement on file with the corporation, but not the other records of the corporation. Neither the *Official Comments* nor the *Draft Comments* offer a reason for this change.

2. New BCA section 7.75(b) conditions the right to examine and copy records upon a prior written demand having been made. The Old BCA did not specify the manner of making the demand so that an oral demand sufficed.⁵⁴ The requirement of a written demand is one of the changes made to conform to Delaware General Corporation Law section 220, but the Advisory Committee omitted the related Delaware Law provision that in effect requires the demand to be made at least five business days prior to the desired examination date.⁵⁵ Under New BCA section 7.75, as written, inspection and copying must be allowed immediately upon presentation of a proper demand even though corporations obviously will need time to have their attorneys determine whether the statement of purpose required to be in the demand is in fact a legally "proper" purpose. The Delaware approach is preferable because it fixes the time within which the corporation must make a decision with respect to a demand. In contrast, the New BCA, by fixing no time limit, invites controversy and litigation.

3. New BCA section 7.75(c) codifies the shareholders' right to obtain a court order compelling examination of corporate records when a corporation refuses to honor a proper demand. Subsection (c) also reverses the burden of proof that existed under Old BCA section 45 by assigning to the corporation the burden of proving improper purpose when the shareholder seeks "to examine minutes or the record of shareholders or a voting trust agreement." According to the *Draft Comments*, this is another change conforming to Delaware General Corporation Law section 220, but that is not completely accurate be-

54. See *Hohman v. Illinois-Iowa Power Co.*, 305 Ill. App. 17, 26 N.E.2d 420 (1940).

55. The *ABA Exposure Draft*, *supra* note 8, § 16.02(a) also requires that the demand be made at least five business days in advance.

cause the Delaware Law assigns the burden of proof to the corporation only for demands to examine the stock ledger or list of shareholders.

4. Under Old BCA section 45, an officer or agent of a corporation who refused to honor a shareholder's request to examine the corporation's books and records for a proper purpose was liable to the shareholder in the amount of a statutorily prescribed penalty. However, it was a defense to an action to recover that penalty if the shareholder had within two years "improperly used" information secured by a prior examination of any corporation's books and records. According to the *Draft Comments*, the Advisory Committee thought this defense to be "vague" and thus eliminated it. Consequently, the defense to the penalty authorized by New BCA section 7.75(d) is narrowed to the case in which the shareholder, within the previous two years, has "sold or offered for sale any list of shareholders of . . . any . . . corporation or has aided or abetted any person in procuring any list of shareholders for any such purpose." This tinkering with the penalty provisions, increasing the pressure on corporations to honor demands by constricting the defenses to the penalty, does not properly balance the conflicting interests involved. A shareholder needs to have his or her inspection allowed, free of the cost of litigation to enforce a proper demand. A corporation may need to refuse a request and place the matter in litigation simply to obtain court supervision of the proper use of information obtained by the examination, especially if the shareholder has improperly used information from a prior examination (and an improper use obviously would not be limited to a sale of a list of shareholders). A better balancing would be achieved by deleting the penalty provisions altogether, substituting a more equitable provision, such as *ABA Exposure Draft* section 16.04(c) which simply allows a court to award the shareholder the costs (including attorneys' fees) which he or she has incurred if it is found that the corporation has improperly opposed a proper request.

13. *Derivative Actions By Shareholders*

New BCA section 7.80 makes a number of changes in Old BCA section 45a, borrowing from several sources in an effort to modernize the provisions relating to derivative actions. However, without any mention in the *Official Comments* to indicate that a substantive change was intended, New BCA section 7.80 makes editorial changes in the language of Old BCA section 45a which eliminate a holder of voting trust certificates as a party eligible to bring derivative actions, with one possible exception. That exception applies only if the holder of the voting trust certificates acquired them by operation of law from a person who held the voting trust certificates at the time of the complained-of transaction.

The possibility of the bizarre result that the heirs can bring a derivative action even though the decedent could not have done so had he or she lived (because only those who acquire voting trust certificates by op-

eration of law can be eligible to sue) appears to be the consequence of careless editing. Old BCA section 45a required the plaintiff to be either a "holder of shares or of voting trust certificates therefor at the time of the transaction of which he complains," but made an exception to the "holder . . . at the time" requirement if the "shares or voting trust certificates thereafter devolved upon [plaintiff] by operation of law from a person who was a holder at such time." New BCA section 7.80(a) eliminates the first reference to voting trust certificates but erroneously retains the second reference. This is one of the several drafting errors that blemish the New BCA. While unlikely to be of material consequence, it does indicate that more time and care were needed before considering the New BCA a finished work.

H. DIRECTORS AND OFFICERS

1. Directors

New BCA Article 8 adds considerable flexibility not found in the Old BCA provisions pertaining to directors. Old BCA section 34 fixed three as the minimum number of directors for a corporation except when there were less than three shareholders, in which case the minimum could not be less than the number of shareholders. Further, under Old BCA section 34 all directors had to be elected annually. In contrast, New BCA section 8.10(a) fixes the minimum number of directors at one, regardless of the number of shareholders. New BCA section 8.10(b) allows the by-laws to prescribe a minimum and maximum number of directors (the latter not to exceed the former by more than five), leaving it to the directors or shareholders to change the number of directors within that range without having to amend the by-laws. Under New BCA section 8.10(c), annual election of all directors continues to be required unless the corporation has a classified board. If the number of directors is six or more, New BCA section 8.10(e) permits them to be divided into not more than three classes to serve for staggered terms.⁵⁶

56. *Roanoke Agency, Inc. v. Edgar*, 101 Ill. 2d 315, 461 N.E.2d 1365 (1984), may require an exception to the classified board provisions in New BCA § 8.10(e) for corporations in existence prior to July 1, 1971 (when the Illinois Constitution of 1970 became effective). *Roanoke* indicates that a corporation incorporated when the cumulative voting requirement in the prior Constitution was in effect can eliminate cumulative voting only by a unanimous shareholders' vote. The *Roanoke* case arose under the Old BCA and the court refused to say whether its decision applies to the New BCA which permits elimination of cumulative voting without unanimous shareholders' approval but with dissenters' rights available to those who oppose the change. If *Roanoke* does apply to the New BCA provisions, pre-July 1, 1971 corporations that have not eliminated cumulative voting by unanimous vote should still be subject to all of the related consequences of the former constitutional requirement for cumulative voting, including the rule in *Wolfson v. Avery*, 6 Ill. 2d 78, 126 N.E.2d 701 (1955) that classified boards violate such cumulative voting requirement.

Old BCA section 37 allowed directors to attend meetings by conference telephone or other equipment allowing all participants to hear each other, but only if a recording was made of the meeting with the consent of a majority of the members of the board (or committee of the board, in the case of a committee meeting). New BCA section 8.15(d) continues to allow such means of attendance but dispenses with the consent and recording requirements.

Under Old BCA section 36, as amended in 1979, the articles of incorporation could authorize the directors to fill vacancies on the board, but vacancies so filled could not exceed one-third of the total board membership. New BCA section 8.30 makes the board's power to fill vacancies more flexible by allowing the board to fill any number of vacancies if the by-laws do not prescribe a different method of filling vacancies.⁵⁷ The one remaining limitation is that those appointed by the board to fill a vacancy in a classified board of directors may serve only until the next meeting of shareholders at which directors are elected whereas if the vacancy is filled by the shareholders, the person may serve for the balance of the term for which he or she is elected. The New BCA vacancy provision is a considerable improvement upon its old BCA counterpart. However, it falls short of the flexibility provided by Delaware General Corporation Law section 223 which allows the remaining directors, *even if less than a quorum*, to fill vacancies. New BCA section 8.30 has no exception to the New BCA section 8.15 quorum requirements in the case in which a board exercises its vacancy filling power.

2. *Removal of Directors*

New BCA section 8.35 reflects a basic public policy change, granting statutory authority for the removal of directors, with or *without* cause, by shareholder action. There was no counterpart to this in the Old BCA so that, prior to the New BCA, only the common law right to remove a director for cause existed.⁵⁸

Removal of directors without cause allows instant change of corpo-

57. A consequence of the *Roanoke* decision, if applicable to the New BCA, may be that a board cannot fill vacancies for a pre-July 1, 1971 corporation until the corporation has eliminated cumulative voting by a unanimous vote of its shareholders. See 1 ILL. BUS. CORP. ACT ANN. 260 (3rd ed. 1975). See also *People ex rel. Weber v. Cohn*, 339 Ill. 121, 171 N.E. 159 (1930), ruling that the power of directors to fill vacancies was inconsistent with the state's Constitution in effect at that time which required cumulative voting in the election of directors and forbade election of directors other than by the shareholders.

58. The general common law rule is that removal for cause is an inherent power of a corporation. 2 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 351 (rev. perm. ed. 1982). One Illinois case has language suggesting that, under the Illinois common law, a director could never be removed during his or her term of office. *Laughlin v. Geer*, 121 Ill. App. 534 (1905).

rate management when a party or group achieves voting control.⁵⁹ As such, the provision works against corporate management concerned with defenses against hostile takeovers. It is not that a statutory “instant change in control” provision of this kind is uncommon. To the contrary, Delaware General Corporation Law section 141(k) authorizes shareholders’ removal of directors without cause, as does *ABA Exposure Draft* section 8.08. The Illinois provision, however, does not permit any avoidance of removal without cause. In contrast, under the Delaware Law, removal without cause may be avoided by corporations having a classified board of directors and under *ABA Exposure Draft* section 8.08 removal without cause may be barred by a charter provision. No such choice is allowed under New BCA section 8.35. The Advisory Committee’s *Official Comments* on that section specify that “[a] charter or by-law provision denying the right of shareholders to remove a director, . . . without cause, is intended to be invalid and against public policy.” To eliminate choice as a matter of public policy counts as a negative in the list of considerations that enter into the process of selecting a domiciliary law for a corporation.

3. Committees

New BCA section 8.40 makes a long-needed improvement by allowing a board of directors to have any number of committees. Old BCA section 38 authorized only a single committee—an executive committee—of the board.

However, the limitations on a committee’s authority are more restrictive than under either Old BCA section 38 or Delaware General Corporation Law section 141(c). Those limitations, found in New BCA section 8.40(c), appear to be patterned on *ABA Exposure Draft* section 8.25(e), with some substantive variations related to the Old BCA section 38 provisions.

The result is that the New BCA bars any committee from authorizing the issuance of shares, fixing the terms of any series of a class of

59. If cumulative voting for directors applies and if less than the whole board is to be removed, an individual director may not be removed when the votes against removal are sufficient to elect that person if cumulatively voted in an election of the entire board. New BCA § 8.35(a)(2). Section 8.35(a)(2) uses the same formula as Delaware General Corporation Law § 141(k)(ii) which makes the “cumulative voting” exception apply only if less than the whole board is removed. Literally applied, the exception would be avoided by removing the entire board even though the minority might have sufficient votes to elect some of the directors in a general election in which cumulative voting applies. If the shareholders voting for removal have sufficient votes, they could amend the by-laws under New BCA § 2.25 to reduce the authorized number of directors to one in conjunction with the removal and then elect only one director to replace the former directors, thereby circumventing New BCA § 8.35(a)(2).

shares issuable in series, or authorizing the repurchase of shares, although those limitations did not exist under Old BCA section 38. Further, Old BCA section 38 allowed the executive committee to fix the terms for the issuance or sale of shares, but a committee's authority to do so under New BCA section 8.40(c) is limited to those terms specified by the whole board. It might have been expected that committees would be allowed to declare dividends, as permitted under Delaware General Corporation Law section 141(c), but that is barred by New BCA section 8.40(c). The *Official Comments* (which paraphrase the comments in the *ABA Exposure Draft* in that regard) explain that the dividend power was withheld from committees "based on the principle that prohibitions against delegation should be limited to prohibit only such actions as . . . might prove to be irrevocable (such as the declaration of a dividend)." That principle, of course, was not consistently applied in formulating the limitations on delegable authority although, if consistently applied, the limitations would have been even more restrictive.

Delaware General Corporation Law section 141(c) is more flexible, permitting delegation to committees of the dividend and stock issuance power. Delaware provides for the regulation of the delegation by leaving it to the board of directors to decide what limitations to impose on the exercise of the delegated power.

4. *Director Conflicts of Interest*

Old BCA section 40a, added as part of the 1981 amendments to the Old BCA, introduced a statutory rule pertaining to corporate transactions in which a director has a personal interest. New BCA section 8.60 discards the approach so recently taken in Old BCA section 40a and sets a new public policy with respect to such transactions which should have been, but was not, singled out for general public exposure and comment before enactment. This flip-flop in policy also indicates an instability that should be of concern to those selecting a domiciliary law. Further, the change may weaken the indemnification provisions in New BCA section 8.75 which should be a matter of concern to all Illinois corporations.

Under the common law business judgment rule, a court will not review, or substitute its own judgment for, action taken by a board of directors "in good faith, in the exercise of their best judgment, and for what they believed to be the advantage of the corporation and all its stockholders."⁶⁰ An exception exists for transactions in which a director has a personal interest. When such a personal interest is involved, the board-

60. *Bodell v. General Gas & Elec. Corp.*, 140 A. 264, 268 (Del. 1927).

approved transaction may be voided if the transaction is not fair to the corporation.

It has become common for the various jurisdictions to statutorily modify or amplify the common law rule relating to interested director transactions. Illinois' first effort in that regard was Old BCA section 40a. Literally applied, Old BCA section 40a avoided the "fairness" issue by providing that a transaction would not be "void or voidable" because of a director's interest therein if approved (after appropriate disclosure) by a majority of disinterested directors or shareholders.

New BCA section 8.60 takes a different approach. It adopts the majority common law rule that an interested director transaction will not be voided if found to be fair. It then goes on to regulate the burden of proving fairness, assigning that burden to the party claiming validity *unless* the transaction has been approved (after appropriate disclosure) by a majority of the disinterested directors or disinterested shareholders, in which case the burden of proof shifts to the party challenging the validity of the transaction. In either event, however (and unlike Old BCA section 40a), the issue of fairness may be adjudicated.

The *Official Comments* claim that the provisions in New BCA section 8.60 "are similar to those in [section] 41 of the existing Model Act and [section] 144 of the Delaware Act" and "identical" to the provisions in the *ABA Exposure Draft*. In other words, the change in Illinois policy made by New BCA section 8.60 is supposedly in line with those examples, but that justification is only partially correct. It is true that *ABA Exposure Draft* section 8.31 retains the common law requirement of a court determination of fairness, as does New BCA section 8.60. It is not true that New BCA section 8.60 is similar to the existing Model Business Corporation Act section 41 or Delaware General Corporation Law section 144. Both the existing Model Act and the Delaware Law, if literally applied, make approval by the shareholders or by the disinterested directors an alternative to proving fairness, although not all courts apply the statutory provisions literally.⁶¹

A literal interpretation of Delaware General Corporation Law section 144, making approval by the shareholders or the disinterested directors an alternative to proving fairness, correlates well with the indemnification provisions in section 145 of that Law which permits in-

61. For example, notwithstanding Delaware General Corporation Law § 144(a)(2) which allows shareholder approval without specifically excluding the vote of shares held by persons having an interest in the transaction, in *Fliegler v. Lawrence*, 361 A. 2d 218 (Del. 1976), it was held that fairness remained a justiciable issue, despite shareholder approval, when the majority of the shares voting to approve were held by parties interested in the transaction.

demnification of directors, officers, employees and agents to be authorized by directors who are not parties to the suit from which the need for indemnification arises. New BCA section 8.75, providing for indemnification, is patterned upon Delaware General Corporation Law section 145. However, New BCA section 8.60 can be construed to permit the fairness of a board's decision to indemnify a director under New BCA section 8.75 to be litigated, while Delaware General Corporation Law section 144, literally applied, would prevent such litigation. Any weakening of the statutory provisions for indemnification, as New BCA section 8.60 appears to do, should be a strong reason for corporate managers to disfavor Illinois as a domiciliary law.

I. DISTRIBUTIONS

New BCA Article 9 and related provisions elsewhere in the New BCA make major changes in the Old BCA concept of corporate capital and rules regulating distributions to shareholders. Under the Old BCA, the corporate capital concept served two functions. *First*, it was the basis for the Illinois corporate franchise tax and license fee (Old BCA sections 129, 132, 136 and 139). *Second*, by a set of complicated rules regulating the use of capital for a corporation's acquisition of its own shares and for payment of dividends and other distributions to shareholders (Old BCA sections 6, 41, 41a, 58, 58a, 59, 60, 60a and 60b), a degree of protection was provided to shareholders (particularly preferred shareholders) and, incidentally, to creditors.

The New BCA continues to use corporate capital as the basis for the Illinois corporate franchise tax and license fee (New BCA sections 15.25, 15.40, 15.55 and 15.70). However, as subsequently explained herein, changes in the definition of corporate capital and the ways corporate capital can be reduced may permit at least some corporations to reduce their bases for such tax and fee.

The second function of the corporate capital concept in the Old BCA—shareholder and creditor protection—is dropped from the New BCA. Instead, New BCA section 9.10 adopts the approach taken in the 1980 changes in the Model Business Corporation Act⁶² and in *ABA Exposure Draft* section 6.40. This permits a corporation to pay dividends, acquire its own shares or make other distributions⁶³ if, after giving effect

62. Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Amendments to Financial Provisions* (pts. 1 & 2), 34 BUS. LAW. 1867 (1979)(proposed amendments), 35 BUS. LAW. 1365 (1980) (notice, amendments adopted).

63. New BCA § 9.10 treats a corporation's repurchase of its shares as a distribution to share-

to the transaction, (i) the corporation would not be "insolvent"⁶⁴ and (ii) the corporation would have "net assets"⁶⁵ equal to not less than zero, unless the corporation has shares with a liquidation preference, in which case the remaining "net assets" must at least equal the total liquidation preference.

Overall, the New BCA rules relating to distributions appear simpler and easier to apply in the usual situation than the rules under the Old BCA. However, for a corporation "skating close to the edge," the question of when "net assets" equal zero and what would make the corporation "insolvent" likely will be just as difficult as any question that could arise under the Old BCA.

Further, the new rules apply, without choice, to corporations existing when the New BCA became effective and to their substantial accumulations of capital existing at that time. It remains to be seen whether the forced change will cause material problems for any of those corporations or their shareholders. Presumably, this was investigated before the decision was made to drop the protective features contained in the Old BCA although the Advisory Committee's *Official Comments* make no mention of such investigation. Instead, the *Official Comments* to New BCA section 1.80(j) suggest that the protective features of the Old BCA's corporate capital concept, including the Old BCA's regulation of the use of capital for distributions, were dropped simply because corporations could *elect* to minimize the protection by using low par value or no par value shares.⁶⁶ In the same vein, the Secretary of State's *Draft Comments* to New BCA section 9.10 justify the change on the grounds that the protections intended by the Old BCA could be avoided "if the shareholders wished to do so by a variety of devices." The fact that the existing rules did not work well in all cases, of course, begs the issue

holders, making a repurchase subject to the same rules as dividends. This is similar to the practice followed by many institutional lenders in developing loan covenants to restrict such transactions.

64. According to the New BCA § 1.80(m) definition, a corporation is "insolvent" when it "is unable to pay its debts as they become due in the usual course of its business." The same definition of "insolvent" was used in Old BCA § 2.15.

65. "Net assets" is defined in New BCA § 1.80(k) as the difference between a corporation's "assets" and its "liabilities." In conjunction with that definition, New BCA § 9.10(d) should be read because § 9.10(d) indicates the alternative methods for determining the amount of "net assets."

66. The Advisory Committee's rationale for eliminating the protective features of the Old BCA is expressed in the *Official Comments*, *supra* note 9, § 1.80(j) as follows:

The drafters recognize that the principles once supporting the use of the terms "par value", "stated capital", and "paid-in surplus" are no longer valid. Traditionally, those terms offered a form of protection and security to creditors and preferred shareholders. Today, provisions based on these terms are meaningless, if not misleading, because many corporations have authorized shares with a nominal par value or without par value.

The argument, which paraphrases the argument in the official commentary on *ABA Exposure Draft*, *supra* note 8, § 6.21, particularly at mimeo 6-24, obviously overstates the case.

whether the protection of shareholders and creditors, particularly in pre-existing situations in which the protection was being relied upon when the New BCA became effective, should have been improved rather than eliminated.

A detailed examination of the changes relating to capital and distributions made by the New BCA is beyond the scope of this article. However, a brief examination of some of the new provisions and their consequences will give insight as to how extensive the changes are for pre-existing corporations.

Under the old BCA, the capital of a corporation was the total of two components, "stated capital" and "paid-in surplus." The total of those two components essentially was the total of the consideration received for the issuance of shares, less expenses of issuance, plus transfers to capital, less formal reductions in capital permitted by law (Old BCA sections 2.11, 2.12 and 19). A corporation's use of its capital to acquire its shares, pay dividends and make other distributions to shareholders was regulated, with distinctions as to whether the capital was "paid-in surplus" or "stated capital" (Old BCA sections 6, 41, 41a, 58, 58a, 59, 60, 60a and 60b). Related to these provisions were the concepts of par value shares and shares without par value. The "stated capital" derived from the issuance of par value shares had to be at least equal to the par value and any remaining consideration received for the issuance of such shares could be assigned to "paid-in surplus" (Old BCA sections 17 and 19). For shares without par value, no minimum consideration for their issuance was prescribed and such consideration as was received could be allocated between "stated capital" and "paid-in surplus" as the board of directors determined, unless the shares had an involuntary liquidation preference, in which case the "stated capital" derived from those shares could not be less than the liquidation preference (Old BCA sections 17 and 19).

1. Minimum Share Price Requirements Eliminated

As previously indicated, under Old BCA sections 17 and 19, par value was the minimum price for which par value shares could be issued and thus was also the minimum capital to be obtained from the issuance of such shares. The New BCA eliminates the concept of par value so that under New BCA section 6.25 all shares may be issued for such price as the board of directors determines. This change applies mandatorily to par value shares of corporations existing at the time the New BCA became effective. If such pre-existing corporations also have charter provisions defining the consequences of par value, those provisions continue to

apply despite the statutory change, but the usual practice of pre-existing corporations was to designate the par value of shares in their charters without further explanation, relying upon the Old BCA to define the consequences of par value. Thus, for the typical pre-existing corporation, the minimum price requirement for par value shares was eliminated automatically by the New BCA becoming effective.

An illustration of the foregoing would be a pre-existing corporation with a charter that authorized common shares having a par value \$100 per share, without any other provision relating to par value. If some of the common shares were authorized but unissued on July 1, 1984, then, to the extent holders of the outstanding shares had relied upon the \$100 par value of the common shares as a degree of protection against dilution from the issuance of the remaining authorized shares for less than \$100 per share, that protection was lost when the New BCA became effective. The authorized but unissued shares now can be issued for such price as the board of directors determines to be proper, even if less than \$100 per share. To re-establish the minimum price requirement for the par value shares of the pre-existing corporation, a charter amendment is needed, spelling out those requirements.⁶⁷

In the case of no par value shares, the only minimum price requirement under the Old BCA was for shares having a preference in the event of involuntary liquidation. Old BCA section 19(b) in effect required those shares to be issued for a price at least equal to the liquidation preference. That requirement is eliminated by the New BCA for shares authorized before the New BCA became effective as well as for subsequently authorized shares. Again, to restore that requirement, a charter amendment is needed. Otherwise, existing shareholders seeking protection against the issuance of preferred shares for a price less than the liquidation preference will have to attack the business judgment of the board of directors that authorizes such issuance, rather than rely upon a statutory prohibition as was the case under Old BCA section 19(b).

67. The *Official Comments*, *supra* note 9, § 9.10 suggest that pre-existing corporations may voluntarily continue to adhere to the Old BCA requirements for par value shares, as indicated by the following statement: "The Advisory Committee believed the new provisions do not mean that par value and stated capital are now illegal. They are merely not required. Any corporation currently operating on the basis of these concepts may continue operating in that manner." Of course, voluntary compliance with the Old BCA provisions does not assure the protection intended by the Old BCA in the same way as statutorily-required compliance.

2. *Elimination Of Corporate Capital As A Reservoir Of Protection*

Under the Old BCA, holders of preferred shares could look upon the "stated capital" derived from the issuance of their preferred shares and the common shares as a reservoir of protection because the use of "stated capital" for distributions was restricted. That protection, of course, was by no means perfect. However, to the extent it was relied upon under the Old BCA, it is automatically eliminated by the New BCA for pre-existing corporations unless their charters contain provisions spelling out such protection (which would not be typical for corporations existing under the Old BCA).

Also, under Old BCA sections 6 and 41(c), a corporation could not use unrealized appreciation of its assets as a source for purchasing its shares or paying dividends (other than dividends payable in shares). Under the New BCA, the opposite is true. New BCA section 9.10(d) expressly allows "net assets" for purposes of distributions to be based "on a fair valuation or other method that is reasonable in the circumstances" as an alternative to relying upon net assets per financial statements. Shareholders who relied upon the Old BCA to prevent distributions from unrealized appreciation are automatically deprived of that protection by the New BCA becoming effective.

Those acquiring newly-issued shares by choice on or after July 1, 1984 have the opportunity to demand contracts or charter provisions if they want corporate capital to serve as a reservoir of protection, as formerly was the case under the Old BCA. However, holders of shares already outstanding when the New BCA became effective who want to regain that protection will have to find a way to force appropriate charter amendments or find a basis for forcing contracts with appropriate covenants to be made with their corporations.

J. POSSIBLE REDUCTIONS IN THE BASIS FOR FRANCHISE TAX AND LICENSE FEE

As previously mentioned, the concept of corporate capital—called "paid-in capital" in the New BCA—serves the single purpose under the New BCA of providing the basis for the Illinois corporate franchise tax and license fee. That fact, coupled with some deficiencies and peculiarities in the New BCA provisions concerning "paid-in capital," creates an opportunity for at least some corporations to reduce the amounts of franchise tax and license fee which they must pay.

Limiting the corporate capital concept to a single purpose under the New BCA frees corporations and their advisors from the interpretive

constraints that existed under the Old BCA. Corporate capital does not have to be deducted in the calculation of funds legally available for distributions under the New BCA, as it did under the Old BCA. Thus, corporations and their advisors no longer will have to reckon with their own judgments as to what is legally available for dividends and other distributions when deciding what constitutes "paid-in capital" for franchise tax and license fee purposes.

Further, because "paid-in capital" no longer enters into the calculation of what is available for dividends and other distributions, there is no reason to try to equate corporate capital for New BCA purposes with capital for financial reporting purposes, as some thought there was under the Old BCA. As hereinafter illustrated, there clearly are major differences between what constitutes capital for financial reporting purposes and what constitutes "paid-in capital" for New BCA purposes, and in a number of instances the latter should be a smaller amount than the former. Therefore, corporations should maintain two sets of books—one to record capital transactions for financial reporting and one to record "paid-in capital" as the basis for the Illinois franchise tax and license fee—to take advantage of the divergence between the accounting requirements and the New BCA requirements.

Freed of the interpretive constraints that were inherent in the dual purpose of corporate capital under the Old BCA, corporations that decide to be more aggressive in minimizing their Illinois franchise tax and license fee obligations will find some interesting possibilities in the New BCA. This involves working through the definition of "paid-in capital" in New BCA section 1.80(j) and the provisions in the New BCA for changing the amount of "paid-in capital."

Working through the New BCA "paid-in capital" provisions also will confirm that special problems exist for corporations in existence on July 1, 1984 when the New BCA became effective. The New BCA contains no transition rule for the initial determination of "paid-in capital" for such pre-existing corporations. Instead, the draftsmen incorrectly assumed that the last reported total of the "stated capital" and "paid-in surplus" under the Old BCA would equal the initial amount of "paid-in capital" under the New BCA for each pre-existing corporation. As hereinafter discussed, pre-existing corporations for which the draftsmen's assumption is incorrect have a choice whether to attempt to reduce their Illinois franchise tax and license fee obligations under the New BCA by reason of such error.

1. Peculiarities In The New BCA "Paid-In Capital" Provisions Applicable To All Corporations

Under New BCA section 1.80(j), "paid-in capital" is the result obtained from the following formula: (consideration received for issuance of shares) — (expenses of issuance) + (shareholders' contributions to the corporation) + (transfers to "paid-in capital" by corporate action) — (distributions from "paid-in capital"). By adhering strictly to the legal requirements, a corporation will eliminate the fourth item in the above formula, namely, transfers to "paid-in capital" by corporate action. Further, those electing a more aggressive interpretation will use only the first two and the last item in the formula, eliminating both shareholders' contributions to the corporation and transfers to "paid-in capital" by corporate action.

In the case of transfers to capital by corporate action (the fourth item in the above formula), the New BCA differs from the Old BCA to the advantage of the corporate taxpayer by allowing a choice not previously available. Although "paid-in capital," as defined in New BCA section 1.80(j), includes "any cash and other consideration . . . transferred to paid-in capital by action of the board of directors or shareholders," there generally is no requirement in the New BCA that corporate transfers to capital from retained earnings or other sources be treated as "paid-in capital." This leaves the board of directors free to transfer to a capital account of a different name, such as "additional capital," to satisfy any accounting requirement that the transfer be reflected as an addition to capital, while avoiding an increase in "paid-in capital" for New BCA purposes. For example, accounting practice may require the capitalization of retained earnings for the issuance of shares to pay a stock dividend. In that regard, Old BCA section 41(e) and (f) required retained earnings (or "surplus") to be transferred to "stated capital" to capitalize stock dividends, but no such requirement exists under New BCA section 6.25(b) which specifies that "any such transactions shall not require consideration."⁶⁸ Therefore, the transfer to capital for financial reporting purposes should be specifically assigned by the board of directors to a capital account other than New BCA "paid-in capital" to

68. The provision in New BCA § 6.25(b) that specifies when no consideration is required for the issuance of shares is not limited to stock dividends. It also applies to a corporation's issuance of "its own shares in exchange for or in conversion of its outstanding shares," raising another possibility for reducing "paid-in capital" because the provision does not properly mesh with New BCA §§ 9.05 and 9.15. That is, if a corporation issues shares in exchange for its outstanding shares, New BCA § 6.25(b) does not require an increase in "paid-in capital" for the shares issued but under New BCA §§ 9.05 and 9.15(a)(4), "paid-in capital" may be reduced by the amount of "paid-in capital" attributable to the reacquired shares.

achieve a franchise tax and license fee savings not possible under the Old BCA.

The third item in the above formula—shareholders' contributions to the corporation—can be construed as limited to voluntary contributions to "paid-in capital" by reconciling the wording of New BCA section 1.80(j) with the apparent intent of the authors of the New BCA. The relevant portion of section 1.80(j) states that "paid-in capital" includes consideration received "in connection with the issuance of shares, plus *any cash and other consideration contributed to the corporation by or on behalf of its shareholders* or transferred to paid-in capital by action of the board of directors or shareholders."⁶⁹ Taking the phrase "any cash and other consideration contributed to the corporation by or on behalf of its shareholders" as a complete statement of this particular item in the formula could cause "paid-in capital" under the New BCA to be more than what the total of "stated capital" and "paid-in surplus" would have been under the Old BCA for corporations that have received contributions from shareholders.

However, the apparent intent of the draftsmen of the New BCA was not to increase the basis for the franchise tax and license fee by adopting "paid-in capital" as a substitute for the Old BCA's "stated capital" and "paid-in surplus." The Secretary of State's *Draft Comments* to New BCA section 1.80(j) refer to the definition of "paid-in capital" as being "similar to a combination of [Old BCA] stated capital and "paid-in surplus." Neither the *Draft Comments* nor the Advisory Committee's *Official Comments* to New BCA sections 15.25, 15.40, 15.55 and 15.70, pertaining to the basis for the franchise tax and license fee, indicate any intention to increase the basis. Instead, they describe the changes in those sections as being only terminology changes. Under the Old BCA, amounts contributed by shareholders could be *voluntarily* assigned to "stated capital" or "paid-in surplus," but shareholders' contributions made after the issuance of their shares generally were *required* to be assigned to "paid-in surplus" only if made *pro rata* by all the shareholders.⁷⁰ To carry out the draftsmen's apparent intent, New BCA section 1.80(j) would be construed to require inclusion in "paid-in capital" of all *pro rata* contributions by shareholders, treating those as part of the consideration received in "connection with the issuance of shares," but would include other contributions by shareholders only if voluntarily assigned to "paid-in capital."

69. New BCA § 1.80(j)(emphasis added).

70. See 1 ILL. BUS. CORP. ACT ANN. 22-23 (3rd ed. 1975).

If, in the case of shareholders' contributions not made on a *pro rata* basis, New BCA section 1.80(j) is construed so as to include in "paid-in capital" only such amounts as are voluntarily assigned to that account, such a voluntary step obviously will work to the disadvantage of the corporation by increasing the basis for its franchise tax and license fee. Even though such contributions may be added to capital for financial reporting purposes, for purposes of the New BCA they should be specifically assigned to a component of capital other than New BCA "paid-in capital" to avoid increasing such tax and fee. While under the Old BCA the contributing shareholder or the corporation may have wanted the contribution assigned to "stated capital" or "paid-in surplus" so as to be subject to the restrictions on use imposed by the Old BCA, the New BCA does not restrict the use of "paid-in capital," making it pointless to assign contributions to New BCA "paid-in capital" for that reason.

The last item in the "paid-in capital" formula in New BCA section 1.80(j) allows the deduction of "any distribution therefrom," but it seems unlikely that any taxpayer advantage can be gained from this provision which involves a drafting oversight. Taken literally, New BCA section 1.80(j) appears to allow a corporation to arbitrarily charge all dividends and other distributions made pursuant to New BCA section 9.10 as deductions from "paid-in capital." This would be consistent with the New BCA's use of the "net assets" concept, rather than the corporate capital concept, to regulate what may be used for distributions. However, the wording of New BCA section 1.80(j) is not consistent with New BCA sections 9.05, 9.15 and 14.25, which are the provisions under which "paid-in capital" can be reduced for franchise tax and license fee purposes.⁷¹ To overcome the internal inconsistency, New BCA section 1.80(j) should be construed as if it read "less any distributions therefrom *for which a reduction in paid-in capital is permitted and made under Section 9.05 or Sections 9.15 and 14.25 of this Act.*"

Another drafting inconsistency exists in that the "paid-in capital" definition in New BCA section 1.80(j) permits reductions due to "distributions" but does not expressly provide for reductions in "paid-in capi-

71. New BCA § 9.15(b) refers only to the distributions and other events specified in New BCA § 9.15(a) as permitted reductions in "paid-in capital" and states that such reductions are not effective to "change the basis for the annual franchise tax payable by the corporation" until a statement complying with New BCA § 14.25 is filed. The Advisory Committee's *Official Comments* to § 9.15 state that "Sections 9.10 [pertaining to permitted distributions] and 9.15 [pertaining to reductions of paid-in capital] do not overlap" and "§ 9.15 deals only with those distributions which may be charged to paid-in capital." Thus, for example, any dividend may be paid from "paid-in capital" under New BCA § 9.10 but, according to New BCA § 9.15, the only dividends which reduce "paid-in capital" for franchise tax and license fee purposes are "dividends paid on preferred shares" and "liquidating dividends."

tal” permitted by New BCA sections 9.15 and 14.25 that are unrelated to “distributions.”⁷² Again, it seems unlikely that any franchise tax or license fee consequence should result from the inconsistency. A reasonable way to cure the inconsistency is to read into the definition of “paid-in capital” in New BCA section 1.80(j) the reductions unrelated to “distributions” that are permitted by New BCA sections 9.15 and 14.25.

In short, New BCA sections 1.80(j), 9.05, 9.15 and 14.25 can be construed to allow the “paid-in capital” of a corporation to be the total consideration received for the issuance of its shares, less expenses of issuance and less formal reductions made pursuant to sections 9.05, 9.15 and 14.25. The remaining components of the New BCA section 1.80(j) definition of “paid-in capital”—contributions to “paid-in capital” by shareholders and transfers to “paid-in capital” by corporate action that involve voluntary, disadvantageous steps—can be avoided simply by assigning such contributions and transfers to a capital account having a name other than “paid-in capital.”

In addition to avoiding voluntary contributions or transfers to “paid-in capital,” interesting possibilities for reducing the basis for a corporation’s franchise tax and license fee derive from New BCA section 9.15. That section specifies the grounds for formal reductions in “paid-in capital.” The grounds listed are the same five grounds for reducing “paid-in surplus” under Old BCA section 60a, adjusted as to language to reflect the “paid-in capital” concept in the New BCA which replaces the Old BCA’s “stated capital” and “paid-in surplus” concepts. However, the draftsmen appear to have overlooked the fact that the five grounds under Old BCA section 60a interrelated with other provisions in the Old BCA which have been eliminated in the New BCA so that different results may occur from at least some of the five grounds in the context of the New BCA.

For example, New BCA section 9.15(a)(2) permits “paid-in capital” to be reduced by a charge for “dividends paid on preferred shares out of paid-in capital *as permitted by law*.”⁷³ The Old BCA counterpart is clause (2) in section 60a which had a similar provision for reducing “paid-in surplus” that interrelated with Old BCA section 41(b). Section 41(b) allowed dividends to be paid on preferred shares only from that part of total corporate capital which constituted “paid-in surplus.” Old

72. This drafting inconsistency would have been avoided by conforming more closely to the Old BCA. The definitions of both “stated capital” and “paid-in surplus” in Old BCA §§ 2.11 and 2.12 allowed deductions for “such formal reductions . . . as may have been effected in a manner permitted by law.”

73. New BCA, § 9.15(a)(2) (emphasis added).

BCA section 41(b) is eliminated in the New BCA; the New BCA permits dividends on any shares from any source so long as net assets are not reduced below zero (or below the amount of the liquidation preference of outstanding shares if the corporation has shares with such a preference) and so long as the corporation is not rendered insolvent. Within those limits, under the New BCA the board of directors appears to be able to charge *all* dividends on preferred stock to "paid-in capital" until the *entire* "paid-in capital" is exhausted, whereas under the Old BCA only the "paid-in surplus" portion of total capital could be exhausted. While such a dividend may be treated as paid from retained earnings for financial reporting purposes, that should not prevent charging the dividends to "paid-in capital" for New BCA purposes. As previously mentioned, under the New BCA there should be a separate accounting for "paid-in capital" in accordance with, and for the limited purpose of determining the basis for the Illinois corporate franchise tax and license fee as intended by, the provisions of the New BCA.

A reduction in "paid-in capital" to the point of exhausting that account for dividends paid on preferred shares is only one of the possibilities for reducing the basis for the franchise tax and license fee. Charging a "deficit" to "paid-in capital" under New BCA section 9.15(a)(1) may be another possibility. Each corporation should carefully study New BCA sections 9.05 and 9.15, and the related provisions in section 14.25, to determine ways in which its franchise tax and license fee might be reduced.⁷⁴ Obviously, however, those who rely upon the draftsmen's intent to avoid adding to "paid-in capital" all shareholders' contributions should recognize the inconsistency of ignoring the draftsmen's intent by relying upon a literal interpretation of the New BCA in other instances to achieve a reduction in the amount of "paid-in capital."

74. Corporations that redeem or purchase their shares should be vigilant about reducing "paid-in capital" in connection with those transactions. Under New BCA § 9.05, those shares automatically revert to authorized but unissued shares unless their reissue is prohibited, in which latter case the shares are cancelled and a § 9.05 filing should be made with the Illinois Secretary of State to reduce authorized shares by a like amount. If such a filing is made, "paid-in capital" is reduced by the amount of "paid-in capital" represented by the cancelled shares. New BCA § 9.05(c). However, if the reissue of shares redeemed or purchased is not prohibited so that they revert to authorized but unissued shares, "paid-in capital" represented by such shares may be reduced only pursuant to New BCA § 9.15 by a filing conforming to the requirements of New BCA § 14.25. In either event, the "paid-in capital" reduction is equal to the amount of "paid-in capital" represented by the reacquired shares *even if that exceeds the amount paid by the corporation to acquire the shares*. Corporations would be well advised to check with counsel each time they acquire their own shares, and again before filing their annual reports, to determine what changes in "paid-in capital" should be made pursuant to New BCA §§ 9.05, 9.15 and 14.25, which then could be reflected in their annual reports.

2. *Special Problems For Pre-Existing Corporations Under The New BCA "Paid-In Capital" Definition*

Under the Old BCA, a corporation's Illinois franchise tax and license fee were based on the total of its "stated capital" and "paid-in surplus" (or the portion thereof allocated to Illinois in the case of a foreign corporation and in the case of the franchise tax for an Illinois corporation). Although badly needed, there is no provision in the New BCA for the transition by corporations already in existence on July 1, 1984 from the Old BCA's basis to the New BCA's "paid-in capital" basis and the *Official Comments* do not offer any guidance.

The absence of a provision in the New BCA for a transition filing by a pre-existing corporation to initially establish the amount of its "paid-in capital" is evidence of the assumption by the draftsmen that for such a corporation, the total of its "stated capital" and "paid-in surplus" last reported under the Old BCA will be the initial amount of its "paid-in capital" for purposes of the New BCA. The assumption clearly is erroneous for at least some pre-existing corporations, as illustrated by the following simple example. Under the Old BCA sections 2.11 and 2.12 definitions, expenses of issuing shares could not be deducted from "stated capital" but could be deducted from "paid-in surplus." If corporation "X" issued 1,000 shares with a par value of \$100 each for a total consideration of \$100,000 and incurred \$10,000 of issuance expenses, its "stated capital" under the Old BCA was \$100,000 and its "paid-in surplus" was zero, for a total of \$100,000. Under New BCA section 1.80(j), expenses of issuance are deducted in calculating "paid-in capital." Consequently, corporation "X" should have an initial "paid-in capital" under the New BCA of \$90,000 as opposed to the \$100,000 basis for franchise tax and license fee purposes under the Old BCA.

Each pre-existing corporation needs to make an initial determination and report of its "paid-in capital" under the New BCA. For many corporations this likely will occur in the first annual report filed under the New BCA. The annual report technically is not the proper instrument for reporting *changes* in "paid-in capital" (see New BCA sections 14.20 and 14.25). However, in the absence of a special provision for an *initial* report by a pre-existing corporation, New BCA section 14.05(j) can be read to allow such a corporation to use the annual report to report the initial amount of its "paid-in capital" even though different from the amount of its capital last reported under the Old BCA. An alternative would be for the Secretary of State to allow the initial amount to be re-

ported under New BCA section 14.25 (technically intended for reports of *changes* within 60 days of the event).

Some pre-existing corporations—likely those with a simple history of transactions affecting their capital accounts—will find that the total of their “stated capital” and “paid-in surplus” last reported under the Old BCA in fact equals their “paid-in capital” under the New BCA. Others with a more complicated history of transactions affecting their capital accounts will find that their “paid-in capital,” as defined in New BCA section 1.80(j), is different from the total of their “stated capital” and “paid-in surplus” under the Old BCA. Those latter corporations either may acquiesce to the error of the draftsmen of the New BCA by treating the Old BCA total as their initial New BCA “paid-in capital” or may be aggressive in trying to establish the lower franchise tax and license fee basis which the New BCA appears to permit.

Those that elect the aggressive approach will find a number of possibilities. The examples already cited relating to the deduction of expenses of issuance of shares and the deduction of all dividends paid on preferred shares are possibilities for pre-existing corporations that have those factual situations. Other examples in making the first-time determination of “paid-in capital” may involve the question whether contributions or transfers to “stated capital” or “paid-in surplus” under the Old BCA can be excluded from “paid-in capital” by a literal interpretation of New BCA section 1.80(j). In that regard, section 1.80(j) includes in “paid-in capital” those amounts that have been “transferred to *paid-in capital* by action of the board of directors” (emphasis added). However, “paid-in capital” is a new concept existing only since July 1, 1984. Prior to July 1, 1984, such transfers would have been to “stated capital” or “paid-in surplus” (e.g., transfers to “stated capital” under Old BCA section 41(e) or (f) to capitalize a stock dividend), not to “paid-in capital.” May a pre-existing corporation omit such transfers in the calculation of its initial “paid-in capital”?

Taking an aggressive approach will raise the question whether the Secretary of State will refuse to honor an amount of initial “paid-in capital” for a pre-existing corporation that is less than the total of the corporation’s “stated capital” and “paid-in surplus” last reported under the Old BCA. If rejected, what would be the legal authority for that position? If rejected, will the Secretary of State in the alternative accept the filing of a New BCA section 14.25 report of changes in “paid-in capital” relating to pre-July 1, 1984 events (even though the filing is supposed to be made within 60 days after the events causing the changes) if made to adjust the total of the pre-existing corporation’s Old BCA “stated capi-

tal” and “paid-in surplus” to the New BCA section 1.80(j) “paid-in capital” definition? If not, how does the “paid-in capital” definition work for pre-existing corporations?

More to the point, the fact that these questions exist indicates the need for legislated repairs.

K. AMENDMENTS

1. *Charter Amendments*

New BCA Article 10 makes a number of changes in the Old BCA charter amendment provisions to add flexibility. These improvements are coupled with editorial streamlining that deletes the considerable detail as to permitted amendments that was set forth in Old BCA sections 52-52.19. As discussed below, such deletion may have the inadvertent consequence of reviving issues as to vested rights of shareholders that had been put to rest by Old BCA sections 52-52.19. Further, in another instance discussed below, the failure to correlate terminology with other parts of the New BCA creates a question of interpretation that should have been avoided.

Perhaps the most significant change, in terms of added flexibility, is New BCA section 10.20(d) which permits the statutory two-thirds minimum vote requirement for shareholders’ approval of charter amendments to be superseded by a charter provision fixing a smaller (not less than a majority) or larger vote. A number of other changes provide additional flexibility. For example, New BCA section 10.05(b), for which there was no counterpart in the Old BCA, permits a corporation with a limited period of duration that has expired to revive itself within five years by an appropriate amendment.⁷⁵ New BCA section 10.15, for which there was no counterpart in the Old BCA, permits certain kinds of charter amendments to be made by the board of directors without shareholders’ approval. Subsection (f) of New BCA section 10.15 provides the convenience (not granted by the Old BCA) of allowing the board of directors to restate amended articles of incorporation without shareholders’ approval when no additional amendments are made by the restatement.⁷⁶

75. The revival power is only for a corporation that improperly continues business after its period of duration expires inasmuch as New BCA § 10.30(a)(10)(iii) requires the reviving corporation to certify that it “has been in continuous operation since before the date of expiration.” Revival validates corporate acts taken during the expiration interval but also restores all “obligations” (for franchise taxes, etc.) during that period. New BCA, § 10.35(b).

76. If the charter is amended by the restatement, the restatement could be done under New BCA § 10.20 which requires shareholders’ approval.

Also without counterpart in the Old BCA is New BCA section 10.10 which allows the board of directors, or, if the initial directors were not named in the articles of incorporation and have not been elected, then the incorporators, to amend the charter if the "corporation has not issued shares." However, does New BCA section 10.10 apply if the corporation has preorganization subscribers but has not in fact issued any shares? Under New BCA section 6.20, preorganization subscribers are "deemed to be the shareholders" once the corporation's charter is accepted for filing by the Secretary of State. While the wording of New BCA section 10.10 ("issued shares") does not mesh precisely with that of New BCA section 6.20 ("subscribers . . . deemed to be the shareholders"), the safe interpretation is to assume that New BCA section 10.10 is inapplicable where there are preorganization subscribers even though the subscribed shares have not in fact been issued.⁷⁷

The potential for a more serious interpretation problem exists under New BCA section 10.05 as a result of editorial streamlining, rather than any attempt to add flexibility. New BCA section 10.05(a) carries forward the general authorization from Old BCA section 52 which allows charter amendments if the amended provisions lawfully could be included in an original charter at the time of the amendment. However, as part of the streamlining, New BCA section 10.05(a) omits other provisions that were in Old BCA section 52, as well as the provisions in Old BCA sections 52.1-52.19, that listed specific examples of permitted charter amendments, including those which effected changes in, or exchanges, reclassifications or cancellations of, outstanding shares. The Advisory Committee thought such provisions to be "unnecessary" and, accordingly, omitted them from New BCA section 10.05.⁷⁸

The editorial streamlining in New BCA section 10.05 is similar to the approach taken in *ABA Exposure Draft* section 10.01, with one important exception. The charter amendment provisions in existing Model Business Corporation Act section 58 are similar to those in the Old BCA and include a list of permitted amendments similar to Old BCA sections 52.1-52.19. That list is deleted from *ABA Exposure Draft* section 10.01,

77. Not having "issued" shares is also a condition to voluntary dissolution by action of the incorporators or directors under New BCA § 12.05. In that context, "issued" more clearly means the issuance of stock certificates inasmuch as that section also requires the refunding of amounts "actually paid in on the subscriptions." New BCA, § 12.05 (d). This also was believed to be the meaning of "issued" in Old BCA § 74 which was the counterpart of New BCA § 12.05. 1 ILL. BUS. CORP. ACT ANN. 451 (3rd ed. 1975). The fact that a question existed as to the meaning of "issued" under Old BCA § 74 should have prompted the use of an appropriate clarifying phrase in conjunction with the use of the word "issued" in both New BCA §§ 10.10 and 12.05.

78. See *Official Comments*, *supra* note 9, § 10.05.

but the draftsmen recognized in their comments on that section that the deleted list “was designed to eliminate the last possible vestige of the ‘vested rights’ theory by expressly referring to and validating all types of amendments to which a vested rights challenge could be made.”⁷⁹ *ABA Exposure Draft* section 10.01(b) makes the deleted list unnecessary by specifying that a “shareholder . . . does not have a vested or property right resulting from any provision in the articles of incorporation.” No similar provision is included in the New BCA.

Clearly, the Advisory Committee did not intend a substantive change by omitting from New BCA section 10.05 the list of permitted amendments that was found in Old BCA sections 52.1-52.19. The *Official Comments* to New BCA section 10.05 assure that the omission “will not diminish any rights of a corporation to amend its articles,” providing another instance of attempting to carry forward the substance of provisions in the Old BCA by omitting them from the New BCA. Whether the courts will accept the omission, and the Advisory Committee’s expression of intent, as a substitute for a statutory provision expressly negating shareholders’ vested rights, remains to be seen. In that regard, the language of New BCA section 10.05 is not supportive of the draftsmen’s intention. The permission in section 10.05 to make amendments if the amended provision could be included in original articles of incorporation, literally applied, does not cover amendments that exchange or cancel outstanding shares because such provisions, by their nature, would not be included in original articles of incorporation.

2. *Class Voting*

New BCA section 10.25 expands the instances in which voting by class or series of shares applies to charter amendments. It also creates an ambiguity as to the voting rights of nonvoting shares.

New BCA section 10.25 provides for class or series voting on charter amendments in two instances not found in Old BCA section 54. One instance is in clause (j) of New BCA section 10.25 which adds class or series voting if the amendment will limit or deny the voting rights of the class or series. When the ability to limit or deny voting rights was introduced into the Old BCA by the 1981 amendments, this change was not made and clause (j) corrects that oversight. The second and more important expansion of class or series voting is in New BCA section 10.25(g). While Old BCA section 54(h) provided for class or series voting on amendments which created a class of shares with “prior and superior”

79. *ABA Exposure Draft*, *supra* note 8, at mimeo 10-4.

rights and preferences, New BCA section 10.25(g) adds class or series voting if the rights and preferences of the new class would be no more than "substantially equal" to those of an existing class or series of shares.

In addition to expanding the instances in which class or series voting applies, New BCA section 10.25 is ambiguous as to whether nonvoting shares have class voting rights for charter amendments pertaining to such shares. Both Delaware General Corporation Law section 242(b)(2) and *ABA Exposure Draft* section 10.04(d) specify that nonvoting shares have such rights; New BCA section 10.25 does not. The lead-in language in New BCA section 10.25 granting class voting rights ("holders of the outstanding shares of a class shall be entitled to vote as a class") is copied verbatim from Old BCA section 54. The Old BCA language, however, was written when all shares had to have voting rights and was not changed when the 1981 amendments for the first time provided for shares with limited or no voting rights.

The conservative interpretation of New BCA section 10.25 would be to read it as giving class voting rights to nonvoting shares. However, the question becomes more difficult when carried back to New BCA section 10.20 where subsections (c) and (d), containing the general provisions for shareholders' approval of a charter amendment, require (in addition to the class vote) approval by the required vote of the "total outstanding shares entitled to vote on such amendment." If nonvoting shares have class voting rights under New BCA section 10.25, do they also constitute "shares entitled to vote" on an amendment for New BCA section 10.20 purposes? Take, for example, a corporation with 100 voting common shares and 100 nonvoting preferred shares that wants to amend its charter to increase the authorized number of preferred shares. Assume that New BCA section 10.25(a) requires approval of the amendment by a class vote of the nonvoting preferred shares. If the corporation has a charter that requires only a majority vote, and if the vote is 51 preferred shares and 50 common shares *for* the amendment, is the amendment passed? The conservative (safe?) interpretation is that it did not pass; that the preferred shares are not "shares entitled to vote on such amendment" for purposes of New BCA section 10.20(c) and (d). Care in drafting the provisions, however, would have eliminated the question.

The class voting requirements of the New BCA (as was true of the Old BCA) will be one of the reasons why corporate managers will continue to prefer the Delaware General Corporation Law. Under Delaware General Corporation Law section 242(b)(2), by an appropriate charter provision, class voting can be avoided for an amendment which increases or decreases the authorized number of shares of the class. Under New

BCA section 10.25(a), class voting on such an amendment cannot be avoided. Further, under Delaware General Corporation Law section 242(b)(2), except for changes in par value, the only other charter amendments for which class voting is statutorily required are those changing the “powers, preferences, or special rights” of the class “so as to affect them adversely.” Creation of a class of shares having superior or equal rights would not require class voting under the Delaware Law, but does under the New BCA. Corporate managers who want to avoid the bargaining power that a class of shares has when class voting rights apply clearly will opt for the Delaware Law.

L. MERGER AND CONSOLIDATION—DISSENTERS’ RIGHTS

1. *Acquisition/Sale Transactions*

While the title of New BCA Article 11 mentions only mergers and consolidations, the Article in fact covers all types of corporate acquisition/sale transactions—mergers, consolidations, share exchanges and sales, leases or exchanges of assets. The major changes from the Old BCA are as follows:

1. The kinds of consideration that may be exchanged for a constituent’s shares in a merger are expanded and, for the first time, “cash-out” mergers are permitted (New BCA section 11.05(c)).
2. A procedure for a mandatory exchange of shares is added for the first time as an acquisition/sale technique (New BCA section 11.10).
3. The two-thirds minimum vote required by statute for shareholders’ approval of corporate acquisition/sale transactions may be superseded by a charter provision requiring a smaller (not less than majority) or larger vote (New BCA sections 11.20(b) and 11.60(e)).
4. A merger or exchange of shares need not be approved by the shareholders of the surviving corporation or the issuing corporation, as the case may be, if its charter is not amended by the plan of merger or exchange, its shares outstanding immediately prior to the transaction remain outstanding without change immediately after the transaction, and its common shares issued in the merger or exchange (or issuable upon conversion of securities issued in such transaction) do not exceed 20% of the common shares outstanding immediately prior to the transaction (New BCA section 11.20(c)).
5. The ownership by a parent corporation of its subsidiary’s shares required for the merger of the subsidiary into the parent or another subsidiary without approval of the shareholders of either the parent or the subsidiary is lowered from 99% to 90% (New BCA section 11.30).
6. A plan of merger, consolidation or exchange of shares may provide for a delayed effective date not more than 30 days after the Secretary of State’s issuance of the certificate of merger, consolidation or

exchange⁸⁰ (New BCA section 11.40).

7. The Old BCA requirement that shareholders' approval be obtained for the sale, lease, exchange, mortgage, pledge or other disposition of all, or substantially all, of a corporation's assets not made in the usual course of business is changed to eliminate the need for such approval in the case of a mortgage or pledge (New BCA section 11.60).⁸¹

While the foregoing changes, overall, provide more flexibility than the Old BCA, in some instances unnecessary limitations are retained or the provisions are inconsistent with other provisions in the New BCA. Examples of this are discussed below.

First, permitted merger consideration still is not completely modernized. Under Old BCA section 61(c), shares of a merging corporation could only be converted into "shares, obligations or other securities" of the surviving corporation or of another corporation which immediately before or after the merger was the owner of all of the outstanding voting securities of the surviving corporation. New BCA section 11.05(c) carries forward that formula but adds to it "cash or other property, or . . . any combination of the foregoing." While this greatly expands the formula and clearly permits "cash-out" mergers that were not permitted under the Old BCA, New BCA section 11.05(c) still is not adequately modernized. By retaining the Old BCA formula that limited "shares, obligations or other securities" to those of the surviving corporation or of a 100% owner of the voting securities of the surviving corporation, the added words "or other property" probably should not be construed to include "shares, obligations or other securities" of any other corporation.

80. While Illinois adds a provision for delaying the effective *date*, which has been permitted for some time under Delaware General Corporation Law § 103(d), the Delaware Law recently was amended to allow a precise *time* for effectiveness on either the filing date or the delayed effective date. This allows control of the sequence of events on the effective date for complex transactions. The New BCA has no counterpart to that Delaware provision.

81. The elimination of the long-standing requirement of shareholders' approval of mortgages or pledges of substantially all of a corporation's assets made otherwise than in the usual course of business depends heavily upon the statement of intent in the Advisory Committee's *Official Comments*, *supra* note 9. First, New BCA § 11.55 copies the language of Old BCA § 71, specifically empowering the board of directors, without shareholders' approval, to authorize a "sale, lease, exchange, mortgage, pledge, or other disposition" of assets in the usual course of business. Then New BCA § 11.60, pertaining to such transactions not made in the usual course of business, copies similar wording from Old BCA § 72 except that the words "mortgage, pledge" are deleted. The *Official Comments* to section 11.60 disclose that the deletion is intended to dispense with the shareholders' approval requirement for mortgages or pledges not made in the usual course of business. However, a reader who does not refer to the *Official Comments* might assume that the phrase "or other disposition" in section 11.60 applies to mortgages and pledges since under section 11.55 a mortgage or pledge is expressly made a type of "disposition" and the only express authority of the board to authorize mortgages or pledges without shareholders' approval is under section 11.55 which pertains only to dispositions in the usual course of business. The foregoing should be compared to the better method of achieving the same result employed in *ABA Exposure Draft*, *supra* note 8, § 12.01, which expressly provides that a mortgage or pledge does not require shareholders' approval, "whether or not in the usual and regular course of business."

Thus, New BCA section 11.05(c) is far more limited than Delaware General Corporation Law section 251(b) which allows a constituent corporation's shares to be converted into "shares or other securities" of the surviving corporation or into "cash, property, rights or securities of *any other corporation*."⁸² Similar to the Delaware provision, and in sharp contrast to the New BCA provision, is *ABA Exposure Draft* section 11.01(b)(3).

Second, the share exchange provisions unduly restrict the consideration that may be issued for exchanged shares. The share exchange provisions in *ABA Exposure Draft* section 11.02(b)(3) allow an exchange for "shares, obligations, or other securities of the acquiring or *any other* corporation or for cash or other property."⁸³ In contrast, New BCA section 11.10(c) allows an exchange to be made only for "shares, obligations, or other securities of the *acquiring* corporation or for cash or other property",⁸⁴ *i.e.*, arguably excluding the use of shares, obligations or other securities of all but the acquiring corporation. It may be, as pointed out in the Advisory Committee's *Official Comments* to section 11.10, that federal income tax and securities laws considerations will limit the use of statutory share exchanges, but that should not be a reason for limiting the types of consideration permitted to be paid for exchanged shares so as to be even more restricted than for mergers.⁸⁵

Third, restrictions in the subsidiary merger provisions are inconsistent with other changes in the New BCA. Old BCA section 66a permitted mergers of subsidiaries, without approval by the constituent corporations' shareholders, if 99% owned by the corporate parent. New BCA section 11.30 lowers the ownership requirement to 90%, but retains two other limitations from Old BCA section 66a, namely, (1) each merging subsidiary must be "solvent" and (2) at least 30 days before the merger can be made effective, the plan of merger must be mailed to the shareholders of each merging subsidiary who have not waived the mailing. Retention of the 30 days advance mailing requirement seems pointless when, as an alternative, the merger procedure requiring

82. DEL. CODE ANN. tit. 8, § 251(b)(1983) (emphasis added).

83. *ABA Exposure Draft*, *supra* note 8, § 11.02(b)(3) (emphasis added).

84. New BCA, § 11.10(c) (emphasis added).

85. If more than 20% of the common shares of the acquiring corporation are to be issued in the share exchange, or upon conversion of securities issued in the share exchange, the acquiring corporation must have the plan of exchange approved by its shareholders. New BCA, § 11.20(c)(3). Under *ABA Exposure Draft* § 11.03, only the shareholders of the corporation being acquired must approve the plan of exchange which also is true of the exchange provisions in the Illinois insurance laws, ILL. REV. STAT. ch. 73, ¶ 771 (1983). The New BCA in effect adopts the shareholder approval policies of the New York and American Stock Exchanges even for corporations that do not have their shares listed on either of those exchanges. See *Official Comments*, *supra* note 9, § 11.20.

shareholders' approval could be used to merge subsidiaries, in which case the 90% shareholder could approve the merger for the subsidiaries by written consent upon only five days' prior notice under New BCA section 7.10 (which eliminates the need for unanimity for shareholders' action by written consent). If the subsidiary is merged into the parent, voting by the parent corporation's shareholders could be avoided under New BCA section 11.20(c) if (as probably would be the case) no more than 20% of the parents' common shares is issued. By the same procedure, the merger of an insolvent subsidiary into the parent could be approved. Thus, both limitations from Old BCA section 66a are anachronisms in the New BCA. Allowing subsidiary mergers without shareholders' approval and without other restrictions when 90% ownership exists, as is the case under Delaware General Corporation Law section 253, would have been more appropriate.

2. *Dissenters' Rights*

New BCA sections 11.65-11.70 contain the provisions for shareholders' dissenters' rights. Old BCA sections 66a, 70 and 73 provided dissenters' rights in the case of mergers, consolidations and sales or exchanges not in the usual course of business of substantially all of the corporate assets. New BCA section 11.65(a) changes that list of transactions to conform to changes elsewhere in the New BCA, such as adding statutory share exchanges (new in the New BCA). Further, New BCA section 11.65(a) adds dissenters' rights for charter amendments that alter or abolish preferential rights or redemption rights of any shares or that limit or eliminate cumulative voting for any shares of corporations existing prior to January 1, 1982.

The New BCA's dissenters' rights provisions, which are substantially more complex than those in the Old BCA, are intended to be protective of shareholders' interests. For corporate managers of public corporations, however, dissenters' rights will continue to be a reason for preferring the Delaware General Corporation Law. Delaware Law section 262 provides dissenters' rights only for mergers or consolidations, rather than the more extensive list of transactions set forth in New BCA section 11.65(a). Further, even for mergers or consolidations, dissenters' rights are available under the Delaware Law only if certain exceptions (principally for holders of listed securities or securities held of record by more than 2,000 shareholders) do not apply. Unlike the Illinois law, Delaware allows publicly-owned corporations considerable freedom from dissenters' rights, relying upon the market place rather than statutory

remedies to provide shareholders an alternative to the transaction to which they dissent.

IV. CONCLUSION

The New BCA is a far more complex statute than its predecessor, the Old BCA. The New BCA makes a number of improvements, but also has a number of deficiencies. The July 1, 1984 effectiveness of the New BCA mooted the question whether the needed improvements could have been made more efficiently by discrete amendments to the Old BCA. The task now should be to promptly correct, improve and more adequately explain the new law, the need for which is apparent.

