

**SFA**

BILL ANALYSIS

Senate Fiscal Agency

Lansing, Michigan 48909

(517) 373-5383

Senate Bill 181 (as enrolled)  
Sponsor: Senator Virgil Smith  
Senate Committee: Commerce and Technology  
House Committee: Corporations and Finance

Date Completed: 7-24-89

**RATIONALE**

The Business Corporation Act, which specifies the powers and duties of corporate shareholders and directors, provides for the distribution of corporate shares, and details the conditions for mergers and dissolutions, was last revised comprehensively in 1973. Since then there have been a number of changes in general corporate structure and finance provisions in response to both the natural evolution of the corporate system and specific legal challenges that have rendered sections of the Business Corporation Act obsolete or superfluous and raised issues that had not been adequately addressed in statute, if even addressed at all. For example, the Act still provides for the issuance of par value shares and generally requires a corporation to repurchase shares only from its surplus, concepts that have been obsolete in legal literature for years. Most corporations currently issue and redeem shares based on general legal principles concerning corporate solvency. Moreover, both the courts and various interested corporate parties reportedly have struggled to decipher provisions that because of their apparent ambiguity or lack of specificity have prompted differing and sometimes contradictory interpretations. It has been suggested that a revision of the Act to update and clarify provisions and procedures and address new issues in corporate finance and structure would be beneficial to corporate management and shareholders and perhaps obviate the need for much litigation.

**PUBLIC ACT 121 of 1989****RECEIVED****AUG 04 1989**

Mich. State Law Library

**CONTENT**

The bill would make a number of changes to the Business Corporation Act's corporate provisions concerning the distribution of dividends and corporate shares, the rights and responsibilities of shareholders and boards of directors, and procedural matters pertaining to such issues as voting, meeting attendance, notice requirements, and inspection of corporate records.

The bill would take effect October 1, 1989.

**Chapter 1 - General Provisions**

The bill generally would delete definitions of such terms as "shareholder", "capital surplus", "earned surplus", "stated capital" and "net assets", which would not be used under the bill's proposed changes concerning corporate financial matters, and would define such terms as "distribution" and "independent director". The term "distribution" would mean the direct or indirect transfer of money or other property, except the corporation's shares or the incurrence of indebtedness by the corporation to or for its shareholders' benefit in respect to the corporation's shares. A distribution could be in the form of a dividend, a purchase, redemption or other acquisition of shares, a distribution of indebtedness, or any other declaration or payment to or for the shareholders. An "independent director" would be a director elected by the shareholders and specifically designated as an independent

director by either the board or the shareholders. An independent director would have to have had at least five years of business, legal, financial, or other equivalent experience, and for the three years prior to being designated an independent director could not have been any of the following:

- An officer or employee of the corporation or any affiliate.
- Engaged in a business transaction, or series of transactions, for profit involving more than \$10,000 with the corporation or any affiliate.
- An affiliate, executive officer, general partner, or immediate family member of anyone engaged in a proscribed business transaction.

The independent director could not propose to enter into a proscribed relationship or transaction and could not have an aggregate of more than three years of service as a director of the corporation.

Further, the bill would add provisions to preclude the application of the Fraudulent Conveyance Act to distributions to shareholders and allow incorporators to sign documents if the board had not yet met.

#### Chapter 2 - Formation: Purposes and Powers

The bill would:

- Prohibit the retroactive application of a provision in a corporation's articles limiting the liability of a director.
- State that the Act's usury defense provision could not be used for loans made to corporations for the personal purposes of their shareholders.
- Allow a corporation to adopt a single common name with a limited partnership or any other enterprise with which the corporation was participating in a joint venture. (Currently, corporations are allowed to assume a common name only with other corporations).
- Allow an individual resident agent's residence (as well as his or her business office) to serve as the registered office that the corporation is required to maintain in this State. If the agent resigned, the residence or business office would no longer be the registered office.

Finally, the bill specifies that a corporation's current power to give guarantees and incur liabilities and secure its obligations by mortgage or pledge of security and interest would include the power to give guarantees that are necessary or convenient to the conduct, promotion, or attainment of the business of any corporation that directly or indirectly owns all of the outstanding stock of the contracting corporation, or whose outstanding stock is directly or indirectly owned by the contracting corporation or by a corporation that directly or indirectly owns all of the outstanding stock of the contracting corporation.

#### Chapter 3 - Capital Structure and Corporate Finance

The bill would replace the current corporate finance structure with a unified approach to distributions and would base their legality on assets and liabilities tests and insolvency tests rather than on the current concepts of surplus and stated capital.

Specifically, the bill would allow a corporation to make distributions to its shareholders, subject to restriction by its articles of incorporation, provided, however, that no distribution could be made if the corporation would not be able to pay its debts as they became due or the corporation's total assets would be less than the sum of its total liabilities plus any amount needed to satisfy the preferential rights of shareholders if the corporation dissolved. The board of a corporation could base a determination that a distribution was not prohibited either on financial statements prepared on the basis of reasonable accounting practices and principles or on a fair valuation or other reasonable method.

The bill also would:

- Allow for the conversion of shares into bonds.
- Allow for the redemption of shares not only at the option of the corporation but also at the option of the holder or upon the occurrence of a specified event.
- Specify that a corporation could retain a security interest in shares to secure a subscriber's obligations.
- Specify that unless otherwise provided in

the articles of incorporation, a shareholder of a corporation would not be personally liable for the acts or debts of the corporation but could become personally liable by reason of his or her own acts or conduct.

- Specify the times at which the validity of distributions would be determined.
- Allow installment obligations to be undertaken by a corporation even if the requisite financial tests were not satisfied at the time of the acquisition, provided the tests for validity of a distribution were met at the time payment was due.
- Specify that the enforceability of a third party guaranty of a distribution would be unaffected by the illegality of the guaranteed distribution.
- Allow boards to issue uncertificated shares and share dividends without having to transfer surplus into stated capital.
- Specify that shareholders would not have a preemptive right to acquire unissued shares except to the extent provided in the articles or an agreement between the corporation and its shareholders.
- Describe the conditions under which a corporation could acquire its own shares.

#### Chapter 4 - Shareholders

The bill would:

- Add language specifying who would have to sign a written consent of the shareholders to a particular action when no meeting was held, when the consent would take effect, and to whom it would have to be delivered.
- Add a provision allowing a corporation to establish a procedure by which the beneficial owner of shares registered in the name of a nominee was recognized as the shareholder by the corporation.
- Specify that the Act's restrictions concerning the voting of shares held by subsidiaries on any matter concerning the parent corporation would apply in the absence of a court order "based upon a determination that special circumstances existed and the best interest of the corporation would be served".

- Specify that failure to include in the articles of incorporation a provision restricting or delegating the management powers of the board would not invalidate an otherwise valid bylaw or agreement.
- Provide additional requirements or conditions concerning the right of the shareholders and the directors to inspect corporate records and to apply to the circuit court for an order to compel the inspection.
- Delete a requirement that an amendment to a corporation's articles to add a super majority provision be adopted by the same super majority.
- Add a new provision to preclude any inference that a high vote provision was invalid unless included in the articles.
- Specify that vote pooling agreements would not be subject to statutory provisions on voting trust agreements, and that pooling agreements would be specifically enforceable.
- Include in the remedies currently available to a shareholder who brings an action alleging unfair and aggressive actions by the corporation the dissolution and liquidation of the corporation's assets and business and the award of damages. None of the remedies would apply to shareholders whose shares are traded on the market.
- Revise the Act's current provisions concerning derivative suits (a suit by a shareholder to enforce a corporate cause of action) to make mandatory a written demand on a board of directors to take action, provide mechanisms for determining whether an action is in the corporation's best interests, and allow the court to stay or dismiss a derivative proceeding.
- Allow incorporators to vary shareholder quorum requirements.

#### Chapter 5 - Directors and Officers

The bill would revise current provisions concerning the removal of directors, the duties of officers and directors, and their ability to rely on certain reports and information. Specifically, the bill would:

- Provide for the designation of an independent director entitled to

reasonable compensation, reimbursement for expenses and the right to communicate with shareholders at the corporation's expense.

- Provide new rules on filling vacancies on the board to allow shareholders as well as directors to fill vacancies and specify which directors and class of shareholders would make the selections.
- Amend provisions concerning transactions in which a director or officer has an interest to protect a transaction from challenge if it were authorized, approved, or ratified by disinterested board members, independent directors, or shareholders.
- Allow incorporators to provide for staggered terms for directors and specify that directors could be elected by series of shares.
- Specify that the right of shareholders to remove a director for cause could not be denied by contrary provisions in the articles or bylaws.
- Allow the circuit court to remove a director, if the court found that the director engaged in fraudulent, illegal, or dishonest conduct or gross abuse of authority or discretion with respect to the corporation.
- Allow directors to rely on information, opinions, reports, and statements of other directors, officers or employees of the corporation, legal counsel, public accountants, engineers and others the director considered competent and reliable.
- Change current provisions concerning indemnification to specify a procedure for evaluating the reasonableness of expenses and amounts paid in settlement for which indemnification was sought.
- Authorize a court to order indemnification if it were deemed to be fair and equitable.
- Specify that not only attorney's fees but all expenses and amounts paid in settlement would be reimbursable only if actually and reasonably incurred.

#### Chapter 6 - Amendments to Articles of Incorporation

The bill would delete references to par and no par shares and add a provision authorizing a

corporation to convert to a nonprofit corporation by adopting restated articles of incorporation.

#### Chapter 7 - Corporate Combinations and Dispositions

The bill would change the Act's current provisions concerning mergers and provide a new method, the share exchange procedure, by which one corporation could acquire all the shares of another while keeping the acquired corporation alive. The bill also would limit the voting rights of shareholders of merger survivors, specify the latitude of boards of directors to propose an asset sale or determine the terms upon which they would submit a plan of merger or share exchange to shareholders, specify that a merger or share exchange could be abandoned without shareholder action in accordance with procedures as established by the plan or determined by the board, provide new procedures to govern the exercise of appraisal rights, and specifically grant appraisal and voting rights to shareholders of the nominal acquiring corporation in an acquisition in which a company that is formally an acquiror has been acquired (commonly called an "upside down" acquisition).

#### Chapter 8 - Dissolution

The bill would amend the Act's current procedures for voluntary dissolution to permit a board to submit a dissolution proposal to shareholders without a recommendation and conditioned on any basis, delete references to class voting by shareholders, require that notice of a dissolution be given to all shareholders (and not just those entitled to vote), allow a dissolving corporation to bar any existing claims not submitted by a specified date, and specify guidelines for determining what provision for claims would have to be made before assets could be distributed to shareholders in a dissolution and when a provision allowing a shareholder to require the dissolution of a corporation would become invalid.

#### Chapter 9 - Reports

The bill would add new provisions specifying that the consequences of failure to file reports and penalties for filing false or fraudulent

reports would apply to foreign as well as domestic corporations. The bill would delete provisions related to the liability of officers, directors, and agents for false reports or other statements.

#### Chapter 10 - Fees

Upon filing its articles of incorporation, a corporation currently must pay organization and admission fees based on the dollar value of its capital stock. The bill would change the fees to a flat fee per number of shares issued, i.e., the fee would be \$50 for the first 60,000 authorized shares and \$30 for each additional 20,000 authorized shares. If a corporation's capital were not divided into shares, its fees would be determined as if it had 60,000 shares.

#### FISCAL IMPACT

The bill would have an indeterminate fiscal impact on State and local government. At the time of filing articles of incorporation or if requesting authorization to issue additional shares of stock under the current Act, each corporation must pay organization and admission fees based on the dollar value of the capital stock. The bill would change the fees to a flat fee per number of shares issued. The number of corporations that would incorporate and pay fees under the new fee structure, and the dollar value of the stock to be issued cannot be determined. The bill would also authorize circuit court action in certain disputes between shareholder corporations. The number of circuit court actions and their additional cost to local government cannot be determined.

#### ARGUMENTS

##### Supporting Argument

By modernizing, streamlining, and clarifying the Business Corporation Act, the bill would eliminate outdated concepts of corporate organizational and financial structure that may hamper a corporation's efforts to conduct business in Michigan, and obviate the need for extensive research by corporate management, and perhaps even litigation, necessitated by the often ambiguous, confusing, and imprecise statutory provisions that currently govern corporations. Moreover, the bill would grant businesses the flexibility they need to respond to the very dynamic corporate world and would

even provide for an innovative mechanism, the independent director, to ensure the validity and legitimacy of transactions between directors and the corporation.

##### Opposing Argument

The bill's proposed fee structure, based on a corporation's number of issued shares rather than on the dollar value of capital stock, could require that some smaller corporations pay disproportionately higher fees than under the current fee structure. In fact, the bill's proposed fees could inadvertently provide for an increase in revenue to the State. The bill, therefore, should provide at least for legislative review of the fees so if significant revenue increases did occur, the fees could be adjusted appropriately.

**Response:** An analysis of similar fees imposed by other states shows that even under the bill, Michigan's corporate franchise fees would be lower than neighboring states, and much lower than those states with the highest fees. The fees proposed in the bill would bring Michigan closer to what other states charge corporations for doing business in their regions.

Legislative Analyst: L. Burghardt

Fiscal Analyst: J. Schultz

##### A8990/S181EA

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.