

COMPETING WITH DELAWARE: RECENT AMENDMENTS TO OHIO'S CORPORATE STATUTES

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In October 2006, Ohio House Bill 301¹ became law, amending Ohio's corporation and other business entity statutes as part of a continuous effort to keep those statutes modern and to maintain Ohio's competitiveness as a business domicile. House Bill 301 is evolutionary, not revolutionary, in its content, but its changes are nonetheless significant for Ohio corporations and their lawyers. To place these changes in context, this article summarizes corporate statutory developments since 1997 that highlight Ohio's previous initiatives to keep up with Delaware, America's dominant state of incorporation,² and then discusses at greater length the recent amendments contained in House Bill 301, concluding with a look ahead at some additional changes that may occur as early as this year.

A discussion of Ohio corporate law developments requires introduction of the Corporation Law Committee of the Ohio State Bar Association ("OSBA"), an active organization of lawyers from around the state who practice in the business entity field and who volunteer their time to develop proposals for statutory change. The Committee, which meets twice annually but operates throughout the year through active subcommittees, is the primary source for Ohio legislation in the corporate, limited liability company, and partnership field. Even

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1. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005). The text of the bill is available at http://www.legislature.state.oh.us/bills.cfm?ID=126_HB_301.

2. See Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 LAW & CONTEMP. PROBS. 135 (2004).

legislative proposals in these fields developed by non-OSBA proponents often evolve during the legislative process into bills that are primarily the Committee's work product before the Legislature adopts them.³

One of the invaluable services that the Corporation Law Committee provides is the creation of official "Committee Comments" for legislation that it originates. These comments, while not acts of the Legislature and not prepared by the official drafting service support arm of the Legislature, known as the Legislative Service Commission,⁴ are a statement by experienced practitioners in the field as to what the legislation is intended to do. As such, and because the more official summaries of the Legislative Service Commission are produced by persons less familiar with the corporate law arena, the Corporation Law Committee's comments are relevant to Ohio judges who are faced with interpreting Ohio's laws.⁵

One of the major tasks of the Corporation Law Committee is to monitor developments in business entity law in other states, especially Delaware. Delaware competes with the 49 other states to be a situs for incorporations, and the franchise and filing fees it charges corporations are a significant revenue generator for its government.⁶ That Delaware is a successful competitor is demonstrated by the numbers: More than 50% of publicly traded companies in the United States are incorporated in Delaware.⁷ In a 2003 survey, 216 members of the *Fortune 500* were incorporated in Delaware despite being headquartered elsewhere, and

3. See Thompson Hine.com, Changes to Ohio Law in Response to TRW/Northrop Takeover Contest, <http://www.thompsonhine.com/publications/publication12.html> (last visited Feb. 11, 2007).

4. The Ohio Legislative Service Commission (LSC) is a nonpartisan agency providing drafting, fiscal, research, training, and other technical and legislative services to the Ohio General Assembly. Ohio Legislative Service Commission, About LSC, <http://www.lsc.state.oh.us/about.html> (last visited Feb. 11, 2007). In addition to revising legislative language for conformity to its standards, the LSC also prepares analyses of each legislative bill for the benefit of the legislators. *Id.* These analyses include *bill analyses* that explain, in relatively plain English, the language of the bill as it progresses through each house, while *fiscal analyses* describe the fiscal impact of the bill. *Id.* The Commission also prepares synopses of amendments to each bill as made by the various legislative committees. *Id.* See also Ohio Legislative Service Commission Home Page, <http://www.lsc.state.oh.us/index.html> (last visited Feb. 11, 2007) for additional information.

5. See *Lake v. Buckeye Steel Castings Co.*, 206 N.E.2d 566, 569-70 (Ohio 1965). See also *Reynolds v. Wingers, Inc.*, 621 N.E.2d 1239, 1241 (Ohio Ct. App. 1993)(quoting from the Corporation Law Committee comments).

6. Delaware Fiscal Notebook (2005), available at http://www.state.de.us/finance/publications/fiscal_notebook_05/Section02/sec2page24.pdf. In 2005, franchise fees paid by corporations and other entities to the State of Delaware generated \$502 million, or over 17% of the state's general fund revenues. *Id.*

7. Greenfield, *supra* note 2, at 135. See also Feng Chen, Kenton Yee & Yong Keun Yoo, *Are Delaware Firms Oranges? Fundamental Attributes and the Delaware Effect*, 1ST ANNUAL CONFERENCE ON EMPIRICAL LEGAL STUDIES 2, <http://ssrn.com/abstract=912942>.

the five next-most-successful states that compete for out-of-state incorporations netted only 27 of the *Fortune 500*.⁸

In the 2003 survey, Ohio was the situs of the corporate headquarters for 192, or 2.94%, of all U.S. publicly traded companies, but the state of incorporation for only 112, or 1.72%.⁹ Ohio had corporate headquarters for 21, or 5.68%, of the *Fortune 500*, but was the place of incorporation for only 13, or 3.51%, of the *Fortune 500*.¹⁰ Nearly all Ohio-based corporations that choose to be incorporated in another state are Delaware corporations.¹¹

The most commonly ascribed reasons for Delaware's current competitive success include the strength of its business court.¹² Delaware uses a separate Court of Chancery that removes business entity cases from the general litigation pool.¹³ Also there are tremendous advantages to sharing experiences among the already large pool of Delaware corporations. Legal experience from one Delaware corporation is readily transferable to another Delaware corporation because they operate under a common set of rules.¹⁴ These factors re-enforce one another, as one commentator has said, "The quality of future case law depends on the number and diversity of lawsuits brought before the courts. These factors, in turn, depend on the number of firms incorporated in the state."¹⁵ As a result, Delaware's corporate law

8. Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 556 (2002).

9. *Id.* at 566-67.

10. *Id.*

11. Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 392-393 (2003).

12. Bebchuk & Hamdani, *supra* note 8, at 580.

13. The Delaware Division of Corporations' website proclaims:

More than half a million business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 60% of the Fortune 500. Businesses choose Delaware because we provide a complete package of incorporation services including modern and flexible corporate laws, our highly-respected Court of Chancery, a business-friendly State Government, and the customer service oriented Staff of the Delaware Division of Corporations.

State of Delaware, Division of Corporations, <http://www.state.de.us/corp/> (last visited Feb. 6, 2007).

The Delaware Court of Chancery's website goes so far as to proclaim:

The Delaware Court of Chancery is widely recognized as the nation's preeminent forum for the determination of disputes involving the internal affairs of the thousands upon thousands of Delaware corporations and other business entities through which a vast amount of the world's commercial affairs is conducted. Its unique competence in and exposure to issues of business law are unmatched.

First State Judiciary- Court of Chancery Welcome!, <http://courts.delaware.gov/Courts/Court%20of%20Chancery/> (last visited Feb. 6, 2007).

14. Bebchuk & Hamdani, *supra* note 8, at 586-88.

15. *Id.* at 586.

(codified in the Delaware General Corporation Law, or “DGCL”) is widely influential far beyond its borders.

I. 1997-2006 – A DECADE OF CHANGE

Since 1997, the Ohio Legislature, most often as the result of initiatives from the OSBA’s Corporation Law Committee, has made numerous changes to chapter 1701 of the Ohio Revised Code (the “ORC”), sometimes called Ohio’s “General Corporation Law.” Many basic features of Ohio corporate law—such as whether shareholders have pre-emptive rights, whether directors may fix voting rights for preferred shares, the means for shareholder and director communications, and the creation or amendment of corporate regulations and articles by directors—have been changed in fundamental ways.¹⁶ Although a few of the changes during the period were intrinsic to Ohio’s anti-takeover laws,¹⁷ which are very dissimilar to Delaware law, most of the changes were directly responsive to the desire to keep Ohio corporate law competitive with Delaware.¹⁸

The following chronology lists the most significant changes to chapter 1701 from 1997 through 2006:

<u>Year</u>	<u>Effect of Amendment</u>	<u>Ohio Statutory Reference</u>	<u>Comparable Delaware Provisions</u>
1997	Amended provisions of Ohio’s Control Share Acquisition Act in response to questions raised in litigation ¹⁹	Title 17, sections 1701.01(Z), 1701.831, and 1701.832 of the Ohio Revised Code	N/A (Delaware has no counterpart to the Control Share Acquisition Act)
1998	Reduced minimum size of board	Title 17, section 1701.63(A) of	Title 8, section 141(c) of the Delaware Code

16. See *infra* pp. 5-11 for a chronology of changes.

17. See *infra* notes 19 and 36

18. See *infra* page 11 for a breakdown of legislative purposes.

19. H.B. 170, 122nd Gen. Assem., Reg. Sess. (Ohio 1997). The legislation responded to questions raised by Judge Graham in *United Dominion Industries, Ltd. v. Commercial Intertech Corp.*, 943 F. Supp. 857 (S.D. Ohio 1996). In that case, Judge Graham upheld the constitutionality of 1990 amendments to Ohio’s Control Share Acquisition Act but invited changes, which were subsequently implemented by the legislature. *Id.* at 862-64.

	committees from 3 directors to 1 ²⁰	the Ohio Revised Code	allows for single director committees)
1999	Authorized use of electronic proxies ²¹	Title 17, section 1701.48 of the Ohio Revised Code	Title 8, section 212 of the Delaware Code authorized delivery of proxies by electronic communications ²²
2000	Eliminated requirement for a statement of corporation's purpose in the articles of incorporation ²³	Title 17, section 1701.04 of the Ohio Revised Code	Title 8, section 102(a)(3) of the Delaware Code retains a purpose clause requirement comparable to the former Ohio provision ²⁴
	Allowed board to fix voting terms of blank check preferred	Title 17, section 1701.06(A)(12) of the Ohio	Title 8, section 102(a)(4) of the Delaware Code allowed

20. H.B. 579, 122nd Gen. Assem., Reg. Sess. (Ohio 1997).

21. H.B. 6, 123rd Gen. Assem., Reg. Sess. (Ohio 1999). House Bill 6 is an example of a legislative proposal originated by others that was amended by substituting language prepared by the OSBA's Corporation Law Committee covering the same topic. See Thomas Geyer, *Sub H.B. 6 Authorizes Electronic Proxies and Makes Technical Changes to 1707*, Ohio Securities Bulletin, Issue 99:2, available at <http://www.securities.state.oh.us/Bulletin/BUL992.pdf>.

22. DEL. CODE ANN. tit. 8, § 212 (2006).

23. H.B. 78, 123rd Gen. Assem., Reg. Sess. (Ohio 1999).

24. Title 8, section 102(a)(3) of the Delaware Code retains a requirement that the certificate of incorporation recite:

The nature of the business or purposes to be conducted or promoted. It shall be sufficient to state, either alone or with other businesses or purposes, that the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware, and by such statement all lawful acts and activities shall be within the purposes of the corporation, except for express limitations, if any.

DEL. CODE ANN. tit. 8, § 102(a)(3) (2006).

25. H.B. 78, 123rd Gen. Assem. Reg. Sess. (Ohio 1999). As stated in the Corporation Law Committee's comments on the legislation:

Previous law expressly permitted the directors, if authorized in the articles of incorporation, to adopt amendments to the articles to fix or change certain of the terms of a class or series of shares that had not yet been issued. However, previous law did not permit the directors to determine the voting rights of a class or series, and it was not clear whether it conferred upon directors the authority to determine whether or not dividends would be cumulative or the relative preferences of a series or class of shares.

These limitations and uncertainties made [the existing provisions] of limited utility.

OHIO REV. CODE ANN. § 1701.06 cmt. (Ohio General Corporation Law Committee comment) (reprinted in PORTER WRIGHT MORRIS & ARTHUR LLP, OHIO GENERAL CORPORATION LAW 18

	shares ²⁵	Revised Code	directors to fix voting rights of preferred shares
	Allowed directors to create regulations for new corporations ²⁶	Title 17, section 1701.10 of the Ohio Revised Code	Title 8, section 109 of the Delaware Code allowed directors to adopt bylaws
	Eliminated statutory pre-emptive rights in new corporations ²⁷	Title 17, section 1701.15 of the Ohio Revised Code	Title 8, section 102 of the Delaware Code provided that there were no statutory pre-emptive rights
2002	Authorized expanded use of "cyberspace" meetings of directors and shareholders ²⁸	Title 17, sections 1701.11 (regulation provisions on meeting locus), 1701.40 (where meetings can be held), 1701.42 (waiver of notices), 1701.51 (quorum for shareholder meetings), 1701.61 (director meetings), 1701.62 (quorum for director meetings) of the Ohio Revised Code	Various sections of the Delaware Code were amended in 2000 to contain similar provisions ²⁹

(Michael A. Ellis ed 2005).

26. H.B. 78, 123rd Gen. Assem., Reg. Sess. (Ohio 1999).

27. *See id.* The amendment sets a trap for the unwary practitioner: it maintains statutory pre-emptive rights for corporations organized prior to the bill's effective date of March 17, 2000, eliminating such rights for corporations organized on or after that date unless they opt into the new regime. OHIO REV. CODE ANN. § 1701.15(C) (West 2006). The trap is heightened by the failure of generally available compilations of Ohio statutes to contain a copy of the historic provisions. *See, e.g.,* PAGE'S OHIO REV. CODE ANN. (LexisNexis); BALDWIN'S OHIO REV. CODE ANN. (West).

28. H.B. 278, 124th Gen. Assem., Reg. Sess. (Ohio 2001).

29. S.B. 363, 140th Gen. Assem., 2nd Sess. (Del. 1999).

	Authorized expanded use of electronic communications to/from shareholders ³⁰	Title 17, sections 1701.25 (express terms of shares), 1701.37 (use of email addresses), 1701.38 (delivery of financial statements), 1701.41 (notices of meetings), 1701.54 (written actions), 1701.69 (notice regarding amendments to the articles), 1701.80 and 1701.801 (notices regarding subsidiary/parent mergers), and additional conforming sections of the Ohio Revised Code	Various sections of the Delaware Code were amended in 2000 to contain similar provisions ³¹
	Expanded authority of the directors to amend corporate articles to (1) change the name of the corporation, (2) change its principal place of business, (3) increase the number of shares to make or	Title 17, sections 1701.70 (powers to amend articles) and 1701.73 (notice to shareholder of amendments) of the Ohio Revised Code	The Delaware Code has no directly corresponding provisions ³³

30. H.B. 278, 124th Gen. Assem., Reg. Sess. (Ohio 2001).

31. S.B. 363, 140th Gen. Assem., 2nd Sess. (Del. 1999).

	reflect a stock split/stock dividend ³²		
	Prohibited removal of directors, without cause, in an issuing public company that has a classified board ³⁴	Title 17, section 1701.11 of the Ohio Revised Code	Title 8, section 141(k) of the Delaware Code prohibited removal of directors on a classified board without cause
	Authorized pre-filing of articles of incorporation to allow selection of a future incorporation date ³⁵	Title 17, section 1701.04(E) of the Ohio Revised Code	Title 8, section 103(d) of the Delaware Code provided for pre-filing of certificates of incorporation
2003	Amended provisions of Ohio's Control Share Acquisition Act in response to questions raised in litigation ³⁶	Title 17, sections 1701.01(Z) and 1701.831 of the Ohio Revised Code	N/A (Delaware has no counterpart to the Control Share Acquisition Act)
2006 ³⁷	Provided limited authority for directors to amend existing corporate regulations ³⁸	Title 17, sections 1701.10 and 1701.11 (power to amend) and additional sections to limit power of the	Title 8, section 109 of the Delaware Code allowed delegation of power to directors to amend bylaws

32. H.B. 278, 124th Gen. Assem., Reg. Sess. (Ohio 2001).

33. DEL. CODE ANN. tit. 8, § 242. However, under title 28 section 253 of the Delaware Code, Delaware directors can effect a name change for the corporation through a merger with a subsidiary of which the corporation owns at least 90% of each class of outstanding shares.

34. S.B. 110, 124th Gen. Assem., Reg. Sess. (Ohio 2001). This bill is another example of legislation that was originated by others but heavily modified through comments and substituted language provided by the Corporation Law Committee. See Linda Wooden, Vice President of Gov't Affairs with the Ohio Chamber of Commerce, Testimony on Sub. S.B. 110 (Oct. 17, 2001) available at <http://www.ohiochamber.com/governmental/testimonySB110.asp>.

35. H. B. 278, 124th Gen. Assem., Reg. Sess. (Ohio 2001).

36. H.B. 7, 125th Gen. Assem., Reg. Sess. (Ohio 2001). The changes implemented were the result of decisions by Judge Manos in *Northrop Grumman Corp. v. TRW, Inc.*, 2002 U.S. Dist. LEXIS 12905 (N.D. Ohio April 18, 2002).

37. All 2006 amendments are contained in H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2006).

38. OHIO REV. CODE ANN. §§ 1701.10(A) and 1701.11(A)(1) (West 2006). See *infra* notes 82-99 and accompanying text.

		Ohio Revised Code	
	Broadened the types of consideration that can be received for shares ³⁹	Title 17, sections 1701.18 and 1701.19 of the Ohio Revised Code	Title 8, section 153 of the Delaware Code was amended in 2004 to permit broader forms of consideration in the issuance of shares ⁴⁰
	Allowed subsidiary spin-offs without a shareholder vote ⁴¹	Title 17, section 1701.76 of the Ohio Revised Code	Delaware Code analogous provision, Title 8, section 271, does not apply to spin-offs by dividend
	Permitted holding company formations without shareholder vote ⁴²	Title 17, section 1701.802 of the Ohio Revised Code	Title 8, section 251(g) of the Delaware Code permitted holding company formations
	Allowed conversions into other forms of entities ⁴³	Title 17, section 1701.801 of the Ohio Revised Code	Title 8, sections 265 and 266 of the Delaware Code permitted conversions into other forms of entities
	Clarified that directors may delegate option-granting authority to officers ⁴⁴	Title 17, section 1701.17 of the Ohio Revised Code	Title 8, section 157(c) of the Delaware Code provided for delegation of option-granting authority to officers
	Clarified that board committees may delegate their authority to subcommittees ⁴⁵	Title 17, section 1701.63 of the Ohio Revised Code	Title 8, section 141(c)(3) of the Delaware Code provided for delegation to subcommittees

39. *Id.* §§ 1701.18; 1701.19. *See also infra* notes 150-152 and accompanying text.

40. DEL. CODE ANN. tit. 8, § 326 (2004).

41. OHIO REV. CODE ANN. § 1701.76 (West 2006). *See also infra* notes 104-06 and accompanying text.

42. *Id.* § 1701.802. *See infra* notes 112-17 and accompanying text.

43. *Id.* § 1701.801. *See infra* notes 121-27 and accompanying text.

44. *Id.* § 1701.17. *See infra* notes 128-33 and accompanying text.

45. *Id.* § 1701.63. *See infra* notes 141-42 and accompanying text.

	Broadened the corporate actions that can be made pursuant to an order of a federal bankruptcy court ⁴⁶	Title 17, section 1701.75 of the Ohio Revised Code	Title 8, section 303 of the Delaware Code had been amended in 2004 to the same effect ⁴⁷
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An analysis of these 21 significant changes to Ohio's corporation law during the past decade breaks down as follows:

- Aligning Ohio more closely with Delaware: 17
- Ohio anti-takeover provisions (no Delaware equivalent): 2
- Other divergences from Delaware: 2

The foregoing ratio of 17:2:2 is somewhat misleading, in that it would give one a sense that Ohio slavishly follows Delaware in most regards. That would somewhat overstate the situation, as many of the Ohio provisions diverge in at least minor ways from choices made by Delaware. What would be fair to say is that Ohio lawyers and legislators have, in most areas, adapted concepts tested in Delaware to a uniquely Ohio framework.

Not all developments in Delaware are viewed as necessary or appropriate for Ohio.⁴⁸ Nor does Ohio follow all of the developments in the Model Business Corporation Act [hereinafter "MBCA"], created under the auspices of the Committee on Corporate Laws of the American Bar Association.⁴⁹ Both chapter 1701 and the DGCL, while sometimes influenced by the MBCA, have evolved separately, leading to a divergence in language, defined terms, and substantive content. This divergence in style and content requires the Ohio practitioner who works with both Delaware and Ohio corporations to stay keenly aware of the

46. *Id.* § 1701.75. See *infra* notes 156-59 and accompanying text.

47. DEL. CODE ANN. tit. 8, § 326 (2006).

48. See *infra* notes 52-58 and accompanying text; Lawrence A. Hamermesh, *Symposium: Litigation Reform Since the PSLRA: A Ten-Year Retrospective: Panel Three: Sarbanes-Oxley Governance Issues: The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1763 n. 60 (2006).

49. See generally MODEL BUS. CORP. ACT (2002), available at <http://www.abanet.org/buslaw/library/onlinepublications/mbca2002.pdf>. Some of the amendments adopted in H. B. 78 in 2000 reflected changes in the MBCA that were reviewed by the Corporation Law Committee and proposed for adoption in Ohio. H.B. 78, 123rd Gen. Assem., Reg. Sess. (Ohio 1999). For example, the elimination of the requirement for a corporate purpose clause in section 1701.04 follows the guide of the MBCA—the Committee comment to that amendment says “Following the lead of the [MBCA], the requirement of a statement of purpose has been deleted as being purely formalistic but a statement is allowed by way of limitation.” OHIO REV. CODE ANN. § 1701.04 cmt. (Ohio General Corporation Law Committee comment) (reprinted in PORTER WRIGHT MORRIS & ARTHUR LLP, *supra* note 25, at 14-15).

differences between the two states, as confusion can easily occur.

Although the changes outlined in the table above have reduced the substantive differences between Ohio and Delaware corporate law in many technical areas, there remains a fundamental difference between the two states in their attitude toward corporate governance. Delaware may – as is the case of Liberia or Panama when it comes to “flags of convenience” for shipping—be looked upon as a “situs of convenience” for incorporation by chartering corporations that have no real contact with Delaware.⁵⁰ Ohio’s corporations, on the other hand, are largely native to its soil, are given their charter by the State for the benefit of the State and its citizens, and still maintain sizable operations within the state.⁵¹ The perceived connection between corporations that are organized in Ohio, Ohio jobs, and the Ohio economy has led the Ohio legislature to provide strong anti-takeover statutes to protect them.⁵² So Ohio, in giving directors of Ohio corporations the discretion to consider constituencies other than shareholders in making any decision,⁵³ has directly renounced some of the doctrines created by the Delaware Court of Chancery that have arisen in takeover cases.⁵⁴ And it has adopted more favorable provisions in protecting directors against lawsuits⁵⁵ and in obtaining indemnification.⁵⁶ Similarly, Ohio’s Legislature has, through provisions such as the “anti-arbitrageur” language of the Control

50. Greenfield, *supra* note 2, at 136. Greenfield identified only two Fortune 500 companies (one of which, MBNA, was subsequently acquired) actually headquartered in Delaware. *Id.* The largest company then incorporated in Delaware, Wal-Mart (which is headquartered in Bentonville, Arkansas), has more than double the number of employees than Delaware has residents, and Delaware corporations’ employees in Delaware account for an infinitesimal fraction of those corporations’ total employee base. *Id.*

51. See generally Bebhuk & Cohen, *supra* note 11.

52. See *supra* notes 19 and 36 (highlighting Ohio’s anti-takeover statutes).

53. OHIO REV. CODE ANN. § 1701.59(E)(1) (West 2006). In contrast, Delaware provides that corporate directors owe their fiduciary duties to shareholders, and obligations toward other constituencies are excluded. Greenfield, *supra* note 2, at 137.

54. § 1701.59(C) (making clear that a director retains the benefit of the business judgment rule even in a corporate takeover situation, thereby renouncing the “Unocal/Unitrin doctrine” enunciated by the Delaware courts). See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361 (Del. 1995).

55. § 1701.59(D) (imposing the burden on a plaintiff to prove with “clear and convincing” evidence that a director’s actions violate the statutory standards).

56. *Id.* § 1701.13(E)(5) (limiting the obligation of a director to return an advancement of costs by requiring proof by “clear and convincing evidence . . . that his action or failure to act involved an act or omission undertaken with deliberate intent to cause injury to the corporation or undertaken with deliberate disregard for the best interests of the corporation”). Coupled with the constituency provisions and other protections of section 1701.59, this severely limits the circumstances under which an advancement of funds would need to be repaid.

Share Acquisition Act⁵⁷ and the profit disgorgement provisions of the Control Bid provisions of the state securities laws,⁵⁸ sought to minimize the impact of quick-buck seeking, short-term investors, thereby favoring the interests of longer-term investors. At the same time, Ohio balances these anti-takeover provisions with a shareholder-centric approach to many fundamental corporate governance changes. For example, Ohio's statutes allow shareholders to amend the articles of incorporation⁵⁹ or regulations⁶⁰ without board approval.

Thus the task for those who work on updating and refreshing Ohio's corporation laws is to try to eliminate mechanical differences between the functioning of title 17, section 1701 of the Ohio Revised Code and title 8 of the Delaware Code while maintaining the special values inherent in Ohio's laws. And that is precisely how the corporate provisions of House Bill 301 came about.

II. HOUSE BILL 301

House Bill 301 contains ten substantive amendments to Title 17, section 1701 of the Ohio Revised Code, that:

- Give directors authority to amend regulations, with some limitations (existing corporations may need to opt into this provision);⁶¹
- Allow spin-offs without a shareholder vote;⁶²
- Permit holding company formations without a shareholder vote;⁶³

57. Title 17, section 1701.831 of the Ohio Revised Code, together with its associated definitions contained in Section 1701.01, is commonly known as the Ohio Control Share Acquisition Act. Section 1701.831(E) requires approval of a control share acquisition by holders of a majority of the voting power in the election of directors (thus typically a majority of the outstanding shares) and also holders of majority of that voting power excluding the voting power of "interested shares." Section 1701.01(CC)(1)(d), adopted in the 1990 amendments to the Act, added to the definition of "interested shares" those shares held by persons who acquire "such shares for valuable consideration beginning with the date of the first public disclosure of a proposal for, or expression of interest in, a control share acquisition. . . ." As the most likely purchasers of shares in this situation are arbitrageurs, the provision is commonly known as the "anti-arbitrageur provision."

58. §§1707.041, 1707.42 and 1707.43 (West 2006) (control bid statutes). Section 1707.43, in particular, can force disgorgement of profits by a person who announces a control bid but fails to consummate the bid.

59. *Id.* § 1701.71.

60. *Id.* § 1701.11.

61. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.11 (A)(1)(d) (West 2006)).

62. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.76 (West 2006)).

63. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN.

- Allow conversions from one form of entity to another;⁶⁴
- Clarify that directors may delegate option grant authority to officers;⁶⁵
- Clarify that Board committees may create and delegate their authority to subcommittees;⁶⁶
- Allow SEC reports to serve as notice of Board-adopted amendments to the articles;⁶⁷
- Broaden the types of consideration for which shares and limited liability membership interests may be issued;⁶⁸
- Allow corporate actions to be taken by bankruptcy court decree in liquidation proceedings as well as in reorganizations;⁶⁹ and
- Allow reliance on corporate good standing certificates for up to seven days (helping to resolve legal opinion issues).⁷⁰

In addition to these provisions amending Title 17, chapter 1701, House Bill 301 includes amendments affecting limited liability companies, partnerships and Ohio's securities laws, that:

- Require notice to the Ohio Division of Securities of material changes to tender offers;⁷¹
- Allow regulations of the Ohio Division of Securities to change automatically with SEC rule changes;⁷²
- Limit the fiduciary duties of those who provide goods or services to business entities⁷³ in response to the decision of the Ohio Supreme Court in *Arpadi v. First MSP Corp.*,⁷⁴

§ 1701.802 (West 2006)).

64. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.782, 1701.792, 1701.811, and 1701.821 (West 2006)).

65. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.17(B)(1) (West 2006)).

66. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.63(G) (West 2006)).

67. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.73(A)(3) (West 2006)).

68. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.18(A)(1) (West 2006)).

69. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.75(A) (West 2006)).

70. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.92(D) (West 2006)).

71. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005).

72. *See id.*

73. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (codified at OHIO REV. CODE ANN. § 1701.921 (West 2006)).

74. 628 N.E.2d 1335 (Ohio 1994).

and

- Clarify aspects of partnership law.⁷⁵

The following discussion describes in more detail the corporate entity provisions of House Bill 301. Although most of the provisions of House Bill 301, including all of the corporate and securities provisions, were developed with OSBA's Corporation Law Committee,⁷⁶ the provisions of House Bill 301 that address *Arpadi* and clarified aspects of partnership law were not changes proposed by the Corporation Law Committee. This article does not address those provisions or the changes to the securities laws.

A. *Providing Directors With Authority To Amend Regulations*

Ohio has long stood apart from other states by requiring any changes to the regulations (called "bylaws" in Delaware and many other states) to be approved by shareholders.⁷⁷ Title 8, section 109 of the Delaware Code allows directors to both adopt the initial regulations and, if expressly authorized by the certificate of incorporation (as is the norm in practice), to amend regulations.⁷⁸ Ohio previously made a partial adjustment toward the Delaware position by the 2000 amendments to Title 17, section 1701.10 of the Ohio Revised Code that permitted directors to adopt regulations for a newly organized corporation if done so within 90 days of its organization.⁷⁹

In the author's experience, the Ohio approach of limiting the directors' authority regarding the regulations created significant, and unnecessary, problems for Ohio corporations. For example, when the

75. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005).

76. David P. Porter, Jeanne M. Rickert, Randall M. Walters & Jennifer C. Lewis, *Amendments to Ohio's Business Entity Statutes Effective in October 2006*, JONES DAY COMMENTARIES, http://www1.jonesday.com/pubs/pubs_detail.aspx?pubID=S3729.

77. OHIO REV. CODE ANN. § 1701.10 (Anderson 1996).

78. DEL. CODE ANN. tit. 8, § 109.

79. The Corporation Law Committee's comment to H. B. 78, recited:

Under Sections 1701.09 and 1701.19 as previously enacted, the only way to organize an Ohio corporation was for the incorporators to issue shares, the shareholders to elect directors and adopt regulations and the directors to elect officers. Following [Revised Model Corporation Act] §2.05, Section 1701.10 has been revised to add alternative methods of organization by allowing initial directors named in the articles to adopt regulations and complete the organization of the corporation or allowing the incorporators to select the initial directors who will complete the organization of the corporation. Section 1701.10 retains the principle that after the organizational period, regulations may be adopted or amended only by the shareholders.

See OHIO REV. CODE ANN. § 1701.09 cmt (Ohio General Corporation Law Committee comment) (reprinted in PORTER WRIGHT MORRIS & ARTHUR LLP, *supra* note 25, at 24).

provisions of title 17, section 1701.48 of the Ohio Revised Code were amended in 1999⁸⁰ to permit the use of internet, telephonic and other means of transmitting proxies, many Ohio corporations were unable to make use of the new authority granted by the Legislature because their existing regulations included language that required proxies to be “by a writing signed by [the shareholder],” paralleling the former statutory language. Before using the new electronic proxy authority, the corporation had to first go to its shareholders and amend the prior regulations to eliminate the restriction. This meant that many public companies, for whom the new authority potentially would mean significant cost savings, were not only faced with a year’s delay in reaping the benefits of the new statute, but also had their proxy process made more difficult and costly for the year in which they sought the amendment to the regulations due to a longer SEC process.⁸¹

In a change that reflects a compromise between retention of Ohio’s historically shareholder-centric standards and a total shift to the board-controlled bylaws practices common in other states, House Bill 301 amended title 17, section 1701.11 of the Ohio Revised Code to give the directors limited authority to amend corporate regulations.⁸² This authority may be granted either by the shareholders or be contained in original regulations adopted by the directors upon incorporation.⁸³ Directors cannot, however, be authorized to amend provisions of the regulations that:

- Specify the percentage of shares a shareholder must hold in order to call a shareholders meeting,⁸⁴
- Specify the length of the time period required for notice of a shareholders meeting;⁸⁵
- Specify that shares that have not yet been fully paid can have voting rights;⁸⁶
- Specify requirements for a quorum at a shareholders

80. See H.B. 6, 123rd General Assem., Reg. Sess. (Ohio 2000).

81. See 17 C.F.R. § 240.14a-6 (2006). The SEC requires the filing of a preliminary proxy statement for proposals other than the election of directors, ratification of accountants or the approval of benefit plans. *Id.* This typically extends the proxy process by more than a month, requiring earlier preparation of proxy materials and risking additional SEC review.

82. OHIO REV. CODE ANN. §§ 1701.10(A) and 1701.11(A)(1).

83. *Id.* § 1701.11 (A)(1)(d).

84. *Id.* § 1701.40(A)(3). The default percentage of outstanding shares a shareholder or group of shareholders must hold in order to call a shareholders meeting is 25%, but can be modified to as high as 50% by the articles or the regulations.

85. *Id.* § 1701.41(A).

86. *Id.* § 1701.44(B).

meeting;⁸⁷

- Prohibit shareholder or director actions from being authorized or taken without a meeting;⁸⁸
- Define terms of office for directors or provide for classification of directors;⁸⁹
- Require greater than a majority vote of shareholders to remove directors without cause;⁹⁰
- Establish requirements for a quorum at directors' meetings, or specify the required vote for an action of the directors;⁹¹
- Delegate authority to committees of the board to adopt, amend or repeal regulations;⁹² or
- Remove the requirement that a control share acquisition of an issuing public corporation be approved by shareholders of the acquired corporation.⁹³

These limitations restrict the directors' ability to enact amendments that could, in the view of the drafters within the Corporation Law Committee who originated these provisions of House Bill 301, significantly alter the fundamental power of the shareholders versus the directors in corporations, or among shareholder groups.⁹⁴ On the other hand, directors can make amendments relating to important but primarily ministerial or procedural issues, such as allowing the use of electronic proxies, fixing the date and location of meetings, or requiring prior

87. *Id.* § 1701.51.

88. *Id.* § 1701.54(A).

89. *Id.* § 1701.57(A), (B).

90. *Id.* §§ 1701.57 and 1701.58(A).

91. *Id.* § 1701.62.

92. *Id.* § 1701.63.

93. *Id.* § 1701.831.

94. In presenting the proposals for approval by the Ohio State Bar Association's Council of Delegates, the Corporation Law Committee submitted the following statement:

In drafting the proposed amendments, the Corporation Law Committee was mindful of the careful balancing between our State's interest in competing with other states as a corporate domicile and the need to facilitate corporate procedural change, versus our State's interest in preserving the rights of shareholders to control the governance of their corporation and the current public concerns over corporate governance. Accordingly, rather than merely extending to the Directors a broad right to amend corporate regulations, the Committee has taken the approach that recognizes that certain matters addressed in a corporation's regulations are fundamental to the relationship between the corporation and its shareholders, and should therefore require approval of the shareholders for amendment. The amendments also clarify that the directors' authority to amend the regulations may not be exercised by an executive or other committee of the board of directors.

Corporation Law Committee, Report and Recommendations to the Ohio State Bar Association Council of Delegates Meeting (Jan. 21, 2005) (on file with author).

notice of nominations or shareholder proposals.⁹⁵ In no event can directors make changes to regulations to restrict the shareholders' authority to adopt, amend, or repeal regulations.⁹⁶

Before relying on House Bill 301 to permit director amendment to the regulations, an Ohio corporation should check its existing regulations. Many will find that their regulations set forth amendment provisions that recite the pre-House Bill 301 statutory standard that limited amendments to those adopted by shareholders.⁹⁷ Those provisions must themselves be amended by shareholders to opt in to the new authorization of director amendments. This outcome is intentional; in addition to constitutional concerns about the power of the legislature to modify existing regulations, the new authority for director amendments is a major change from the status quo, and the drafters believed an opt-in statute was appropriate.⁹⁸ However, new corporations may include provisions in their regulations to opt in to the new provisions.⁹⁹

B. Permitting Spin-Offs Without a Shareholder Vote

Spin-offs—the distribution by a parent company of the shares of a subsidiary to the parent's shareholders¹⁰⁰—are popular capital market transactions that allow a public corporation to become more focused on its core competencies by separating unlike businesses or maximizing shareholder value through higher valuations for the several independent business parts as opposed to the consolidated whole. In most states, spin-offs do not require shareholder approval, no matter how large the transaction is, as the concept of a dividend or distribution does not fall within the “sale or lease of all or substantially all of the corporation's

95. § 1701.11(B).

96. *Id.* The previous version of title 17, section 1701.11(B)(10) of the Ohio Revised Code allowed regulations to define, limit or regulate the exercise of authority by the corporation, directors, officers or all shareholders. The amendments remove shareholders from that group. Title 17, section 1701.11(B)(11) of the Ohio Revised Code permits regulations that define, limit or regulate the exercise of authority by shareholders, but provides that regulations that change or eliminate shareholder authority can only be adopted by shareholders.

97. *See, e.g., supra* note 78 (explaining the delay in SEC filings due to duplication of statutory language in corporation regulations).

98. H.B. 301, 126th Gen. Assem., Reg. Sess. (Ohio 2005) (Committee Comments to section 1701.11).

99. OHIO REV. CODE ANN. § 1701.15(C) (West 2006).

100. BLACK'S LAW DICTIONARY 1437 (8th ed. 2004) (defining spin-off as “[a] corporate divestiture in which a division of a corporation becomes an independent company and stock of the new company is distributed to the corporation's shareholders”).

assets” statutory provisions.¹⁰¹ In contrast, title 17, section 1701.76 of the Ohio Revised Code applies to any “transfer, or other disposition of all, or substantially all, of the assets . . . of a corporation” and therefore can apply to a transfer by dividend or distribution of subsidiary shares.¹⁰² Few cases construe the Ohio statute, adding to the interpretative difficulty. This has sometimes resulted in spin-offs being problematic for lawyers advising Ohio corporations that seek to achieve a spin-off.

House Bill 301 amended title 17, section 1701.76 of the Ohio Revised Code to allow an “issuing public corporation”¹⁰³ to spin off a subsidiary business to holders of shares in the issuing public corporation without shareholder approval.¹⁰⁴ Two exceptions could require shareholder approval: first, if a spun-off entity is a party to an agreement to engage in a subsequent transaction, such as a merger, that would, if entered into following the spin-off, have required shareholder approval,¹⁰⁵ and second, if the issuing public corporation has more than one class of shares outstanding immediately prior to the spin-off.¹⁰⁶

The amendment to title 17, section 1701.76 of the Ohio Revised Code reflects the continuation of an interesting development in Ohio corporate law: the differential treatment of corporations, in this case based on the corporation meeting the requirements of being an “issuing public corporation.” As defined in title 17, section 1701.01(Y) of the Ohio Revised Code, this means “a domestic corporation with fifty or more shareholders that has its principal place of business, its principal executive offices, assets having substantial value, or a substantial percentage of its assets within this state and as to which no valid close

101. See, e.g., DEL. CODE ANN. tit 8, § 271 (2004); CAL CORP. CODE § 1002 (West 2006)

102. OHIO REV. CODE ANN. § 1701.76(A) (West 2006).

103. “Issuing public corporation” is defined as:

a domestic corporation with fifty or more shareholders that has its principal place of business, its principal executive offices, assets having substantial value, or a substantial percentage of its assets within this state, and as to which no valid close corporation agreement exists under division (H) of section 1701.591 [1701.59.1] of the Revised Code.

§ 1701.01(Y).

104. *Id.* § 1701.76(G).

105. *Id.* § 1701.76(G)(1) as adopted in House Bill 301. Such a transaction might, for example, be a “reverse Morris Trust transaction,” in which a spin-off of a subsidiary occurs followed immediately by a merger of the spun-off entity with a third party. Robert Willens, *Developments in the Fields of Accounting and Tax*, 10 U. MIAMI BUS. L. REV. 99, 103 (Spring 1999). An example of such a transaction was the acquisition by the J.M. Smucker Company of the Jif-Crisco businesses of Procter & Gamble Company in 2002. Kristina Buchthal, *Fortune Brands Avoids Hefty Tax Bill in Spinoff*, CRAIN’S CHICAGO BUSINESS, March 17, 2005, available at <http://chicagobusiness.com/cgi-bin/news.pl?id=15844&rel=1>.

106. § 1701.76(G)(2).

corporation agreement exists. . . .”¹⁰⁷ So a public company incorporated in Ohio, but lacking other meaningful connections to the state, will not benefit from the amendment. And despite the reference to “public” in the defined term, the company need not be a public reporting company under the federal securities laws.¹⁰⁸

The following examples illustrate how the new provisions of title 17, section 1701.76 of the Ohio Revised Code could affect three differing spin-off situations:

Illustration 1: Company A, an issuing public corporation, owns all of the shares of Company B and wants to distribute those shares to its shareholders. Company A has a single class of shares, and there are no existing commitments affecting Company B that would otherwise require shareholder approval. With the effectiveness of House Bill 301’s amendment to title 17, section 1701.76 of the Ohio Revised Code, there need no longer be any inquiry into whether Company B constitutes all or substantially all of Company A’s assets.

Illustration 2: The same facts as in Illustration 1, but Company A has, in addition to its outstanding Class A (voting) common shares, outstanding shares of Class B (non-voting) common shares. Since there are two classes of shares outstanding, the relief from title 17, section 1701.76 of the Ohio Revised Code does not apply, and whether or not Company B constitutes all or substantially all of Company A’s assets must be tested.

Illustration 3: The same facts as in Illustration 1, but shortly before the spin-off Company A, as sole shareholder of Company B, and Company B have agreed with Company C (an unrelated third party) that Company B will merge with and into a subsidiary of Company C. As the merger with Company C would, if authorized after the spin-off, require the approval of Company B’s shareholders, the relief from title 17, section 1701.76 of the Ohio Revised Code does not apply, and whether or not Company B constitutes all or substantially all of Company A’s assets must be tested.

C. Permitting Holding Company Formations without Shareholder Approval

A holding company formation transaction is a transaction in which a new parent corporation becomes the sole shareholder of an existing

107. *Id.* § 1701.01(Y).

108. *See* 17 C.F.R. § 200.1 (2006).

company, typically by a merger process involving a third affiliated corporation formed solely to effect the merger, and thereby moving the shareholders of the old company to the new parent holding company as the only shareholders of the parent.¹⁰⁹ In essence, the shareholders are moved up one tier in the corporation organizational chart, one step further removed from the assets used in the business. This process is a useful mechanism by which corporate lawyers facilitate the future disposition of corporate assets, better match asset ownership with asset management, or provide greater protection against liability exposure between operating subsidiaries. Under amendments to DGCL §251(g) adopted several years ago, the directors of Delaware corporations were empowered to create new holding companies without shareholder approval and without triggering dissenters' rights.¹¹⁰ Like Delaware's prior laws, Ohio's merger provisions as they existed prior to House Bill 301 required shareholder approval and provided for dissenters' rights for these transactions.¹¹¹ This made it harder and more expensive for corporations to enter into holding company restructuring transactions in Ohio, placing Ohio corporations at a relative disadvantage to those in Delaware.

House Bill 301 incorporated the substance of title 8, section 251(g) of the Delaware Code into Ohio law through adoption of new title 17, section 1701.802 of the Ohio Revised Code. Now, directors of Ohio corporations can effect a holding company reorganization without shareholder approval and without triggering dissenters' rights, provided that five basic requirements intended to ensure continuity of shareholder rights are met:

- (1) The parent¹¹² company and a direct or indirect wholly owned subsidiary are the only constituent entities in the merger;¹¹³
- (2) Each outstanding share in the parent corporation before the merger

109. See OHIO REV. CODE ANN. § 1701.802(A) (West 2006).

110. DEL. CODE ANN. tit. 8, § 251(g) (2006).

111. OHIO REV. CODE ANN. § 1701.801 (Anderson 1996).

112. "Parent" is defined in section 1701.01(P), but section 1701.802 alters the requirements of that definition by requiring the parent to directly or indirectly own 100% of the shares of the subsidiary, and immediately following the holding company merger, the new holding company must directly or indirectly own 100% of the former parent.

113. OHIO REV. CODE ANN. § 1701.802(B)(1) (West 2006). This allows the following sequence: Company A, a public company, forms Holdco as a direct subsidiary, which in turn forms MergerCo, a second-tier subsidiary of Company A. HoldCo contributes its own shares to MergerCo. Company A merges with MergerCo, becoming a direct subsidiary of HoldCo. Company A's shares are converted into HoldCo shares, MergerCo shares are converted into Company A shares, and HoldCo becomes Company A's parent.

is converted into a share in the holding company with the same material terms;¹¹⁴

(3) The articles and regulations of the holding company after the merger are not materially different from those of the parent corporation;¹¹⁵

(4) As a result of the merger, the parent becomes a wholly owned subsidiary of the holding company;¹¹⁶ and

(5) The parent corporation's directors are the directors of the holding company after the merger.¹¹⁷

These requirements are comparable to those that apply in Delaware.¹¹⁸

Lawyers who make use of new title 17, section 1701.802 of the Ohio Revised Code will need to use judgment in determining what changes may be made to articles and regulations of the new holding company from those of the parent. It should be apparent that the holding company's articles and regulations should be able to differ in those provisions that could have been amended by the directors of the original corporation without shareholder approval. For example, the new holding company should be able to have a different name unless the articles of the original corporation prohibited them from changing its name. And if the corporation has adopted the flexibility for director amendments to the regulations afforded by other sections of House Bill 301, so that its own regulations could be amended without shareholder approval, the regulations of the new holding company should be able to differ to the same degree. But it should be equally apparent that fundamental changes — including changes to regulations that could not have been adopted by the parent's directors under the other provisions of House Bill 301 — to the corporation would require the approval of the original corporation's shareholders.

D. Allowing Conversions from One Form of Entity to Another

At different stages of a business's development, different business entity structures present various advantages and disadvantages. As limited liability companies have become more popular, states have

114. *Id.* § 1701.802(B)(2).

115. *Id.* § 1701.802(B)(3).

116. *Id.* § 1701.802(B)(4).

117. *Id.* § 1701.802(B)(5).

118. DEL. CODE ANN. tit. 8, § 251(g) (2006).

sought to simplify the statutory mechanisms for changing from one form of entity to another.¹¹⁹ The notion of “conversion” — the metaphysical change of one form of entity into another, without a change in the entity itself — is the simplest approach and was adopted by Delaware in 1999.¹²⁰ In the absence of a conversion statute, it was necessary to form a new entity, and to merge the old entity into the new entity to change the old entity into its new form.

House Bill 301 provides procedures for business entities to convert between organizational forms. Conversions are specifically permitted for for-profit corporations,¹²¹ limited liability companies,¹²² limited partnerships,¹²³ and partnerships.¹²⁴ No changes were made to title 17, chapter 1702 of the Ohio Revised Code, so there is no conversion mechanism into or from a non-profit corporation.

Dissenters’ rights may apply, unless otherwise restricted, as permitted by the statute.¹²⁵ The legal consequences of conversion are the same as what occurs in a merger or consolidation.¹²⁶ Conversions are effected by filing with the Secretary of State’s office.¹²⁷

119. *See, e.g.*, S.B. 137, 140th Gen. Assem., 2nd Sess. (Del. 1999). *See also supra* notes 121-24 for Ohio Conversion Statutes.

120. S.B. 137, 140th Gen. Assem., 2nd Sess. (Del. 1999).

121. *See* OHIO REV. CODE ANN. § 1701.782 (West 2006) (discussing conversion from a business entity, other than a domestic corporation or nonprofit corporation, to a domestic corporation). *See also id.* § 1705.792 (discussing conversion from a domestic corporation to a domestic or foreign business entity, other than a domestic corporation or nonprofit corporation).

122. *See id.* § 1705.361 (discussing conversion from a domestic or foreign business entity (not a domestic limited liability company) to a domestic limited liability company). *See also id.* § 1705.371 (discussing conversion from a domestic limited liability company to a domestic or foreign business entity).

123. *See id.* § 1782.438 (discussing conversion from a domestic or foreign business entity (not a domestic limited partnership) to a domestic limited partnership). *See also id.* § 1782.439 (dealing with conversion from a domestic limited partnership to a domestic or foreign business entity).

124. *See id.* § 1775.53 (dealing with conversion from a domestic or foreign business entity (not a domestic partnership) to a domestic partnership). *See also id.* § 1775.54 (dealing with conversion from a domestic partnership to a domestic or foreign business entity).

125. *See id.* §§ 1701.84-85 (dealing with corporations); §§ 1705.40-42 (dealing with limited liability companies); §§ 1775.50-51 (dealing with partnerships); §§ 1782.435-437 (dealing with limited partnerships).

126. *See id.* §§ 1701.821 (dealing with corporations); § 1705.391 (dealing with limited liability companies); § 1775.56 (dealing with partnerships); § 1782.4311 (dealing with limited partnerships).

127. *See id.* §§ 111.16(D) (West 2006) (discussing the fee for filing and recording a certificate of conversion) and 111.16(K)(2) (fee for creating and affixing the seal of the Secretary of State); § 1701.811 (discussing corporate conversion certificate filing requirement); § 1705.381 (discussing limited liability company conversion certificate filing requirement); § 1775.55 (discussing partnership conversion certificate filing requirement); § 1782.4310 (discussing limited partnership conversion certificate filing requirement). The provisions for fees chargeable for conversions does not become effective until April 10, 2007, but the Secretary of State’s office has committed to effect conversions prior to that on a temporary fee schedule.

Based on feedback received from practitioners both before and after the effectiveness of House Bill 301, the conversion provisions will be very useful to many smaller entities and business owners, and they are also proving useful to larger companies that wish to convert corporate subsidiaries into LLCs, or vice-versa.

E. Clarifying Option Grant Authority of Officers

Delaware corporate law authorizes directors to delegate to officers the authority to grant employee stock options.¹²⁸ Prior to House Bill 301, some Ohio corporations believed that they were already authorized to delegate option-granting authority to officers, notwithstanding statutory language that seemed to require director action.¹²⁹ But many practitioners disagreed, believing that the statutory scheme envisions option granting to be a fiduciary function of the directors that cannot be delegated to non-directors. The OSBA's Corporation Law Committee recognized this situation and believed a statutory clarification was desirable.¹³⁰

To resolve the disagreement, House Bill 301 amends title 17, section 1701.17 of the Ohio Revised Code to expressly authorize directors of Ohio corporations to delegate the authority to issue employee stock options.¹³¹ The directors must specify the total number of shares or options the officers may issue and the terms of those shares or options.¹³² The authorized officer may not designate himself or herself as the recipient of any shares or options.¹³³ These provisions parallel Delaware law.¹³⁴

Corporations should take special care when using these delegation provisions, as abuse of this discretionary authority may be blamed for

128. See DEL. CODE ANN. tit. 8, § 157(c) (2006).

129. Title 17, section 1701.16(A) of the Ohio Revised Code states “. . . a corporation *by its directors* may grant options. . .”, and section 1701.17 says “[a] corporation *by its directors*, . . . may provide and carry out plans for the issuance, offering, or sale, or the grant of options . . .” (emphasis added).

130. In its recommendation to the OSBA Council of Delegates regarding this amendment, the Corporation Law Committee said: “Delaware General Corporation Law section 157(c) allows the board of directors of Delaware corporations to delegate to one or more officers the authority to grant employee stock options. It is not clear that this authority exists under the corresponding Ohio provision. The proposed language clarifies that this authority exists.” Corporation Law Committee, Report and Recommendations to the Ohio State Bar Association Council of Delegates Meeting 11 (Nov. 7, 2003).

131. OHIO REV. CODE ANN. § 1701.17(B)(1) (West 2006).

132. *Id.*

133. *Id.* § 1701.17(B)(2).

134. See DEL. CODE ANN. tit. 8, § 157(c) (2006).

some cases of “option backdating” that raise serious accounting and legal issues.¹³⁵ Compensation committees and boards of directors should limit the scope of the delegated authority and monitor its use.

F. Clarifying the Creation and Powers of Board Subcommittees

Following the enactment by Congress of the Sarbanes-Oxley Act¹³⁶ in 2002, the demands for board-level activities to be conducted at the committee, rather than full board, level exploded, as the New York Stock Exchange and NASDAQ formally required the use of committees composed of independent directors in crucial areas such as audit, nominating, and compensation.¹³⁷ This placed tremendous pressure on outside directors serving on those key committees, often requiring them to greatly increase their workloads, especially on smaller boards.¹³⁸ A way around the resulting logjams was thought to be the division and further delegation of some of the workload among the committee members through creation of subcommittees to consider specific issues or aspects of the committee’s role.¹³⁹

This practical solution faced the problem that neither title 8 of the Delaware Code nor title 17, section 1701 of the Ohio Revised Code directly referred to subcommittees. Although there is probably less doubt associated with a delegation by directors, or a committee of directors, to a subset of their fellows than there is in the delegation of fiduciary judgments to non-directors,¹⁴⁰ it was still thought best to clarify the statute. The Delaware legislature amended title 8, section 141(c)(3) of the Delaware Code in 2003 to authorize the use of subcommittees, and House Bill 301 followed this lead by amending title 17, section 1701.63 of the Ohio Revised Code to allow a committee to subdivide itself into subcommittees with any or all of the committee’s power and authority.¹⁴¹ This power can be limited in the articles, the regulations, or by board resolution.¹⁴² A subcommittee may consist of one or more

135. See Scott Harshbarger & Goutam U. Jois, *Looking Back and Looking Forward: Sarbanes-Oxley and the Future of Corporate Governance*, 40 AKRON L. REV. 1 (2007).

136. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

137. Ben White, *Declining a Place at the Table; More Politicians, Executives Say ‘No Thanks’ to Director Seats*, THE WASH. POST, Feb. 27, 2003, at E01.

138. *Id.*

139. See H.B. 301, 126th Gen. Assem., Reg. Sess. cmt (Ohio 2005) (Committee Comments to OHIO REV. CODE ANN. § 1701.63 (West 2006)).

140. See *supra* notes 128-35 and accompanying text.

141. DEL. CODE ANN. tit. 8, § 141(c)(3) (2006); OHIO REV. CODE ANN. § 1701.63 (West 2006).

142. OHIO REV. CODE ANN. § 1701.63(E) (West 2006).

directors.¹⁴³

G. Allowing SEC Reports to Serve as Notice of Board-Adopted Amendments to the Articles

In 2002, the authority of directors to amend a corporation's articles of incorporation without shareholder approval was expanded.¹⁴⁴ Historically, title 17, section 1701.70 of the Ohio Revised Code had authorized directors to independently amend the articles of incorporation under five circumstances; this was increased to ten circumstances by the 2002 amendments.¹⁴⁵ At the same time, a new requirement was added to title 17, section 1701.73 of the Ohio Revised Code, requiring notice to be sent to shareholders within 20 days after the filing of the amendments with the Secretary of State.¹⁴⁶ After the 2002 amendments became law, it was discovered by practitioners that the new notice provision had unintended consequences: notices would be required even if the action taken by the directors fell into one of the five historical categories, not just one of the five new categories.¹⁴⁷ Further, there was a potentially high cost associated with these notices for large public companies that have many shareholders of record. In response to these practical concerns, House Bill 301 amended title 17, section 1701.73 of the Ohio Revised Code to allow companies that file periodic public reports with the SEC under sections 13 and 15(d) of the Securities Exchange Act of 1934 to meet these notice provisions through those filings.¹⁴⁸ For corporations with a large number of shareholders, this should provide significant future savings.

143. The decision to permit one-member subcommittees is in line with the prior 1998 amendment to title 17, section 1701.63 of the Ohio Revised Code that allowed committees to be reduced to a single member from the prior requirement of at least three directors. As the committee comment to the prior legislation said: "Recent changes in regulations under federal tax and securities laws have encouraged the use of smaller committees." In addition, the 1986 amendments to the Ohio General Corporation Law permitting corporations to eliminate cumulative voting, together with Ohio decisions interpreting the fiduciary duties of majority shareholders to minority shareholders, have eliminated the need for a statute setting the size of committees." See OHIO REV. CODE ANN. § 1701.63 cmt. (Ohio General Corporation Law Committee comment) (reprinted in PORTER WRIGHT MORRIS & ARTHUR LLP, *supra* note 25, at 118).

144. See § 1701.70 (adopted in H.B. 278, 124th Gen. Assem., Reg. Sess., (Ohio 2002)).

145. *Id.*

146. See *id.* § 1701.73(a).

147. OHIO REV. CODE ANN. § 1701.73 (West 2004). For example, a corporation was required to mail notice of the directors' adoption of an articles amendment that eliminated references in the articles to a class of shares that had been redeemed as allowed in title 17, section 1701.70(B)(3). *Id.*

148. OHIO REV. CODE ANN. § 1701.73(A)(3) (West 2006).

H. Broadening Permissible Consideration for Shares

In June 2004, title 8 of the Delaware Code was amended to broaden the range of permissible consideration for the issuance of shares.¹⁴⁹ The Delaware revisions reflected contemporary business economics and corporate transactional practice. These changes led the Corporation Law Committee to analyze title 17, section 1701.18 of the Ohio Revised Code, which governs the consideration acceptable for the payment for shares. That provision limited the forms of payment that corporations could accept in exchange for the issuance of shares to “money or other property of any description, or any interest in property, actually transferred to the corporation, or labor or services actually rendered to the corporation.”¹⁵⁰ These restrictions meant that shares could not be issued in exchange for future services, as a signing bonus, or for the prospective value of a relationship.

House Bill 301 amends title 17, section 1701.18 of the Ohio Revised Code to allow for a much broader range of acceptable consideration for shares. An Ohio corporation may now accept “cash, property, services rendered, a promissory note, or any other binding obligation to contribute cash or property or to perform services; the provision of any other benefit to the corporation; or any combination of these” as valid consideration for shares.¹⁵¹ The catch-all language, “any other benefit,” is intentionally broad. Valuation of the benefit to the corporation is left to the directors.¹⁵² Under the amended language, while shares may now be issued in consideration of a promise to perform services in the future, such shares remain “unpaid” until the services are performed.¹⁵³ In a parallel amendment contained in House Bill 301, limited liability companies were authorized to also accept any of these forms of consideration in exchange for membership interests.¹⁵⁴

I. Recognizing Corporate Actions In Accordance With Bankruptcy Court Orders

Both title 8 of the Delaware Code and title 17, chapter 1701 of the Ohio Revised Code have for many years recognized that a federal

149. DEL. CODE ANN. tit. 8, §§152, 154, 157 (2006).

150. See H.B. 301, 126th Gen. Assem., Reg. Sess. (2006) (deleting portions of section 1701.18(A)(1)).

151. OHIO REV. CODE ANN. § 1701.18(A)(1) (West 2006).

152. See *id.* § 1701.19(A), (B).

153. *Id.* § 1701.18(C).

154. See *id.* § 1705.09 (stating that contributions of “any benefit to the limited liability company” suffice).

bankruptcy court could, in a bankruptcy plan of reorganization, take actions (for example, charter amendments or mergers) concerning a corporation that ordinarily would require director and/or shareholder action under non-bankruptcy conditions.¹⁵⁵ Both title 8, section 303 of the Delaware Code and title 17, section 1701.75 of the Ohio Revised Code permitted companies undergoing reorganization in bankruptcy proceedings to accomplish these actions under a plan of reorganization.¹⁵⁶ Such plans are adopted in reorganizations under chapter 11 of the Federal Bankruptcy Code, but not in liquidations under either that chapter or chapter 7 of the Federal Bankruptcy Code. Also, some preliminary corporate actions will, even in reorganizations under chapter 11, fall outside the prior provisions of title 17, section 1701.75 of the Ohio Revised Code.¹⁵⁷

In August 2004, title 8, section 303 of the Delaware Code was amended to permit corporate activity under any order or decree from a federal bankruptcy court without director or shareholder approval, thus expanding the law's scope to include liquidations as well as reorganizations.¹⁵⁸ House Bill 301 contains a parallel amendment in title 17, section 1701.75 of the Ohio Revised Code.¹⁵⁹ This change should reduce the problems that practitioners would face when presenting bankruptcy court-approved documents to the Ohio Secretary of State's office that formerly did not appear to be authorized by chapter 1701.

J. Reliance on Certificates of Good Standing

Ohio corporate lawyers and others who worry about whether a corporation is validly existing and in good standing at the time the corporation undertakes a contract or engages in business have historically faced a concern over how much reliance they could take on the "good standing" certificates issued by Ohio's Secretary of State.

155. See OHIO REV. CODE ANN. § 1701.75 (1996); DEL. CODE ANN. tit. 8, § 303 (1991).

156. DEL. CODE ANN. tit. 8, § 303 (2006); OHIO REV. CODE ANN. § 1701.75 (West 2006).

157. For example, the sale of assets constituting substantially all (but not all) of the assets of the debtor corporation could have been authorized under applicable Federal bankruptcy principles pursuant to an order of the bankruptcy court prior to the entry of a plan of reorganization; under title 17, section 1701.76 of the Ohio Revised Code, this would have required the approval of the shareholders but Federal bankruptcy procedures would have ignored this state law requirement. Similarly, the bankruptcy court could have ordered the merger of subsidiaries into the debtor corporation; under section 1701.80 of the Ohio Revised Code this would require approval by directors of each corporation. The amendments to section 1701.75 eliminate these state law requirements.

158. See DEL. CODE ANN. tit. 8, § 303 (2006).

159. OHIO REV. CODE ANN. § 1701.75 (West 2006).

Although custom and practice in corporate business transactions require reliance by lawyers, title insurers, and others on these good standing certificates, the reality is that a corporation's good standing may change in a single day, without notice to someone who received the Secretary of State's certification earlier that day. As a result of concerns from lawyers who understood the potential for embarrassment, if not malpractice, for opinions as to good standing that were given in reliance on a certificate that was literally untrue at the moment it was relied on, House Bill 301 amends title 17, section 1701.92 of the Ohio Revised Code to define "good standing" and to expressly allow reliance on a certificate of good standing issued by the Secretary of State.¹⁶⁰ The new language provides that a person may rely on a certificate of good standing for a period of seven days after the date on the certificate, provided that person had no knowledge that the corporation's articles had been canceled and the certificate is not presented as evidence against the State.¹⁶¹ This makes it easier to complete transaction closings because it provides a window of time during which reliance on the certificate is legally justified, eliminating the possible need for obtaining "bring-down" certificates from the Secretary of State and the Ohio tax division.

III. WHAT DOES THE FUTURE HOLD?

As the chart earlier in this article shows, House Bill 301 is but one step in the continuing evolution of Ohio corporate law.¹⁶² Many changes have already occurred; Ohio is making good progress in "keeping up with Delaware." But we know that law is not static, and that more change is ahead of us. What might these changes be? Here are some changes that we may see in the future.

A. Majority Voting Proposals

The OSBA Council of Delegates has already approved a recommendation by the Corporation Law Committee to support

160. House Bill 301 provides that the certificate of good standing is conclusive evidence that:

- (1) a domestic corporation's authority has not been limited under dissolution provisions, as long as
 - (a) the person relying on the certificate had no knowledge that the articles had been canceled, and
 - (b) the certificate is not presented as evidence against the state; and
- (2) a foreign corporation's license to transact business in Ohio has not expired, been canceled or been surrendered.

161. See § 1701.92(D)(1).

162. See *supra* pp. 178-84.

legislation to amend title 17, section 1701.55 of the Ohio Revised Code to clearly permit Ohio corporations to amend their articles of incorporation to provide for majority voting in the election of directors.¹⁶³ This change is necessary in order to respond to a groundswell of shareholder activists who believe that the current plurality standard that has been the general rule in U.S. corporate elections undercuts “shareholder democracy” and promotes entrenchment of management.¹⁶⁴ This is part of a much larger national fight to give shareholders more influence over who serves as directors of America’s public corporations.¹⁶⁵ While there are many who believe the current system works well, the voting results in 2006 show that many shareholders believe otherwise, as at least 36 shareholder proposals seeking majority voting standards received majority support from shareholders.¹⁶⁶

Delaware law has historically allowed its corporations to opt in to majority voting requirements.¹⁶⁷ However, Delaware recently adopted a package of legislative changes to numerous sections of title 8 of the Delaware Code to better accommodate majority voting, for example by allowing conditional director resignations to be effective at a later date.¹⁶⁸ In the author’s view, these changes are not necessary in Ohio because existing law already permits such resignations.¹⁶⁹

163. OHIO STATE CAR ASSOCIATION COUNCIL OF DELEGATES, FALL 2006 MEETING, 10 available at http://downloads.ohioabar.org/pubs/council_files/Report_of_the_Corporation_Law_Committee_Fa06.pdf. The suggested language would insert “Unless the articles otherwise provide,” at the beginning of title 17, section 1701.55 of the Ohio Revised Code’s current language. *Id.*

164. *Id.*

165. *Id.*

166. The following is an excerpt from a report from Institutional Shareholder Services (ISS), a leading advisor to institutional investors:

According to ISS records, shareholders filed 84 majority election proposals that came to a vote in the first half of 2006. This compares with 54 proposals that came to a vote in the first six months of 2005, and 12 in 2004. For the first half of 2006, shareholder support for these majority vote proposals averaged 47.7 percent (compared with 44.3 percent during the first half of 2005). And by August 2006, 36 proposals had received more than 50 percent support, nearly triple the number in 2005. In 2004, these proposals averaged less than 12 percent of votes in favor, without a single proposal winning a majority.

ISS Governance Center, Governance Weekly, <http://www.issproxy.com/governance/publications/2007archived/005.jsp> (last visited Feb. 17, 2007).

167. See S.B. 322, 143rd Gen. Assem., Reg. Sess. (Del. 2006).

168. *Id.* at § 3 (amending 8 DEL ALS § 141(b)).

169. See OHIO REV. CODE ANN. § 1701.58(A) (West 2006) (“A resignation shall take effect immediately or at such other time as the director may specify.”). The use of the word “time,” rather than “date” as previously used in title 8 of the Delaware Code and the MBCA, allows the director to fix a set of conditions upon which the resignation becomes effective. See DEL. CODE ANN. tit. 8, § 223(d) (2006); MODEL BUS. CORP. ACT § 8.07(b) (2006).

The author expects that the majority voting amendment would become part of a legislative proposal this year.

B. Responding to Hollinger Dicta

In *Hollinger, Inc. v. Hollinger Int'l, Inc.*,¹⁷⁰ Vice Chancellor Strine's opinion contained dicta that caused concern to Delaware lawyers regarding the application of Delaware's "sale of all or substantially all" statutes, title 8, section 171 of the Delaware Code, in holding company situations.¹⁷¹ Thus, the question: Are sales of assets held by subsidiaries covered by the statute, or only assets held directly by the corporation? Conversely, are sales of assets to wholly-owned subsidiaries subject to title 8, section 171 of the Delaware Code, or not?

In 2006, Delaware responded to these concerns with legislation that amended title 8, section 171 of the Delaware Code to clarify that the statute indeed covers assets held by direct and indirect wholly-owned subsidiaries, and that sales to subsidiaries are not covered by the statute.¹⁷²

Ohio's analog to title 8, section 171 of the Delaware Code, as previously discussed in connection with House Bill 301, is title 17, section 1701.76 of the Ohio Revised Code.¹⁷³ The Corporation Law Committee has recently approved proposed language that would, if approved by the OSBA Council of Delegates, be part of a future legislative package.¹⁷⁴ The language generally adopts the Delaware approach. In the author's view, this would not be a change from current interpretations of Ohio law, but the changes would remove any doubt and assist in advising clients.

C. Eliminating the Opt-Out Waiting Period for Cumulative Voting

In 1986, Ohio reversed its historic requirement that corporations must permit cumulative voting in the election of directors, allowing

170. 858 A.2d 342 (Del. Ch. 2004).

171. *Id.* at 373.

172. DEL. CODE ANN. tit. 8 § 171 (2006).

173. OHIO REV. CODE ANN. § 1701.76 (West 2006).

174. The Committee Comment is as follows:

This amendment clarifies that (1) the "sale of all or substantially all assets" provision under ORC §1701.76 applies to sales of assets whether owned directly by a corporation or owned indirectly through one or more layers of wholly owned entities, and (2) the section does not apply to downstream movement of assets from a corporation to its to wholly-owned subsidiary entities.

Id. (Corporation Law Committee Comments, approved 2006).

corporations to opt out of that requirement by amending their articles of incorporation.¹⁷⁵ When those amendments were adopted, it was thought too radical to allow newly formed corporations to immediately opt out of cumulative voting, and instead a 90 day waiting period was imposed.¹⁷⁶ The Corporation Law Committee recently concluded that the waiting period is no longer desirable and has recommended that the waiting period be eliminated.¹⁷⁷ The author anticipates that this would be combined with the amendment described above to title 17, section 1701.76 of the Ohio Revised Code for consideration by the OSBA Council of Delegates and, if approved, be part of a future legislative package.

D. And There Will be More!

The OSBA's Corporation Law Committee is constantly looking to improve Ohio's entity statutes. Ideas for change flow in from practitioners around the state. Some die an early death, others move quickly into legislation, while yet others percolate through the Committee's processes for years. No one can predict precisely what future changes will be. What is certain is that there will be changes. Who knows, someday we may accomplish my own pet project: the elimination of stated capital as a statutory concept!¹⁷⁸

175. See §§ 1701.04 (discussing the contents of articles of incorporation) and 1701.69 (discussing the amendments to articles).

176. *Id.* § 1701.04(E).

177. See *supra*, note 174.

178. See, for example, the use of stated capital in §§ 1701.30, 1701.31, 1701.32, 1701.34 and 1701.35. Bayless Manning asked the questions:

Does the present day statutory legal capital machinery made up of par value, stated capital, and related non-economic concepts – controlled as it is by the shareholders, directors and their lawyers and accountants – effectively perform any significant relevant function in protecting creditors of corporations? . . . Is anything more needed than the Massachusetts provision forbidding a distribution to shareholders if the company is insolvent or if it would be rendered insolvent by the distribution?

BAYLESS MANNING, A CONCISE TEXTBOOK ON LEGAL CAPITAL 108 (New York, Foundation Press 1971). His answer to each of these questions: “No.” *Id.* Stay tuned.