Legislative Activities Of The Corporations Committee

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The Corporations Committee ("Committee") is charged with the duty of studying, considering, taking a position on and advocating that position with respect to needed changes to the California Corporations Code ("Code") and related statutory changes that would promote efficiency or effectiveness in practice. In pursuing its mission during the 2012 Bar Year, the Committee prepared three affirmative legislative proposals to amend the Code ("ALPs") and monitored and commented upon other proposed legislation affecting businesses. These activities are summarized in this article. The Committee plans to continue to dedicate substantial time and energy to legislative matters during the 2013 Bar Year.

Affirmative Legislative Proposals

ALPs typically are developed under the following process. Individual Committee members, a designated subcommittee, or both, study the Code and identify areas needing improvement, resulting in a draft ALP that includes a detailed explanation of why the change in law is necessary or appropriate. Many ALPs address problem areas of the law encountered by Committee members in their practices. Several drafts are often prepared and reviewed at the Committee level, comments are given, and ultimately an ALP is approved by the Committee. The ALP is then submitted for the further approval of the Executive Committee of the Business Law Section and the Board of Trustees of the State Bar. The Bar's legislative consultant then seeks sponsors, and the Committee provides technical support, including assistance in drafting the legislation and testifying before legislative committees, when appropriate. The ALPs discussed below have been approved by the State Bar's Board of Trustees. Legislative sponsors will be sought by the State Bar's lobbyists to carry the bills forward in 2013. Copies of these ALPs may be found at the following location: http://www.calbar.ca.gov/AboutUs/Legislation/LegislativeChairInformation/2013LegislativeProposals.aspx.

A Proposed Safe Harbor for "Finders"

The first ALP proposes to enact a safe harbor for "finders" in connection with securities transactions. A broker-dealer may not conduct business in California without first securing a license absent a statutory exemption.[1]

While the term "broker-dealer" is clearly defined by statute,[2] the definition of a "finder" is not so clearly defined by case law, although it is generally understood to refer to a person who merely introduces parties to each other, without negotiating on behalf of either party, and without providing any information on which either party may rely.[3]

Many persons act as "finders" in the state of California in connection with securities transactions without being registered with the State as a "broker-dealer." A finder's activity may be lawful or unlawful depending upon its degree of involvement in the securities transaction. Persons engaged in unlicensed broker-dealer activities can lead to severe consequences for the issuer as well the unlicensed

[1] Cal. Corp. Code § 25210.
[2] Cal. Corp. Code § 25004.
[3] Dept. of Corporations, Invitations for Comments on Administration Regulation Under the Corporate Securities Law, No. PRO 31/06 (September 13, 2006); See also Commissioners Opinion No. 81/1C (January 19, 1981).

person. Thus, legitimate transactional activity may be stifled absent greater clarity distinguishing "finders" from "broker-dealers."

The Committee believes that the activities of legitimate "finders" are beneficial to the orderly flow of transactions, and are particularly important in the raising of capital by small to mid-sized businesses. Therefore, the Committee proposed a statutory amendment to provide a clear framework within which issuers and finders may lawfully conduct business, while simultaneously regulating finders with a view towards investor protection and raising tax and fee revenue for the State of California. The proposed safe harbor would require (1) an initial filing with the Department of Corporations, (2) a notice filing and payment of a fee to the Department on a per transaction basis, (3) the filing of an annual statement of information renewal and the payment of a related filing fee, (4) the informed written consent of each investor, and (5) maintenance of certain records. The proposal also prohibits certain actions, such as taking custody of client funds, conducting due diligence, and making disclosures to investors other than permitted disclosures.

Emergency Powers and Related Bylaws

In contrast to the growing national trend, the Code does not provide operational powers for a corporation's board of directors during the period of an emergency. California has neither an emergency powers statute, whereby a corporation would be expressly authorized to take certain actions it might not otherwise be able to take, nor an emergency bylaws statute, whereby a corporation would be authorized to adopt any provisions, not conflicting with the articles, as are necessary to manage the business during an emergency.

Without emergency powers or bylaws, a corporation may be unable to continue its business, or risk a challenge to any actions taken with a lesser quorum, during an emergency. Acts of terrorism and disasters such as earthquakes, tsunamis and nuclear or aviation accidents are examples of how corporations may become vulnerable in the face of large-scale emergencies. It is important that boards of directors have the necessary powers to act in lieu of the officers or to elect temporary officers to act in an emergency.

Accordingly, the Committee has proposed amendments to the Code to adopt both emergency powers and emergency bylaw provisions. The former specifies those actions that can be taken during an emergency and provides basic protections for a corporation that does not adopt emergency bylaws. The latter would expressly permit California corporations to adopt emergency bylaws allowing any actions not conflicting with the articles to manage the corporation during an emergency. These amendments would protect corporate actions taken in good faith and contain limitations intended to prevent abuse of the emergency powers.

Actions by Written Consent of the Shareholders

The Committee has proposed an amendment of the Corporations Code section 603 to eliminate the 10-day waiting period for consummating certain corporate reorganizations that are approved by less than unanimous written consent of the shareholders. The rationale for the proposal is that there is no need for a 10-day waiting period when the shareholders have validly approved a transaction and non-consenting shareholders have adequate remedies in the form of dissenter's rights. In these situations, the 10-day waiting period subjects the consummation of such reorganizations to unnecessary risk and increases corporate costs by requiring the corporation to deliver information packages despite the fact that the transaction was already validly approved. Eliminating the 10-day waiting period for reorganizations which provide dissenters' rights will not adversely impact shareholders since current law prohibits shareholders in these cases from attacking the validity of, or seeking to enjoin, the reorganization. The 10-day waiting period would continue to apply to actions approved by less than unanimous written consent where dissenters' rights do not apply, such as approvals of certain transactions involving conflicts of interest or indemnification.

Activities on Other Proposed Legislation

Letters of Support and Opposition

The Committee's Vice-Chair(s), Legislation, actively monitor proposed legislation of interest and report on same at the Committee's monthly meetings. The Committee may then adopt a support, oppose or neutral position on a particular bill. If the decision is to support or oppose, a sub-committee develops a position letter for action by the Committee.

During the 2012 Bar Year, the Committee did not issue any letters of opposition, but did issue one letter of support for A.B. 2260 (2011-2012 Sess.) (Hagman), a proposal to repeal section 2115 of the Code. Section 2115 imposes 22 sections of the Code on corporations organized in other states that have substantial business in California. These provisions include such fundamental matters as shareholder voting requirements, the election and removal of directors, and mergers and acquisitions. Section 2115 thus attempts to supplant the law of the state in which the foreign corporation is organized. A.B. 2260 (2011-2012 Sess.) would have conformed California law to the fundamental principle of corporate law that prevails in most other jurisdictions, that the internal affairs of a corporation are governed by the law of the state in which the corporation is organized and which the organizers and shareholders have selected.

The Committee asserted that the efficient and profitable operation of a corporation demands certainty and predictability regarding the corporate law that applies to the company. Under current law, a corporation may find that its local state law requires it to take one course of action, while California state law requires it to take a different course of action. The Committee also noted that additional uncertainty arises over whether section 2115 will apply to a corporation in any particular year, given that the application of section 2115 depends on a corporation's ties to California, which often vary over time. Among the factors considered are the residence of shareholders and the amount of the corporation's business (judged by property, payroll and sales) that is conducted in California. In practice, determining whether a corporation has the required nexus with California can be difficult.

The uncertainties created by section 2115 often go to the heart of a corporation's business. For example, the provisions imposed on foreign corporations include those defining the duties of the corporation's directors, the right of shareholders to cumulate votes in director elections, and shareholder voting requirements in significant corporate transactions. In these matters, there are significant differences between the law of California and the law of Delaware, where many corporations choose to incorporate. The consequences of such uncertainty are increased operating and transaction costs, which create a disincentive to doing business in California. The uncertainty created by section 2115 may encourage foreign corporations to purposely limit their business in California to avoid the imposition of its requirements. In sum, the Committee felt that the repeal of section 2115 would simplify the legal landscape for corporations operating in California and make the state a more attractive place to do business.

A.B. 2260 (2011-2012 Sess.) passed the Assembly by a 75-0 vote. The bill, however, failed in the Senate Judiciary Committee by a one-three vote. The Senate Judiciary Committee's file on A.B. 2260 (2011-2012 Sess.) contained only a single letter of opposition from an individual who was previously the Commissioner of California's Department of Corporations. Thus, section 2115 remains the law of California.

Other Legislative Activities

During the 2012 Bar Year, the Committee also provided input on a wide variety of pending bills, effectively acting as a sounding board for legislative staff working on proposed amendments to the Code. It provided technical corrections for A.B. 571 (2011-2012 Sess.), the bill which overhauled California's

corporate distribution provisions effective as of January 1, 2012.[4] The Committee also participated in tailoring the statutory formulation under S.B. 978 (2011-2012 Sess.) (Vargas and Price), a bill seeking to address abuse of investors in hard money lending transactions. Due to common concerns on S.B. 978 regarding potential limitation or elimination of commonly used California securities law exemptions, the Committee formed a joint subcommittee with the Partnerships and Limited Liability Companies Committee. This joint subcommittee engaged in direct dialogue and drafting sessions with Eileen Newhall, the Staff Director of the Senate's Banking, Finance and Insurance Committee. The Committee also fielded technical questions from and provided advice to legislative proponents for the new dissenters' rights provisions (A.B. 1680 (2011-2012 Sess.)), which passed, and a new securities exemption permitting general solicitation or general advertising (A.B. 2081 (2011-2012 Sess.)), which did not. The JOBS Act does, however, include a substantially similar exemption to that contemplated by A.B. 2081 (2011-2012 Sess.).

[4] See Voxman, California Corporations Code Provision Governing Distribution Amended and Streamlined with the Passage of AB 571, Bus. Law News (State Bar of California, S.F., Cal.) Issue 1, 2012, at 1.