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Corporations Act Changes the Landscape*

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William H. Clark, Jr

Amber A. Hough

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# A NEW PARADIGM FOR STATE CORPORATION LAWS

WILLIAM H. CLARK, JR.<sup>†</sup> AND AMBER A. HOUGH<sup>††</sup>

*“The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”<sup>1</sup>*

## I. INTRODUCTION

The North Dakota Publicly Traded Corporations Act (Act), found in Section 10-35 of the North Dakota Century Code, has been described in news reports as “the first corporate governance ‘shareholder-friendly’ law in the nation.”<sup>2</sup> As this Article discusses, that statement accurately summarizes the nature of the Act’s provisions as they relate to the major topics in the current corporate governance debate, such as majority voting, proxy access, reimbursement of proxy contest expenses, “say on pay,” separation of the roles of chair of the board and chief executive officer, and limitations on poison pills.<sup>3</sup> But the Act also needs to be understood as not simply a collection of piecemeal shareholder protections but rather as proposing a new paradigm for state corporation laws.

In addition to reviewing many of the specific provisions of the Act itself, this Article argues that the Act represents a two-fold fundamental change in the way state corporation statutes address corporate governance. The first and most important fundamental change is to shift the entire paradigm of how directors and boards are monitored and elected by the shareholders to a system of contemporaneous oversight.<sup>4</sup> The Act shifts away from the current system of monitoring the performance of directors in a reactionary manner, largely in the context of change of control transactions or wrongdoing, where oversight comes mostly through the courts, in

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<sup>†</sup>Mr. Clark is a Partner in Drinker Biddle & Reath LLP and President of the North Dakota Corporate Governance Council. He was the principal drafter of the North Dakota Publicly Traded Corporations Act.

<sup>††</sup>Amber Hough is an Associate at Drinker Biddle & Reath LLP.

1. *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988).

2. Crystal R. Reid, *Corporate Landscape Changing*, BISMARCK TRIBUNE, May 6, 2007, available at <http://www.bismarcktribune.com/articles/2007/05/06/news/local/132998.txt>.

3. See discussion *infra* Part III (explaining the provisions of the North Dakota Publicly Traded Corporations Act).

4. See discussion *infra* Parts III.E & IV (examining the Act’s impact on the oversight and election of directors and board members).

favor of a system that reinvigorates the shareholder franchise which should result in greater accountability of directors to the constituency that elects them.<sup>5</sup> The fundamental approach of the Act is that monitoring the performance of the board of directors should come through open, responsive annual elections rather than litigation or proxy contests.

The second fundamental change made by the Act is to create an instantly identifiable corporate governance “brand,” thereby allowing the market to “price” the corporation’s governance structure in a way that has not previously been possible. The Act accomplishes this “branding” by requiring a corporation to either opt in or out of being subject to all of the provisions of the Act, and thus prohibiting a corporation from cherry-picking among the Act’s provisions.<sup>6</sup> This is a departure from all existing state corporate codes which, regardless of their general structure, allow corporations to opt out of many provisions by simply including appropriate provisions in the company charter or bylaws. By making the Act an invariable set of rules, a potential investor in a North Dakota corporation subject to the Act will know without any further research that the corporation has elected a progressive and shareholder friendly structure. That clear communication of a corporation’s governance structure should permit the market to price the corporation’s governance structure in a way that typical state codes do not allow.

Part II of this Article provides a brief overview of the evolution of United States corporation law with a focus on how that history highlights the unique nature of the Act.<sup>7</sup> Part III introduces the existing North Dakota Business Corporations Act (NDBCA)<sup>8</sup> and discusses in detail the key corporate governance provisions of the Act.<sup>9</sup> The discussion in Part III also

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5. See generally William J. Carney & George B. Shepherd, *The Mystery of Delaware Law’s Continuing Success*, 2009 U. ILL. L. REV. 1, 64-76 (2009) (arguing that Delaware is in fact an increasingly complicated place to incorporate thanks to inconsistent judicial decisions); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1913-19 (1998) (discussing Delaware’s heavy dependency on the courts to moderate and make more determinate the state’s very indeterminate corporate code).

6. N.D. CENT. CODE § 10-35-03 (2007).

7. See discussion *infra* Part II (discussing the history of corporate law in the United States). Much has been written about the competition among the states to attract corporate chartering business and does not need to be repeated here except to the extent it helps frame the paradigm represented by the Act. See, e.g., Oren Bar-Gill, Michal Barzuz & Lucian Bebchuk, *The Market for Corporate Law* 162, J. INSTITUTIONAL & THEORETICAL ECON. 134, 137 (2006); William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619, *passim* (2006); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, *passim* (1974); Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, *passim* (1977).

8. N.D. CENT. CODE ch. 10-19.1 (1985).

9. See discussion *infra* Part III (exploring the key provisions of the Act).

provides a brief legislative history of the Act and includes a comparison of the key governance provisions of the Act to the Model Business Corporation Act (Model Act) and the General Corporation law of the State of Delaware (Delaware GCL).<sup>10</sup> Part IV concludes the discussion and returns to the theme that the Act shifts shareholder influence on corporate governance from a reactive and illusory right, to a proactive and vital system.<sup>11</sup>

## II. THE EVOLUTION OF U.S. CORPORATION LAW

### A. INTRODUCTION: THE ROLE OF SHAREHOLDERS GENERALLY

As a matter of legal theory, shareholders own their corporation and the directors they elect represent the interests of the shareholders as the directors manage or supervise the corporation's affairs.<sup>12</sup> Within that framework, the issue becomes how the shareholders can ensure that management works for the best interests of the shareholders while at the same time allowing management to run the company in the most profitable fashion. Or, stated negatively, when shareholders are not happy with the way management is running the company, what can the shareholders do about it? Business leaders, academics and shareholders have long debated how to address this inherent tension in the corporate structure.<sup>13</sup> The traditional answer has been twofold. First, shareholders who are unhappy with the management of a corporation can sell their shares and walk away.<sup>14</sup> Secondly, from a purely structural perspective, “[i]f the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.”<sup>15</sup>

In practice, however, both of the answers to the separation between ownership and control in the corporate structure have proven illusory. The ability to liquidate a position and invest in a different corporation—the so-called “Wall Street Walk”—is increasingly difficult for institutional

10. DEL. CODE ANN. tit. 8 (2001); COMMITTEE ON CORPORATE LAWS, MODEL BUSINESS CORPORATIONS ACT, OFFICIAL TEXT WITH OFFICIAL COMMENT AND STATUTORY CROSS REFERENCES REVISED THROUGH DECEMBER 2007 (American Bar Association 2008).

11. See discussion *infra* Part IV (discussing the impact the Act has on shareholder influence).

12. See J. Bradford DeLong, *The Corporation as a Command Economy* (1997), [http://www.j-bradford-delong.net/Econ\\_Articles/Command\\_Corporations.html](http://www.j-bradford-delong.net/Econ_Articles/Command_Corporations.html) (last visited May 13, 2009) (giving a concise outline of the legal structure of corporations).

13. See generally ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (Harcourt, Brace and World 1967) (1932). Berle and Gardiner were among the first to outline the problems with management-friendly state codes.

14. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 959 (Del. 1985); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988).

15. *Unocal Corp.*, 493 A.2d at 959.

investors thanks to self-imposed limitations on the type of investments a fund can make, or because the size of an institution's holdings renders its shares illiquid in the market, leaving the institution few if any other choices for alternate investments.<sup>16</sup> Under the current paradigm, in cases where walking away is not an option, shareholders have "the powers of corporate democracy . . . at their disposal" only if they are willing to incur the substantial costs of a proxy contest.<sup>17</sup> For shareholders who are not interested in acquiring control of a corporation, the prospect of mounting a proxy contest raises an insurmountable "free rider" problem: Why should one shareholder incur the costs of a proxy contest that will benefit all of the shareholders?<sup>18</sup> The task is made more difficult because shareholder power to bring a proxy contest can be, and often is, reduced in various ways including: advance notice requirements; denying shareholders access to the corporation's proxy statement; and the use of staggered elections to dilute shareholder influence over the composition of the board.<sup>19</sup> Indeed, one commentator believes, "[shareholder voting rights are] so weak that they scarcely qualify as part of corporate governance."<sup>20</sup> Other than mounting a proxy contest, modern corporation laws do not provide shareholders who are not seeking control with any effective means to exercise their theoretical powers of corporate democracy.

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16. Aaron Bernstein, *Shareholder Power: A Look at the Rise of Activist Shareholders*, DIRECTORSHIP BOARDROOM INTELLIGENCE, Oct. 1, 2007, <http://www.directorship.com/power-to-the-shareholders> (last visited May 13, 2009).

17. *Unocal Corp.*, 493 A.2d at 959.

18. Sanford J. Grossman & Oliver D. Hart, *Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation*, 11 BELL J. ECON. 42 *passim* (1980); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 114-15 (1965). When one shareholder carries the costs of a proxy contest, all the shareholders benefit from the outcome but none of them were required to support the contest financially, thereby becoming "free-riders" to the contest benefits.

19. See generally WILLIAM H. CLARK, JR. ET AL., UPDATING YOUR COMPANY'S CORPORATE GOVERNANCE POLICIES—LEADING LAWYERS ON ANALYZING COMPLIANCE PROGRAMS, EVALUATING POSSIBLE RISKS, AND TAILORING POLICIES TO FIT THE NEEDS OF VARIOUS COMPANIES *passim* (2008) (outlining how the NDBCA works and how it might effect the corporate governance world in the next several years); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 843-75 (2005) [hereinafter *Increasing Shareholder Power*] (describing in detail the arguments for and against codifying the various shareholder protections listed above); Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 688 (2007) [hereinafter *Myth of the Shareholder Franchise*] (describing in detail why the current system of corporate governance prohibits meaningful shareholder participation).

20. Steven Levington, *Icahn, Time Warner End Fight; Dissident Investor Won't Seek Control*, WASH. POST, at 413, Feb. 18, 2006.

## B. THE DEVELOPMENT OF STATE CORPORATION LAWS

The structuring of corporate laws to limit shareholder influence is no accident. The trend of enticing companies to domicile within a state by enacting flexible, manager friendly codes has been common practice since the 1890s, generally with great success for the state that enacted such codes.<sup>21</sup> States, starting with West Virginia in 1888, hypothesized that significant sums of tax revenue could be gained if the state was an attractive domicile for the then-burgeoning corporate population.<sup>22</sup> The states accomplished the goal of revenue enhancement by drafting codes that allowed for such innovative actions as allowing alterations to the business, amendments to the charter, changes to capital structures, and opening the door for combining companies—thereby creating the merger.<sup>23</sup> More importantly for the current discussion, the new codes also expressed for the first time that the management and control of a corporation would rest in a board of directors rather than the shareholders.<sup>24</sup> This, the states believed, would attract corporations because the board decides where to domicile the company, and they would naturally choose a state which gave them the greatest amount of flexibility.<sup>25</sup> This theory proved to be a success both for corporations and for the states. For corporations, not only did the less restrictive codes allow companies the kind of flexibility they needed to evolve and grow; New Jersey and, in quick succession, many other states—most notably the bellwether state of Delaware—found that this type of liberal corporate code attracted sufficient corporate activity and tax revenue to keep the states completely in the black.<sup>26</sup> This trend continues today. Every state has a more or less liberal, manager friendly code designed to entice managers to domicile their business in that particular state or to not leave the state for a more hospitable jurisdiction.<sup>27</sup>

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21. See Bratton & McCahery, *supra* note 7, at 626-29 (providing an overview of competitive state charters starting in 1888).

22. *Id.* at 627.

23. *Id.*

24. JAMES B. DILL, THE STATUTORY AND CASE LAW APPLICABLE TO PRIVATE COMPANIES UNDER THE GENERAL CORPORATIONS ACT OF NEW JERSEY 42-43 (1898).

25. See, e.g., Lucian A. Bebchuk, *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784, 1803 (2006) (arguing that this board-friendly approach is harmful and shareholders should have more direct say in the state of incorporation or reincorporation of a company); Lucian A. Bebchuk & Allen Ferrell, *Federal Intervention to Enhance Shareholder Choice*, 87 VA. L. REV. 993, 997 (2001) (discussing the distortion that occurs when boards decide where to incorporate).

26. RALPH NADER ET AL., CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR THE FEDERAL CHARTERING OF GIANT CORPORATIONS 45 (1976).

27. See generally Mark J. Roe, *Does Delaware Compete?*, Dec. 12, 2008, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1315342](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1315342) (discussing generally the trend towards liberal codes and Delaware's attempts to stay the most popular state for incorporation); Bar-Gill,

Despite the clear trend to enact corporate charters without shareholder protections, the question of whether that is the best public policy has long been strenuously debated.<sup>28</sup> As early as 1932, economists Adolf Berle and Gardiner Means described how these flexible codes could ultimately be detrimental to the shareholder owners of corporations, because the codes fail to police problems with competence and responsibility among managers.<sup>29</sup> This argument has been echoed and expanded on over the years as the tension between shareholders and directors has increased. In 1974, Professor William Cary, former chair of the Securities and Exchange Commission, first articulated a theory he called the “race to the bottom,” which expanded on Berle and Means’ theory.<sup>30</sup> He argued that the obvious upshot of codes like Delaware, which expressly allow for anyone including directors to elect the state of incorporation,<sup>31</sup> was that the decision was effectively being made by the managers.<sup>32</sup> He posited that since Delaware, in order to increase its revenues from franchise taxes, crafted their corporate laws to favor managers and entice them to incorporate in Delaware, other states would try to draft even more manager friendly codes.<sup>33</sup> This creates a “race to the bottom” competition between states that amplifies the move towards liberal codes exponentially and ultimately results in poor corporate codes across the nation law that blindly favor managers over shareholders.<sup>34</sup>

Another approach to concerns over the trend toward manager friendly state codes came in a response to Cary’s “race to the bottom” theory.<sup>35</sup> Judge Ralph Winter, in a 1977 article, argued for a theory he called the “race to the top.”<sup>36</sup> According to Winter, states would offer shareholder friendly, more limited corporate laws because these types of codes would

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Barzuza & Bebchuk, *supra* note 7, at 136-56 (discussing generally the trend towards liberal codes and why states such as Delaware become dominant).

28. Bratton & McCahery, *supra* note 7, at 619.

29. BERLE & MEANS, *supra* note 13, *passim*.

30. Cary, *supra* note 7, at 666.

31. DEL. CODE ANN. tit. 8, § 101 (2001).

32. Cary, *supra* note 7, at 705.

33. *Id.* at 666.

34. *Id.* at 663-66.

35. Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 254 (1977) (refuting Cary’s proposition on and suggesting an alternate theory).

36. *Id.*; see also Daniel R. Fischel, *The “Race to the Bottom” Revisited: Reflections on Recent Developments in Delaware’s Corporation Law*, 76 N.W. U. L. REV. 913, 919-20 (1982) (using the phrase “climb to the top”). For another possibility, namely that state competition produces a “race to the top” in some issues and a “race to the bottom” in others, see Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1440 (1992). See also Bar-Gill, Barzuza & Bebchuk, *supra* note 7, at 137.

maximize the value of corporations.<sup>37</sup> Winter argued that if a state unduly favors managers, the value of corporations incorporated in the state would eventually decrease.<sup>38</sup> If the value of a corporation decreased, either the corporation would be taken over while at this vulnerable devalued state or become bankrupt by the higher cost of capital it would face.<sup>39</sup> Thus, Winter posited that states have an interest in promoting shareholder friendly corporate laws in order to keep the value of the corporations incorporated in their state valuable and stable, and in turn encourage more corporations to incorporate under their code.<sup>40</sup>

For purposes of this Article, it is not necessary to resolve the debate over whether the states are engaged in a race to the bottom or a race to the top. Regardless of the nature of the race, what is clear is that state law based changes in corporate governance are coming largely from two sources, the shareholders and the courts.<sup>41</sup> Over the last several years, shareholder friendly changes have been made in record numbers.<sup>42</sup> But those changes have occurred in a slow, piece-meal process as stockholders have agitated for discrete changes through the shareholder proposal process or through litigation—particularly in major corporate transactions.<sup>43</sup> This manner of effecting change has been detrimental both to shareholders and to the corporations they target because it raises costs and, particularly in the

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37. See Winter, *supra* note 35, at 256.

38. *Id.*

39. *Id.*

40. *Id.*

41. See Jay W. Eisenhofer & Greg S. Levin, *Does Corporate Governance Matter to Investment Returns?*, CORPORATE ACCOUNTABILITY REPORT, Sept. 23, 2005, at 930 (“[T]he quality of a particular company’s governance practices and procedures positively correlates with both good corporate financial performance and stockholder value.”).

42. See 2008 ANNUAL CORPORATE GOVERNANCE REVIEW 4 (2008), available at <http://www.georgesonshareholder.com/usa/acgr08.php> (summarizing proxy results and corporate governance proposals for 2008).

43. See generally Vincent R. Cappucci, *Shareholder Activism and the Use of Litigation to Accomplish Investment Goals*, FUND MANAGEMENT LEGAL AND REGULATORY REPORT (2006), available at [http://www.entwistle-law.com/news/publications/000019/\\_res/id=sa\\_File1/shareholder%20activism.pdf](http://www.entwistle-law.com/news/publications/000019/_res/id=sa_File1/shareholder%20activism.pdf) (discussing the rising trend of using litigation by shareholders to force corporate changes); Emily Heller, *Investors Press Their Demands: The Path to Power in the Boardroom May Pass Through the Courtroom*, NAT’L L.J., Oct. 9, 2006, available at [http://www.law.harvard.edu/programs/olin\\_center/corporate\\_governance/MediaMentions/10-09-06\\_NLJ.pdf](http://www.law.harvard.edu/programs/olin_center/corporate_governance/MediaMentions/10-09-06_NLJ.pdf) (considering the use of litigation by shareholders to gain governance control rather than to police bad behavior); Lin Peng & Alisa Roell, *Executive Pay and Shareholder Litigation*, 12 OXFORD REV. OF FIN. J. 141, 158-70 (2007), available at <http://rof.oxfordjournals.org/cgi/content/full/12/1/141> (addressing the effects of executive compensation on securities litigation); Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 136-37 (2005) (discussing litigation used traditionally as a check on managerial misconduct and the increase in suits focusing on management control in acquisitions and mergers).



case of litigation, the outcomes are inherently uncertain.<sup>44</sup> It has created a patchwork for fact-based rulings that minimize the very strengths of an indeterminate and flexible code.<sup>45</sup> As a result, corporations are less efficient and consistency in corporate governance becomes even more difficult.<sup>46</sup>

Seen against this background, the significance of what North Dakota has done becomes clear. Instead of forcing shareholder activists to seek piecemeal corporate reform, the Act enables a corporation, which chooses to be subject to the Act, to change its entire corporate structure in one step. By subjecting directors to meaningful annual elections, the Act should significantly reduce the need for litigation to police the performance of directors because the directors will be more attuned to the opinions of the shareholders and the value of the corporation.<sup>47</sup> Shifting governance to a system based on the rights conferred by the Act, and less on state court litigation, will save both shareholders and corporations in the long run as it will avoid the “omnipresent risk of liability” engendered by the indeterminacy of court made law.<sup>48</sup>

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44. See Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1909 (1998) [hereinafter *Regulatory Competition Theory*] (arguing that by having to rely on “ad hoc judicial interpretation” of “crudely defined guidelines for managerial behavior” liberal corporate codes create costs and uncertainty); Ehud Kamar, *Shareholder Litigation Under Indeterminate Corporate Law*, 66 U. CHI. L. REV. 887, 891-96 (1999) [hereinafter *Shareholder Litigation*] (describing how continual litigation raises costs to corporations, creates cost uncertainty, and leaves corporations without certainty as to how the courts will come out on certain issues).

45. See *Regulatory Competition Theory*, *supra* note 44, 1913-23 (pointing out Delaware gives itself an even greater advantage because it combines the indeterminate code that requires judicial interpretation with the most developed business judiciary in the nation); *Shareholder Litigation*, *supra* note 44, at 891-96 (arguing that American corporate law relies heavily on open-ended court decisions in resolving corporate disputes, in doing so deprives corporate actions of bright line rules, and instead creates inconclusive and ultimately costly and inconsistent criteria for behavior). Since corporations know they will need such interpretation, they go to Delaware where the process is more developed. *Regulatory Competition Theory*, *supra* note 44, at 1913-23. Delaware thereby gives itself a competitive advantage. *Id.*

46. *Shareholder Litigation*, *supra* note 44, at 891-96.

47. *Increasing Shareholder Power*, *supra* note 19, at 865-75.

48. *Shareholder Litigation*, *supra* note 44, at 899; see also Joshua D. Fulop, *Agency Costs and the Strike Suit: Reducing Frivolous Litigation Through Empowerment of Shareholders*, 7 J. BUS. & SEC. L. 213, 214 (2007) (discussing the costs of shareholder litigation and arguing that a code-based set of shareholder rights will significantly decrease costs and be a better tool for corporate oversight than shareholder suits).

### III. NORTH DAKOTA LAW AND THE ACT

All corporations incorporated in North Dakota are subject to the NDBCA.<sup>49</sup> The NDBCA is the general business code for incorporation and management of corporations in North Dakota.<sup>50</sup> While the NDBCA has been periodically amended to address the evolving concerns of businesses, including a restatement in 1985, it is a manager friendly code just like the laws in other states.<sup>51</sup> The NDBCA allows great latitude in drafting the charter and bylaws, and does not protect shareholder rights in a manner any different from that in other states.<sup>52</sup>

Since the NDBCA applies generally to all corporations domiciled in North Dakota, the Act is designed to work in tandem with, and expand on, the NDBCA.<sup>53</sup> The first four sections of the Act (Sections 10-35-01, 10-35-02, 10-35-03 and 10-35-04) describe the relationship between the NDBCA and the Act, and specify which corporations are subject to the Act.<sup>54</sup> Section 10-35-02 provides that a “corporation” or “publicly traded corporation” (as defined in the Act) will be subject to the Act if: (i) it becomes governed by the NDBCA after July 1, 2007; and (ii) its articles of incorporation state that the corporation is governed by the Act.<sup>55</sup> Thus, any company incorporating in North Dakota after July 1, 2007 may choose to be governed by the Act and the NDBCA or by the NDBCA only.<sup>56</sup> Similarly, a corporation can choose to cease to be subject to the Act by amending its charter to remove the reference to the Act.<sup>57</sup> Section 10-35-03(3) provides that if a corporation does elect to be subject to the Act, all of the provisions of the corporation’s articles of incorporation and bylaws must be consistent with the Act.<sup>58</sup> The first four sections of the Act require it to be taken as a whole

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49. N.D. CENT. CODE § 10-19.1-04 (1985).

50. *Id.*

51. *See* discussion *infra* Part III.A-K.

52. *See* discussion *infra* Part III.A-K.

53. *See* N.D. CENT. CODE § 10-35-04 (2007) (confirming the dual applications of the NDBCA of the Act; specifying that the definitions found in Chapter 10-19.1 are applicable to the Act; and stating that where the Act has been elected and its terms vary from the terms of the NDBCA, the provisions of the Act control).

54. *Id.* §§ 10-35-01 to -04.

55. *Id.* § 10-35-02(6). A “Publicly traded corporation” is defined as “a corporation as defined in Section 10-19.1-01: (a) that becomes governed by Chapter 10-19.1 after July 1, 2007; and (b) the articles of which state that the corporation is governed by this chapter.” *Id.*

56. *Id.*

57. *See id.* § 10-35-03(1) (“[T]his chapter applies only to a publicly traded corporation meeting the definition of a ‘publicly traded corporation’ in section 10-35-02 during such time as its articles state that it is governed by this chapter.”).

58. *Id.* § 10-35-03(3).

and create the “branding” aspect of the Act.<sup>59</sup> This provides investors buying shares in a corporation subject to the Act with the knowledge that the shares carry with them all of the substantive rules found in the Act regarding the corporate governance of the corporation.

Sections 10-35-05 through 10-35-27 of the Act set forth the specific changes and additions to the NDBCA that give shareholders the substantive protections and rights that make the Act unique.<sup>60</sup> The following discussion highlights the most important of these sections for shareholder participation and compares and contrasts them with not only the underlying NDBCA, but also with the Delaware GCL and the Model Act.<sup>61</sup>

#### A. SECTION 10-35-05: AMENDMENT OF THE BYLAWS

Section 10-35-05 of the Act permits any shareholder to propose the adoption, amendment or repeal of a bylaw, and expressly prohibits amending the articles of incorporation or bylaws to impose additional requirements on proposals by shareholders to amend the bylaws.<sup>62</sup> This overrides Section 10-19.1-31 of the NDBCA, which limits the right of shareholders to make such proposals to shareholders who own 5% or more of a company’s outstanding shares, but allows for the bylaws to impose stiffer requirements for proposing an amendment if desired.<sup>63</sup> Section 10-35-05 of the Act brings North Dakota more closely in line with Section 109 of the Delaware GCL, which grants “the power to adopt, amend or repeal bylaws” to the “stockholders entitled to vote.”<sup>64</sup> Section 10-35-05 also brings North Dakota more closely in line with Section 10.20 of the Model Act, which similarly allows for amendment of the bylaws at the proposal of the shareholders.<sup>65</sup>

#### B. SECTION 10-35-06: BOARD OF DIRECTORS

Section 10-35-06 limits the term a board member may serve; requires all board members to stand for election at the same time; limits the ways in which the size of a board may be changed; and limits who may serve as the

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59. *See supra* notes 57-60 and accompanying text.

60. *See* discussion *infra* Part III.A-K.

61. *See* discussion *infra* Part III.A-K.

62. N.D. CENT. CODE § 10-35-05. Section 10-35-05(1) grants the right to propose amendments and Section 10-35-05(2) reverses the otherwise applicable Section 10-19.1-31(3)(c) of the NDBCA expressly allowing for alterations.

63. *Id.* § 10-19.1-31 (1985).

64. DEL. CODE ANN. tit. 8, § 109 (2001).

65. MODEL BUS. CORP. ACT § 10.20 (2008).

chair of the board.<sup>66</sup> Section 10-35-06(1), prohibiting board member terms of more than one year, is a significant departure from NDBCA Section 10-19.1-35(1) which permits either an indefinite term or, if provided in the articles or bylaws, a fixed term of up to five years.<sup>67</sup> Section 10-35-06(2) of the Act, prohibiting staggered board member terms, reverses the rule in Section 10-19.1-35(2) of the NDBCA, which follows the Delaware GCL and the Model Act, and permits staggered boards.<sup>68</sup> The result of Sections 10-35-06(1) and (2) of the Act is that every director of a publicly traded corporation must be elected each year.<sup>69</sup>

Staggered elections of directors are an impediment to a successful challenge to an incumbent board in several ways. First, having to challenge board members at two separate elections, at least a year apart, will increase the costs of a challenge.<sup>70</sup> Secondly, if the first challenge is successful, the staggered election leads to an interim period where members of both the incumbent and challenger slates sit on the board and internal divisions and friction are likely to occur.<sup>71</sup> Therefore, many shareholders are reluctant to vote for a year of friction regardless of the merit of the challenge. Lastly, removing the possibility of staggered boards reduces the potency of poison pill provisions because a staggered board delays any takeover for as long as a majority of the board members against the takeover are in place.<sup>72</sup> Depending on the terms, the takeover could be delayed several years.<sup>73</sup> If the entire board is elected each year, the shareholders could use the election on a referendum, elect a new board, and stop the board from further blocking the takeover bid.<sup>74</sup>

In a similar vein, Section 10-35-06(3) of the Act prohibits corporations from changing the size of its board of directors where the board has notice that there will be a contested election of directors, or where, pursuant to Section 10-35-07, shareholders do not have the right to nominate candidates

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66. See N.D. CENT. CODE § 10-35-06(1) (2007) (limiting board members' terms); § 10-35-06(2) (requiring all board members to stand for election at the same time); § 10-35-06(3) (restricting changes in board size); § 10-35-06(4) (limiting who may serve as chair of board).

67. Compare *id.* § 10-35-06(1) (prohibiting board member terms over one year), with *id.* § 10-19.1-35(1) (1985) (permitting indefinite board member terms).

68. DEL. CODE ANN. tit. 8, § 141(d); MODEL BUS. CORP. ACT § 8.06.

69. N.D. CENT. CODE §§ 10-35-06(1)-(2).

70. See *Myth of the Shareholder Franchise*, *supra* note 19, at 694 (explaining the structure of staggered boards and describing how two elections makes challenging the existing board more costly).

71. *Id.*

72. Kevin L. Turner, *Settling the Debate: A Response to Professor Bebchuk's Proposed Reform of Hostile Takeover Defenses*, 57 ALA. L. REV. 907, 907 (2006).

73. *Id.* at 907-08.

74. Lucian A. Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 944 (2002).

for election at the next regular shareholder meeting.<sup>75</sup> Consistent with the case law in Delaware, Section 10-35-06(3) is intended to prevent management or current directors from improperly interfering with an upcoming election contest by diluting the power of any single director sitting on the board.<sup>76</sup>

Finally, Section 10-35-06(4) requires the board of directors to elect a chairperson for the board and prohibits the chair from serving as an executive officer of the corporation.<sup>77</sup> The Delaware GCL is silent on this point. Section 7.08(a) of the Model Act simply provides that there will be a chair of the board, but does not impose any restrictions on who may serve in that capacity.<sup>78</sup>

### C. SECTION 10-35-07: NOMINATION OF DIRECTORS AND NOTICE FOR AMENDMENTS

Section 10-35-07 of the Act prevents corporations from imposing burdensome informational requirements on shareholders by limiting the scope of what a corporation may require if a shareholder nominates a candidate for election as a director.<sup>79</sup> This contrasts with the NDBCA, the Delaware GCL, and the Model Act, none of which places any limitations on the requirements corporations can impose for nominations. Furthermore, Sections 10-35-07(3) and (5) limit how much advance notice a corporation may require a shareholder, nominating a candidate for election as a director, to provide.<sup>80</sup> These requirements are designed to make sure shareholders have adequate time to nominate candidates or propose bylaw amendments without being hindered by prohibitive early due dates or overly cumbersome requirements. Section 10-35-07 also gives shareholders the assurance

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75. N.D. CENT. CODE §§ 10-35-06(3), -07 (2007).

76. *E.g.*, *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 655 (Del. Ch. 1988) (creating the standard of review for when a court can overlook the business judgment rule and review corporate board actions when the action is for the primary purpose of impeding or interfering in the effectiveness of shareholder votes without a compelling justification); *see also* *MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1131 (Del. 2003) (where the court found the management of a corporation's expansion the board was expressly to impede the effectiveness of a shareholder vote without a compelling justification and therefore was invalid).

77. "Executive Officer" is defined in Rule 3-B7 of the Securities and Exchange Act of 1934. The SEC has attempted to implement a similar independent chairman requirement in other regulatory areas. *See* Release No. IC-26520 (describing Investment Company Act governance rule, issued but then reversed, currently under consideration).

78. MODEL BUS. CORP. ACT § 7.08(a) (2008).

79. N.D. CENT. CODE § 10-35-07.

80. *Id.* § 10-35-07(3), (5).

that the rules under which they must give notice will not change unexpectedly before an annual meeting.<sup>81</sup>

D. SECTION 10-35-08: ACCESS TO THE CORPORATION'S PROXY STATEMENT

Section 10-35-08 of the Act provides that if a shareholder holding at least 5% of the shares of a corporation nominates a candidate for director, the corporation must include the nomination in the corporation's proxy statement.<sup>82</sup> This is one of the core elements of the paradigm shift, allowing for greater and more direct shareholder oversight and pro-active influence over the action of the members of the board. It is also one of the places where the Act most fundamentally departs from other corporate codes. The Delaware GCL, the Model Act, and the NDBCA do not give a shareholder the right to include nominations in the corporation's proxy statement. As a result, under the Delaware GCL, the Model Act, and the NDBCA, a shareholder who wishes to see alternative candidates for election as directors must distribute a separate proxy statement. The absence of a right of proxy access creates a huge functional barrier to meaningful elections of directors. The Delaware legislature has amended the Delaware GCL, effective August 1, 2009, to allow the bylaws of a corporation to require inclusion of shareholder nominees in the corporate proxy statement.<sup>83</sup> Unlike the NDBCA however, the new Delaware law does not require corporations to include shareholder nominations, but simply allows corporations to require such inclusion if they choose.<sup>84</sup>

Shareholder access to corporate proxy statements has been a hotly debated issue since the Securities and Exchange Commission (SEC) proposed in 2003 to give shareholders access to the corporate proxy statement.<sup>85</sup> Although the SEC's proposal has been on hold for several years, the language of Section 10-35-08 of the Act is patterned after portions of

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81. *Id.* § 10-35-07(5). Similar provisions apply under Section 10-35-14 of the Act to shareholder proposals of business at a regular meeting.

82. *Id.* § 10-35-08.

83. Del. Code Ann. TIT. 8, § 112.

84. *Id.*

85. Proposed Rules: Securities and Exchange Commission, 68 Fed. Reg. 60,784, 60,819 et seq. (Oct. 23, 2003); Security Holder Director Nominations, Exchange Act Release No. 34-48626, Fed. Sec. L. Rep. (CCH) ¶ 87,101 (Oct. 14, 2003), available at <http://www.sec.gov/rules/proposed/34-48626.htm>; see also Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, Inc., 462 F.3d 121, 124 (2006) (holding that the SEC regulations do give the shareholders of AFSCME the right to access to amend the bylaws to allow for shareholder-nominated candidates to be included on the corporate ballot as such action does "relate to an election").

the SEC's 2003 proposal.<sup>86</sup> Section 10-35-08(1) gives a shareholder, or group of shareholders, who have held 5% of a publicly traded corporation for two years, the right to include a candidate nomination directly in the corporation's proxy statement.<sup>87</sup> The right to proxy access is limited to 5% shareholders who have held shares for two years to avoid frivolous additions to the proxy statement and to stop new purchasers from using access to the proxy statement as a takeover tool.

The right of shareholders to have access to the corporate proxy statement has been considered on the federal level since as early as 1942 when the SEC debated adopting such a proposal.<sup>88</sup> The debate has continued on the federal level with subsequent discussions on the issue in 1977, 1992, and 2003.<sup>89</sup> Most recently, the SEC has approved a new proposal which, although the actual rule has not yet been promulgated, may require corporate proxy statements to be opened to shareholders.<sup>90</sup> The proposal, although not yet final, is already drawing sharp criticism.<sup>91</sup> Some of the arguments against shareholder access echo the reoccurring themes: that directors have a duty of care to the shareholders so it is unnecessary as they will vote in the shareholder's interest; that shareholders may do the Wall Street walk if they are unsatisfied; or that shareholders or special interest groups, with no duty towards the corporation would nominate candidates

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86. Specifically, Section 10-35-08(1) is patterned after proposed SEC Rule 14a-11(a), and Sections 10-35-08(2)(c), (d), and (e) are patterned after proposed SEC Rules 14a-11(c)(1), (8), and (7) respectively. 68 Fed. Reg. 60,784, 60,819 et seq.; Security Holder Director Nominations, Exchange Act Release No. 34-48626, Fed. Sec. L. Rep. (CCH) ¶ 87,101, (Oct. 14, 2003), available at <http://www.sec.gov/rules/proposed/34-48626.htm>. The most significant differences between Section 10-35-08 and the SEC proposal are that the SEC proposal would give shareholders the right to include only a limited number of nominees and would only apply after certain triggering events had occurred. Compare N.D. CENT. CODE § 10-35-08, with 68 Fed. Reg. 60,784, 60,819 et seq.; Security Holder Director Nominations, Exchange Act Release No. 34-48626, Fed. Sec. L. Rep. (CCH) ¶ 87,101 (Oct. 14, 2003).

87. N.D. CENT. CODE § 10-35-08(1). Setting a minimum ownership requirement for shareholders who are permitted access to the corporation's proxy statement is desirable to prevent the corporation's ballot from being overrun by candidates nominated by "fringe" investors. Additionally, the two-year minimum holding requirement is intended to limit access to shareholders who are focused on long-term rather than short-term value.

88. Lewis J. Sundquist III, *Proposal to Allow Shareholder Nomination of Corporate Directors: Overreaction in Times of Corporate Scandal*, 30 WM. MITCHELL L. REV. 1471, 1474 (2004).

89. *Id.*

90. Press Release, Securities and Exchange Commission, SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholders to Nominate Directors (May 20, 2009) (providing an overview of the as-yet-to-be-proposed new rules) available at <http://www.sec.gov/news/press/2009/2009-116.htm> (last visited May 26, 2009).

91. *Strategies for the New Reality of Shareholder Proxy Access*, Wachtell, Lipton, Rosen & Katz (2009) (reiterating the firm's opposition to proxy access and outlining various approaches to draft bylaws to avoid the most stringent aspects of what the SEC may propose), available at <http://blogs.law.harvard.edu/corpgov/2009/05/14/>.

solely for their own benefit rather than the benefit of the corporation as a whole.<sup>92</sup> Proponents of proxy access point to: the functional difficulties of liquidating shares; the duty of care which has not kept directors in line historically; limits on access including the 5% of shareholders rule; and reimbursing only successful proxy bids limits special interest proxy actions by shareholders.<sup>93</sup>

#### E. SECTION 10-35-09: ELECTION OF DIRECTORS

Section 10-35-09 of the Act requires majority voting in the election of directors unless the corporation has cumulative voting.<sup>94</sup> This is one place where the Act permits a choice by a corporation. Shareholders traditionally have preferred cumulative voting to plurality voting, but recently shareholders have begun to favor majority voting. Cumulative and majority voting is permissible under the Act, but plurality voting is not.<sup>95</sup> If shareholders are not entitled to vote cumulatively, then they must vote “yes,” “no,” or “abstain” on each candidate. Both the NDBCA and the North Dakota Constitution default to a system of cumulative voting “unless otherwise provided in the articles of incorporation.”<sup>96</sup> Under cumulative voting, each shareholder votes in favor of candidates or withholds their votes.<sup>97</sup> Those candidates receiving the highest number of votes, up to the number of positions to be filled, are elected.<sup>98</sup> In order to be elected, a nominee must receive at least fifty percent of “yes” votes. This is in contrast with plurality voting where a director may be elected by as little as one vote.<sup>99</sup>

Changing the electoral system is an issue that corporations and shareholders have been increasingly addressing on a company-by-company basis. Since 2004, more than two-thirds of the corporations in the S&P 500 have adopted provisions similar to the ones codified by Section 10-35-09 of the Act.<sup>100</sup> Shareholder activists seek to change the current system from a plurality or cumulative system to a majority system for two reasons: (1) to

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92. *Id.* at 1490-96.

93. Jayne W. Barnard, *Shareholder Access to the Proxy Revisited*, 40 CATH. U.L. REV. 37, 48-61 (1990); Jeff Kominsky, *Access Granted: Proxies and the SEC*, 2 ENTREPRENEURIAL BUS. L.J. 573, 573 (2007); *see also* Bebehuk, *Increasing Shareholder Power*, *supra* note 19, at 836-912 (describing in detail each of these issues and how increased shareholder access to proxy helps these issues).

94. N.D. CENT. CODE § 10-35-09 (2007).

95. *Id.* § 10-35-09(2)(a).

96. N.D. CONST. art. XII, §6; N.D. CENT. CODE § 10-19.1-39 (1985).

97. Barnard, *supra* note 93, at 46-49.

98. *Id.*

99. Joshua R. Mourning, *The Majority-Voting Movement: Curtailing Shareholder Disenfranchisement in Corporate Director Elections*, 85 WASH. U.L. REV. 1143, 1160 (2007).

100. 2008 ANNUAL CORPORATE GOVERNANCE REVIEW, *supra* note 42, at 6.



provide shareholders an effective means to express their displeasure with a nominee; and (2) the existing system can result in a candidate being elected a board director with as few as one affirmative vote. Under the Act if a majority vote results in not all the vacant director positions filled, the board may not appoint to the board an individual who has been voted on and not elected, nor may any former director not reelected continue as director past the end of his or her term for more than 90 days.<sup>101</sup>

#### F. SECTION 10-35-10: REIMBURSEMENT OF PROXY EXPENSES

Section 10-35-10(1) of the Act requires reimbursement of a shareholder's proxy expenses, if the shareholder nominates a candidate not supported by management or the board, and that director is elected.<sup>102</sup> The amount of reimbursement is tied to the success of the shareholder in having alternative candidates elected.<sup>103</sup> Shareholders do not automatically have this right under the Model Act, NDBCA, Delaware GCL, or any other state law. However, the Delaware GCL has been amended, effective August 1, 2009, to permit a corporation to provide in the bylaws for the reimbursement of such expenses.<sup>104</sup> Under Section 10-35-10(1), if a shareholder nominates four candidates and three are elected, the shareholder will be reimbursed for 75% of the shareholder's expenses in bringing the challenge.<sup>105</sup> The expenses that will be reimbursed include amounts paid to third parties relating to the solicitation, including lawyers, proxy solicitors, public relations firms, printers, and media outlets.<sup>106</sup> Expense reimbursement is tied to success in a proxy contest so that compensation is limited to shareholders that actively participate in corporate governance measures while not rewarding frivolous challenges expected to receive only little support.<sup>107</sup>

Under the current system in other states the proxy expenses of the corporation are paid for by the corporation, but a shareholder mounting a proxy contest must pay its own expenses even if successful.<sup>108</sup> Therefore, the current system is significantly tilted in favor of incumbent management. Not surprisingly then, reimbursement has been a heated debate within the

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101. N.D. CENT. CODE § 10-35-09(2)(d) (2007); *see generally* Mourning, *supra* note 99, at 1169-86 (discussing the pros and cons of majority-voting issue and a detailed discussion of the history of the movement to have majority-voting implemented).

102. N.D. CENT. CODE § 10-35-10(1).

103. *Id.*

104. DEL. CODE ANN. tit. 8, § 113.

105. N.D. CENT. CODE § 10-35-10(1).

106. *Id.* § 10-35-10(2).

107. *See Myth of the Shareholder Franchise*, *supra* note 19, at 688.

108. *See Increasing Shareholder Power*, *supra* note 19, at 856.

corporate and academic community, because the costs to shareholders for an unreimbursed proxy contest average in the hundreds of thousands of dollars for each contest.<sup>109</sup>

#### G. SECTION 10-35-11: SUPERMAJORITY PROVISIONS PROHIBITED

Section 10-35-11 of the Act prohibits supermajority voting requirements for both boards and shareholders.<sup>110</sup> This is in direct contrast to the Model Act, Delaware GCL, and NDBCA, each of which permit supermajority voting requirements.<sup>111</sup> Section 10-35-11(1) provides that a simple majority of the full board constitutes a quorum, and a majority of the votes cast at a meeting is sufficient to take action.<sup>112</sup> Section 10-35-11(2) similarly provides that the presence of a majority of the shareholders entitled to vote constitutes a quorum, and a majority of the votes cast is sufficient for the shareholders to take action.<sup>113</sup>

#### H. SECTION 10-35-12: REGULAR MEETING OF SHAREHOLDERS AND EXECUTIVE COMPENSATION

##### 1. *Regular Meetings*

Sections 10-35-12(1) and (2) of the Act require a publicly traded corporation to hold a shareholding meeting annually and to fix in its articles or bylaws the latest date by which the corporation's regular meeting must be held each year.<sup>114</sup> This is in contrast to NDBCA Section 10-19.1-71, which provides that "regular meetings of shareholders may be held on an annual or other less frequent periodic basis but need not be held unless required by the articles or bylaws."<sup>115</sup> Under the Act, if a meeting has not occurred by the set date, Section 10-35-12(3) gives shareholders the right to demand a regular meeting of shareholders, or apply for a court order directing the shareholder meeting to be held.<sup>116</sup> In each case, the shareholder's right is

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109. *Id.*

110. N.D. CENT. CODE § 10-35-11.

111. MODEL BUS. CORP. ACT §§ 7.27, 8.24 (2008) (expressly allowing the articles of incorporation to provide for greater than majority voting for shareholders (Section 7.27) and directors (Section 8.23)); DEL. CODE ANN. tit. 8, §§ 141, 216 (2001) (allowing the certificate of incorporation or bylaws to specify greater than majority voting for shareholders (Section 216) and directors (Section 141)); N.D. CENT. CODE §§ 10-19.1-46, -74 (1985) (sections 46 and 74 of the NDBCA have identical flexibility to allow for a supermajority voting).

112. N.D. CENT. CODE § 10-35-11(1) (2007).

113. *Id.* § 10-35-11(2).

114. *Id.* § 10-35-12(1), (2).

115. *Id.* § 10-19.1-71 (1985).

116. *Id.* § 10-35-12(3) (2007).

without regard to the percentage of voting power held by that shareholder.<sup>117</sup> This is in contrast to Section 10-19.1-71(2) of the NDBCA, which limits the right to demand a meeting to shareholders with a 5% or more interest.<sup>118</sup> Section 10-35-12 of the Act is similar to Section 7.03(a)(2) of the Model Act, which permits a shareholder to petition a court to order an annual meeting if one has not occurred within six months after the end of the corporation's fiscal year or within fifteen months after the last meeting, and Section 211(c) of the Delaware GCL, under which any shareholder may petition for a court-ordered annual meeting thirteen months after the last annual meeting has passed.<sup>119</sup>

## 2. *Executive Compensation*

An issue that has been in the news recently and creates perhaps the most obvious public ire in regard to corporate governance is that of executive compensation.<sup>120</sup> To address concerns that boards are setting compensation at irresponsibly high levels, Section 10-35-12(5) requires the board committee that sets executive compensation to report to the shareholders at each regular shareholder meeting.<sup>121</sup> At each regular shareholder meeting, shareholders entitled to vote for the election of directors are also entitled to vote, on an advisory basis, on whether they accept the report of the compensation committee.<sup>122</sup> An advisory vote requirement on executive compensation is not found in either the Model Act or the Delaware GCL, but is required under the laws of the United Kingdom.<sup>123</sup> A bill was introduced in the U.S. House of Representatives in 2007 that would have required the type of nonbinding vote on compensation that the Act requires.<sup>124</sup> Although the bill did not ultimately pass, the idea was originally cham-

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117. Subsection 3 adopts the rule in Section 211(c) of the Delaware GCL, which permits any stockholder to demand a delinquent annual meeting. *See NewCastle Partners, L.P. v. Vesta Ins. Group, Inc.*, 887 A.2d 975, 981-2 (Del. Ch. 2005) (holding that the Delaware provision does not necessarily create an insurmountable conflict with the SEC proxy rules); *see also* N.D. CENT. CODE § 10-35-05(1) (making a similar change with respect to proposing amendments to the bylaws).

118. N.D. CENT. CODE § 10-19.1-71(2) (1985).

119. DEL. CODE ANN. tit. 8, § 211(c) (2001); MODEL BUS. CORP. ACT § 7.03(a)(2) (2008).

120. *See* Edward Labaton & Ethan Wohl, *Selective "Say-on-Pay" the Best Remedy*, EXECUTIVE COUNSEL, Nov./Dec. 2008, at 18 (discussing the "say-on-pay" movement and concluding shareholders will continue to try to gain greater control over executive compensation).

121. N.D. CENT. CODE § 10-35-12(5) (2007).

122. *Id.*

123. COMPANIES ACT 2006, ch. 46 § 439; *see also Increasing Shareholder Power*, *supra* note 23, at 848-50.

124. Kara Scannell & Siobhan Hughes, *House Clears an Executive-Pay Measure*, WALL STREET J., Apr. 21, 2007, available at <http://online.wsj.com/article/SB117709548923877174.html>.

pioned by then-Senator Obama and has become part of the Democratic Party platform, and thus, is likely to continue to be a hot topic in the federal area for the foreseeable future.<sup>125</sup>

I. SECTION 10-35-13: CALL OF SPECIAL MEETING OF SHAREHOLDERS

Section 10-35-13 permits shareholders holding at least 10% of the outstanding shares to demand a special meeting of shareholders at any time, and for any purpose.<sup>126</sup> The Act differs from the corresponding NDBCA Section 10-19.1-72, which permits the holders of at least 10% of the votes, entitled to be cast on an issue, to call a special meeting of shareholders to vote regarding that issue, but limits the ability of shareholders to call a meeting to consider a business combination to shareholders owning 25% or more of the outstanding shares.<sup>127</sup> Section 10-35-13 eliminates the special rule for calling a meeting to consider a business combination, with the result that 10% of the shares will be able to call a meeting for any purpose. Section 10-35-13 is similar to but stricter than Section 7.02 of the Model Act, because while the Model Act permits 10% of the shareholders to demand a meeting, the Model Act allows that percentage to be raised to 25% by a provision in the articles of incorporation.<sup>128</sup>

J. SECTION 10-35-15: SHAREHOLDER PROPOSALS OF AMENDMENT OF THE ARTICLES

In a manner similar to the limits in Sections 10-35-14 and 10-35-07, advance notice requirements a corporation may impose, Sections 10-35-14(2) and 10-35-15(1) prevent corporations from imposing burdensome informational requirements on shareholders exercising their right to propose an amendment to the articles.<sup>129</sup> Section 10-19.1-19(2) of the NDBCA, allows shareholders holding at least 5% of outstanding shares to propose

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125. DEMOCRATIC NATIONAL CONVENTION COMMITTEE, INC., THE 2008 DEMOCRATIC PARTY PLATFORM: RENEWING AMERICA'S PROMISE 25 (2008), available at [http://s3.amazonaws.com/apache.3cdn.net/8a738445026d1d5f0f\\_bcm6b517a.pdf](http://s3.amazonaws.com/apache.3cdn.net/8a738445026d1d5f0f_bcm6b517a.pdf).

126. N.D. CENT. CODE § 10-35-13 (2007).

127. *Id.* § 10-19.1-72 (1985).

128. MODEL BUS. CORP. ACT § 7.02 (2008).

129. N.D. CENT. CODE §§ 10-35-14(2), 10-35-15(1). Specifically, Section 10-35-15(1) prohibits a corporation from requiring a shareholder proposal to amend the articles to include more than: (a) the name of the shareholder or the names of the members of the group of shareholders; (b) a statement of the number of shares of each class owned beneficially or of record by the shareholder or group of shareholders and reasonable evidence of that ownership; and (c) the text of the proposed amendment. *Id.* § 10-35-15(1).

amendments to the articles of incorporation.<sup>130</sup> What is significant about the Act is that Section 10-35-15(3) provides that an amendment to the articles proposed by a shareholder and approved by shareholders need not be approved by the board to be adopted and become effective.<sup>131</sup> This is in contrast with Section 10.03 of the Model Act, which expressly requires any shareholder proposed amendment to be adopted by the board of directors, and puts no limit on the other requirements the board may put on such proposals.<sup>132</sup> Similarly, Section 242(b)(1) of the Delaware GCL requires that all amendments to the certificate of incorporation be approved by the board.<sup>133</sup>

#### K. SECTION 10-35-16: REQUIREMENTS FOR CONVENING SHAREHOLDER MEETINGS

A key goal throughout the Act was to make sure shareholders have a realistic ability to exercise their corporate governance rights and that those rights are not limited or circumvented by logistical difficulties. Section 10-35-16 requires corporations to make a public announcement of the date of a regular meeting far enough in advance so its shareholders can comply with any advance notice requirements adopted under Section 10-35-07 or 10-35-14.<sup>134</sup> Furthermore, Section 10-35-16(1) ensures any announcement of a changed meeting date must be easy to find in the body of a public filing rather than buried in an attachment.<sup>135</sup>

#### L. SECTION 10-35-17: APPROVAL OF CERTAIN ISSUANCES OF SHARES

Section 10-35-17 requires that a corporation obtain shareholder approval for issuance of shares, or other securities convertible into or rights exercisable for shares in a transaction or a series of integrated transactions, if the issuance will exceed 20% of the voting power of the shares outstanding immediately before the transaction.<sup>136</sup> Many corporations are already

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130. *Id.* § 10-19.1-19(2) (1985).

131. *Id.* § 10-35-15(3) (2007).

132. MODEL BUS. CORP. ACT § 10.03 (2008).

133. DEL. CODE. ANN. tit. 8, § 242(b)(1) (2001).

134. N.D. CENT. CODE § 10-35-16.

135. *Id.* § 10-35-16(1). This Section expressly addresses the problem presented in *Accipiter Life Sciences Fund, L.P. v. Helfer*, where the announcement was found to be insufficient because it was buried in an earnings release. *Accipiter Life Sciences Fund, L.P. v. Helfer*, 905 A.2d 115, 127 (2006).

136. *See* N.D. CENT. CODE § 10-35-17. For purposes of this section, the voting power of shares issued and issuable as a result of a transaction or series of integrated transactions shall be the greater of: (i) the voting power of the shares to be issued; or (ii) the voting power of the shares

subject to this type of requirement because of Section 6.21(f) of the Model Act.<sup>137</sup> NASDAQ and the New York Stock Exchange require shareholder approval before a corporation may issue shares of more than 20% of the outstanding voting power.<sup>138</sup> This limitation protects shareholders from having their interests watered down by the board issuing additional shares.

M. SECTION 10-35-19: CONDUCT AND BUSINESS OF SHAREHOLDER MEETINGS

Section 10-35-19 of the Act, patterned after Section 7.08 of the Model Act, provides rules on how shareholder meetings are to be conducted.<sup>139</sup> The Delaware GCL is silent on this matter. Pursuant to Section 10-35-19(1), a presiding officer must be present at every shareholder meeting of the shareholders of a publicly traded corporation.<sup>140</sup> Unless the corporation's articles or bylaws state otherwise, the presiding officer determines the order of business and has the authority to establish rules for the conduct of the meeting.<sup>141</sup> Generally, the order of business, rules for the conduct of a meeting and any action by the presiding officer must be reasonable, fair to all shareholders and may not favor or disadvantage the proponent of any action at the meeting.<sup>142</sup> Finally, the presiding officer may announce at the meeting when the polls close for each matter voted upon.<sup>143</sup> If no announcement is made, the polls close upon the final adjournment of the meeting.<sup>144</sup>

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that would be outstanding after giving effect to the conversion of convertible shares and other securities and the exercise of rights to be issued. *Id.* § 10-35-17(3)(a)(1)-(2). Additionally, a series of transactions is integrated if consummation of one transaction is made contingent on consummation of one or more of the other transactions. *Id.* § 10-35-17(3)(b).

137. MODEL BUS. CORP. ACT § 6.21(f) (2008).

138. *See* New York Stock Exchange Listed Company Manual Rule 312.03; American Stock Exchange Company Guide Rule 712(b); NASDAQ Stock Market Rule 4310(c)(25)(H)(i). Section 6.21(f) of the Model Act is generally patterned on New York Stock Exchange Listed Company Manual Rule 312.03, American Stock Exchange Company Guide Rule 712(b) and NASDAQ Stock Market Rule 4310(c)(25)(H)(i). Corporations should look to comments on Section 6.21(f) of the Model Act for illustrations of the 20% requirement. *See* MODEL BUS. CORP. ACT § 6.21(f) comments.

139. N.D. CENT. CODE § 10-35-19; MODEL BUS. CORP. ACT § 7.08.

140. N.D. CENT. CODE § 10-35-19(1). The presiding officer must be appointed in the manner provided in the articles or bylaws or, in the absence of such a provision, by the board before the meeting or by the shareholders at the meeting. *Id.* If the articles or bylaws are silent on the appointment of a presiding officer and the board and the shareholders fail to designate a presiding officer, the president is the presiding officer. *Id.*

141. *Id.* § 10-35-19(2).

142. *Id.* § 10-35-19(3).

143. *Id.* § 10-35-19(4).

144. *Id.* (Except as provided in § 10-35-09(1)).

N. SECTION 10-35-20: ACTION BY SHAREHOLDERS WITHOUT A MEETING

Section 10-35-20 reverses the rule in NDBCA Section 10-19.1-75, which permits shareholders to act by majority consent without a meeting, but only if the articles authorize them to do so.<sup>145</sup> Under the Act, action taken by majority consent is always available.<sup>146</sup> Section 10-35-20(2) provides that action may not be taken by ballot without a meeting.<sup>147</sup> This reverses NDBCA section 10-19.1-75.1, which permits action by ballot without a meeting unless the articles or bylaws provide otherwise.<sup>148</sup>

O. POISON PILLS AND ANTITAKEOVER PROVISIONS

The term “Poison Pill” was originally coined as a pejorative term for an effective antitakeover device developed during the 1980s.<sup>149</sup> The Act does not prohibit the adoption of all poison pills as experience has shown poison pills can be used to benefit shareholders by preventing a corporation from being sold at an inadequate price.<sup>150</sup> However, the Act places limitations on the use of poison pills to prevent them from being used to entrench incumbent management.<sup>151</sup>

1. *Section 10-35-22: Duration of Poison Pills Limited*

Section 10-35-22(1) prohibits a poison pill adopted by the board and not approved by the shareholders from being in effect for longer than the shorter of (i) one year or (ii) ninety days after a majority of shareholders have voted to accept an offer for the sale of the corporation.<sup>152</sup> The ninety-day period is based on the practice of the Ontario Securities Commission, which requires the withdrawal of a poison pill under those circumstances.<sup>153</sup>

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145. *Id.* § 10-19.1-75 (1985).

146. *Id.* § 10-35-20(1) (2007).

147. *Id.* § 10-35-20(2).

148. *Id.* § 10-19.1-75.1 (1985).

149. Walter Hamilton, *Gemstar Wilds '80s Weapon: Poison Pill Takeover Defense*, L.A. TIMES, July 16, 1998, at D-1, available at <http://articles.latimes.com/1998/jul/16/business/fi-4149>. The more formal reference to a poison pill is “shareholder rights plan.” *Id.* The definition of “poison pill” in North Dakota Century Code section 10-35-2 is patterned in part after Pennsylvania’s statute. See 15 PA. STAT. ANN. § 2513 (2000).

150. N.D. CENT. CODE §§ 10-35-22(2), -26 (2007).

151. See discussion *infra* Part III.O.2 (explaining the poison pill limits).

152. N.D. CENT. CODE § 10-35-22(1).

153. See National Policy 62-202, Ontario Securities Commission (stating “[t]he primary objective of the take-over bid provisions of Canadian securities legislation is the protection of the

However, under Section 10-35-22(2) of the Act, a poison pill approved by the shareholders is subject to a longer time limit of the shorter of (i) two years or (ii) ninety days after a majority of the shareholders have indicated that they wish to accept an offer for the sale of the corporation.<sup>154</sup> Additionally, under Section 10-35-22(3), corporations may not adopt, create, or issue a poison pill without the approval of its shareholders until it has held a regular shareholder meeting, after its most recent prior poison pill has expired or been redeemed.<sup>155</sup> These provisions ensure that the board cannot maintain a poison pill indefinitely without the approval of shareholders at a regular meeting.

## 2. *Section 10-35-23: Protection of Power of Current Directors Over Poison Pill*

Section 10-35-23 prohibits the inclusion of provisions that limit in any way the power of the board of directors, as it may be constituted at any point in time, to take action with respect to a poison pill.<sup>156</sup> Such provisions are commonly referred to as “dead hand” or “slow hand” pills.<sup>157</sup> Under these provisions, only directors in office before an offer is made for the corporation (or successors that those directors approve) may redeem or

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bona fide interests of the shareholders of the target company. A secondary objective is to provide a regulatory framework within which take-over bids may proceed in an open and even-handed environment. The take-over bid provisions should favour neither the offeror nor the management of the target company, and should leave the shareholders of the target company free to make a fully informed decision. The Canadian securities regulatory authorities are concerned that certain defensive measures taken by management of a target company may have the effect of denying to shareholders the ability to make such a decision and of frustrating an open take-over bid process.”); *Re Canadian Jorex Ltd.* (1992), 15 O.S.C.B. 257 (finding that “there comes a time when the pill has to go”); *Re Royal Host Real Estate Investment Trust and Canadian Income Properties Real Estate Investment Trust* (1999) 22 O.S.C.B. 7819 (stating “[w]e recognize that the board of a target company facing a hostile bid may adopt defensive tactics in a genuine attempt to increase shareholder value. However, we also confirm that we will step in if their tactics appear likely to deny or severely limit the opportunity of the shareholders to respond to the bid.”).

154. N.D. CENT. CODE § 10-35-22(2).

155. *Id.* § 10-35-22(3). The date of the regular meeting of shareholders must:

- (a) [c]omply with section 10-35-12; (b) be at least ninety days after the date on which the prior poison pill expired, was redeemed, or otherwise ceased to be of any force or effect; and (c) if the corporation has an advance notice requirement adopted pursuant to section 10-35-07, give the shareholders the full period of time required by [section 10-35-07(4)] in which to provide notice to the corporation of an intention to nominate candidates for election at the meeting.

*Id.*

156. *Id.* § 10-35-23.

157. A “dead hand” poison pill is one that states that only the original directors who put the provision into place can dismantle the pill, so any new directors are prevented from interfering. A “slow hand” poison pill is when this “dead hand” provision is of a limited duration.



otherwise disable the poison pill. The prohibition of “dead hand” provisions in the Act is consistent with Delaware case law.<sup>158</sup>

### 3. *Section 10-35-26: Adoption of Antitakeover Provisions*

Section 10-35-26(1) requires any antitakeover provision included in the articles or bylaws of a corporation, subject to the Act, to be approved by at least a two-thirds vote of the shareholders.<sup>159</sup> Section 10-35-26(2) defines an antitakeover provision as a provision that blocks an acquisition by any person or group of persons or blocks a change in control of the corporation absent compliance with the provision.<sup>160</sup> Requiring a two-thirds vote is particularly important in the current troubled market as threat of hostile or unsolicited takeovers increase.<sup>161</sup>

## IV. CONCLUDING REMARKS ON THE PARADIGM SHIFT

Each of the changes discussed in Part III is important in its own right as a protection of shareholder influence over corporate governance.<sup>162</sup> The true significance of the Act, however, becomes clear when these sections are considered together. The combination of rights provided by the Act will create true accountability of directors to the shareholders. Under the Act,

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158. *See* *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1291-92 (Del. 1998) (“we hold that the Delayed Redemption Provision is invalid under [8 Del. C. §] 141(a), which confers upon any newly elected board of directors full power to manage and direct the business and affairs of a Delaware corporation”); *Carmody v. Toll Brothers, Inc.*, 723 A.2d 1180, 1194 (Del. Ch. 1998) (discussing whether the “dead hand” provision was an unreasonable defensive measure and concluding it was).

159. N.D. CENT. CODE § 10-35-26(1).

160. *Id.* § 10-35-26(2). An antitakeover provision under Section 10-35-26(2) is also any provision that, upon acquisition or change of control (1) restricts the terms, limits the price or alters how the transaction must be approved by the directors or shareholders; (2) requires an approval of the directors or shareholders in addition to, or in a different manner from, the relevant approvals required under the Act and the NDBCA; (3) requires the approval of a nongovernmental third party; (4) requires the corporation, directly or indirectly, to take an action that it would not have been required to otherwise take; (5) limits, directly or indirectly, the power of the corporation to take an action that the corporation would have had the power to take; (6) changes or limits the voting rights of any shares of the corporation; (7) gives any shareholder of the corporation a direct right of action against a person or group of persons with respect to the acquisition or control of the corporation; or (8) is designed or intended to operate as what is commonly referred to as a “business combination,” “control share acquisition,” “control share cash out,” “freeze out,” “fair price,” “disgorgement,” or other “antitakeover” provision. The term “antitakeover provision” does not include a provision if the shares are issuable upon the exercise of a poison pill or where the provision serves to protect dividend, interest, sinking fund, conversion, exchange, or other rights of the shares, or to protect against the issuance of additional securities that would be on a parity with or superior to the shares. *Id.*

161. DAVID A. KATZ & LAURA A. MCINTOSH, CORPORATE GOVERNANCE UPDATE: SHAREHOLDERS FOCUSED ON STABILITY IN PROXY VOTES 5 (2008), <http://blogs.law.harvard.edu/corpgov/files/2008/11/shareholders-focused-on-stability-in-proxy-votes.pdf>.

162. *See* discussion *supra* Part II.

directors know they will be held accountable each year for their stewardship of the corporation because the shareholders are empowered, logistically and financially, to vote them out if dissatisfied.<sup>163</sup> By emphasizing to directors that shareholders have the actual, rather than just theoretical ability to change the composition of the board, the Act should focus directors in a new way on how they are performing.

Opponents of the reforms in the Act fear that giving shareholders the rights provided by the Act will create chaos with unknowledgeable shareholders meddling in the day-to-day activities of the corporation.<sup>164</sup> Proponents of the reforms in the Act, in contrast, believe that the Act will not have this effect.<sup>165</sup> Directors will be aware in a new and more direct way of the importance of their stewardship over the corporation, and instances of directorial misconduct should diminish. There will be less need for proxy contests because directors will be more in tune with their shareholder constituency. There will also be less need for litigation and review of director actions after the fact, because shareholders will be able to intervene and refocus the board before problems requiring judicial oversight arise. Ultimately, the North Dakota Publicly Traded Corporations Act is a paradigm shift in corporate governance.

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163. See discussion *supra* Parts III.B-C, III.E, III.H (exploring the various aspects of director accountability to shareholder under the Act).

164. E.g., Leo E. Strine, Jr., *Towards a True Corporate Republic: A Traditionalist Response to Lucian's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1764 (2006); Lewis J. Sundquist III, *Proposal to Allow Shareholder Nomination of Corporate Directors: Overreaction in Times of Corporate Scandal*, 30 WM. MITCHELL L. REV. 1471, 1474 (2004); Kevin L. Turner, *Settling the Debate: a Response to Professor Bebchuk's Proposed Reform of Hostile Takeover Defenses*, 57 ALA. L. REV. 907, 907 (2006).

165. E.g., Bar-Gill, *supra* note 7, *passim*; Cary, *supra* note 7, *passim*; *Increasing Shareholder Power*, *supra* note 19, *passim*; McCahery, *supra* note 7, *passim*; *Myth of the Shareholder Franchise*, *supra* note 19, *passim*.