

RESOLUTION 09-07-2016

DIGEST

Corporations: Buyout Agreements

Amends Corporations Code section 2000 to clarify that a buyout agreement may supersede the judicial dissolution procedure.

TEXT OF RESOLUTION

RESOLVED that the Conference of California Bar Associations recommends that legislation be sponsored to amend Corporations Code section 2000 to read as follows:

§2000

1 (a) Subject to any contrary provision in the articles, which may include a reference to a
2 separate shareholder agreement: In any suit for involuntary dissolution, or in any proceeding for
3 voluntary dissolution initiated by the vote of shareholders representing only 50 percent of the
4 voting power, the corporation or, if it does not elect to purchase, the holders of 50 percent or
5 more of the voting power of the corporation (the "purchasing parties") may avoid the dissolution
6 of the corporation and the appointment of any receiver by purchasing for cash the shares owned
7 by the plaintiffs or by the shareholders so initiating the proceeding (the "moving parties") at their
8 fair value. The fair value shall be determined on the basis of the liquidation value as of the
9 valuation date but taking into account the possibility, if any, of sale of the entire business as a
10 going concern in a liquidation. In fixing the value, the amount of any damages resulting if the
11 initiation of the dissolution is a breach by any moving party or parties of an agreement with the
12 purchasing party or parties may be deducted from the amount payable to such moving party or
13 parties, unless the ground for dissolution is that specified in paragraph (4) of subdivision (b) of
14 Section 1800. The election of the corporation to purchase may be made by the approval of the
15 outstanding shares (Section 152) excluding shares held by the moving parties.

16 (b) If the purchasing parties (1) elect to purchase the shares owned by the moving parties,
17 and (2) are unable to agree with the moving parties upon the fair value of such shares, and (3)
18 give bond with sufficient security to pay the estimated reasonable expenses (including attorneys'
19 fees) of the moving parties if such expenses are recoverable under subdivision (c), the court upon
20 application of the purchasing parties, either in the pending action or in a proceeding initiated in
21 the superior court of the proper county by the purchasing parties in the case of a voluntary
22 election to wind up and dissolve, shall stay the winding up and dissolution proceeding and shall
23 proceed to ascertain and fix the fair value of the shares owned by the moving parties.

24 (c) The court shall appoint three disinterested appraisers to appraise the fair value of the
25 shares owned by the moving parties, and shall make an order referring the matter to the
26 appraisers so appointed for the purpose of ascertaining such value. The order shall prescribe the
27 time and manner of producing evidence, if evidence is required. The award of the appraisers or
28 of a majority of them, when confirmed by the court, shall be final and conclusive upon all
29 parties. The court shall enter a decree which shall provide in the alternative for winding up and
30 dissolution of the corporation unless payment is made for the shares within the time specified by
31 the decree. If the purchasing parties do not make payment for the shares within the time
32 specified, judgment shall be entered against them and the surety or sureties on the bond for the

33 amount of the expenses (including attorneys' fees) of the moving parties. Any shareholder
34 aggrieved by the action of the court may appeal therefrom.

35 (d) If the purchasing parties desire to prevent the winding up and dissolution, they shall
36 pay to the moving parties the value of their shares ascertained and decreed within the time
37 specified pursuant to this section, or, in case of an appeal, as fixed on appeal. On receiving such
38 payment or the tender thereof, the moving parties shall transfer their shares to the purchasing
39 parties.

40 (e) For the purposes of this section, "shareholder" includes a beneficial owner of shares
41 who has entered into an agreement under Section 300 or 706.

42 (f) For the purposes of this section, the valuation date shall be (1) in the case of a suit for
43 involuntary dissolution under Section 1800, the date upon which that action was commenced, or
44 (2) in the case of a proceeding for voluntary dissolution initiated by the vote of shareholders
45 representing only 50 percent of the voting power, the date upon which that proceeding was
46 initiated. However, in either case the court may, upon the hearing of a motion by any party, and
47 for good cause shown, designate some other date as the valuation date.

(Proposed new language underlined; language to be deleted stricken)

PROPONENT: Bar Association of Northern San Diego County

STATEMENT OF REASONS

The Problem: The Secretary of State's office has interpreted the existing language to only allow subsection (a) to be altered by the Articles, and then, only by specific provisions. However, it is common practice (and every single corporate practice guide recommends) including a provision in the Articles to reference any shareholder buy-out agreement and allow that agreement to supersede Section 2000, to the extent the shareholder agreement conflicts with Corporations Code §2000. Typical language in articles would include: If proceedings for dissolution of the corporation to which Corporations Code section 2000 applies are instituted, the provisions of any Buy-Out Agreement then in effect among the corporation's shareholders shall govern and supersede any provisions of Section 2000(a) inconsistent therewith, to the extent required to enforce such agreement.

However, the Secretary of State has rejected this language since the specific terms of the Buy Out Agreement are not embodied in the article itself. However, there may not be an existing buy out agreement at the time of filing, or the terms of the agreement may change over the years, which would necessitate continuous amendments to the articles.

The Solution: This resolution clarifies that the separate buyout agreement may supersede any part of Corporations Code section 2000 and that the Articles may just refer to the Buy Out Agreement and not include specific terms. There are other statutes that cross reference to separate shareholder agreements without the need to place all of the terms of those shareholder agreements in the Articles (which would make the Articles extremely long and cumbersome). Rather, with this resolution, corporations can simply refer to a buy out agreement, which would only apply to shareholders who have contractually agreed to abide by those separate buy out terms.

IMPACT STATEMENT

This proposed resolution does not affect any other law, statute or rule.

CURRENT OR PRIOR RELATED LEGISLATION

Not known.

AUTHOR AND PERMANENT CONTACT: Melissa L. Bustarde, Esq., Mayfield Bustarde, LLP, 462 Stevens Ave., Suite 303, Solana Beach, CA 92075, (858) 793-8090

RESPONSIBLE FLOOR DELEGATE: Melissa L. Bustarde, Esq.

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RESOLUTIONS COMMITTEE RECOMMENDATION

APPROVE IN PRINCIPLE

History:

Similar to Resolution 01-02-2009, which was approved as amended.

Reasons:

This resolution amends Corporations Code section 2000 to clarify that a buyout agreement may supersede the judicial dissolution procedure. This resolution should be approved in principle because it reduces the need for unnecessary corporate action and codifies what is now considered best practices.

Corporations Code section 2000 is often interpreted to require that a corporation’s buyout terms must be included in the articles of incorporation, which not only is contrary to common practice but also creates an unnecessary burden on corporations. Such a requirement necessitates continuous amendments to the articles of incorporation for every change to buyout procedures. Since the proposed amendment does require that the articles of incorporation at least reference the potential existence of separate shareholder agreements governing buyouts, there is no danger of lack of notice to shareholders. Furthermore, the proposed amendment does not impose any substantial burden on corporations to create a separate shareholder agreement at the time of incorporation; it merely allows such a shareholder agreement (to be created in the future and) to address buyout terms and procedures.

COUNTERARGUMENTS

SANTA CLARA COUNTY BAR ASSOCIATION

The Santa Clara County Bar Association opposes Resolution 09-07-2016; it proposes to amend Corporations Code §2000 to include a reference to a separate shareholder agreement in the articles of incorporation. The articles of incorporation constitute the very first document signifying the proposed setup of the legal entity; often, at that stage, there is no other agreement entered into by and among investors or shareholders yet. Referencing to a document that has not come about is illogical. Once the shareholders enter into an agreement, the corporation can

amend its articles at any time to include the language as a pre-condition to effect the shareholders' agreement.

The proposed Resolution is unnecessary. The SCCBA therefore urges disapproval.