

**COMMITTEE ON CORPORATE LAWS OF THE AMERICAN  
BAR ASSOCIATION SECTION OF BUSINESS LAW —  
REPORT ON THE ROLES OF BOARDS OF DIRECTORS AND  
SHAREHOLDERS OF PUBLICLY OWNED CORPORATIONS**

In the last decade, we have witnessed an accelerating shift in the ownership of corporate America from individual investors to institutional investors. Today, more than 75% of the shares of America's publicly owned corporations are beneficially owned by institutional shareholders.<sup>1</sup> Accompanying this shift has been a broadening of the types of institutional investors and in the forms of investing and trading activities. One consequence of these changes has been an increase in the level of trading activity. The average annual share turnover for many publicly owned corporations now approaches or even exceeds 100% of the corporation's outstanding shares.<sup>2</sup> More importantly, for purposes of this report, these developments have increased scrutiny of the performance of boards of directors and management, including by shareholders, and have changed the dynamics between boards of directors and shareholders.

In view of these developments, the Committee on Corporate Laws of the American Bar Association Section of Business Law, as the author of the Model Business Corporation Act, has been revisiting the role of the board of directors and the relationship between boards and shareholders. This Committee and other Committees of the Section of Business Law have been participants in the ongoing deliberations regarding corporate governance. The recent Report of the Task Force of the ABA Section of Business Law Corporate Governance Committee on Delineation of Governance Roles and Responsibilities, issued August 1, 2009,<sup>3</sup> admirably

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<sup>1</sup> Remarks of John C. Bogle, Building a Fiduciary Society (Mar. 13, 2009).

<sup>2</sup> Marcel Kahan & Edward Rock, The Hanging Chads of Corporate Voting, 96 Geo. L.J. 1227, 1232 (2008).

<sup>3</sup> See 65 Bus. Law. 107 (Nov. 2009).

addresses corporate governance issues related to board and shareholder roles. A number of programs addressing these issues, including those which this Committee has co-sponsored, have also been presented at Section meetings.

The Committee on Corporate Laws has for several years, been considering these issues from the perspective of assessing the place for state corporate law, and particularly the Model Act, in defining director and shareholder roles. As discussed below, the Committee supports the centralized model of corporate governance embodied in the Act, which model gives the board of directors power and corresponding responsibility to direct and oversee the management of the corporation. The Committee also believes that providing statutory flexibility for private ordering by boards and/or shareholders within the centralized model generally is preferable to a more prescriptive one-size-fits-all approach.

In furtherance of the centralized model, the Committee in 2005 amended the Model Act to make express the oversight responsibilities of the board of a publicly owned corporation. Section 8.01(c) of the Act now states that in the case of a public corporation the board's oversight responsibilities "include attention to:

- (i) business performance and plans;
- (ii) major risks to which the corporation is or may be exposed;
- (iii) the performance and compensation of senior officers;
- (iv) policies and practices to foster the corporation's compliance with law and ethical conduct;
- (v) preparation of the corporation's financial statements;
- (vi) the effectiveness of the corporation's internal controls;

(vii) arrangements for providing adequate and timely information to directors;  
and

(viii) the composition of the board and its committees, taking into account the important role of independent directors.”<sup>4</sup>

To enhance board oversight and management accountability, the Committee contemporaneously amended the Act to provide expressly that an officer’s duties include the obligation to inform his or her superior officer or the board or board committee to whom or to which the officer reports of (i) information about the corporation’s affairs known by such officer to be material to such superior officer, board or committee, and (ii) any actual or probable material violation of law or material breach of duty to the corporation that the officer believes has occurred or is likely to occur.<sup>5</sup> In addition, the Committee in 2006 amended the Model Act to permit “opt-in” director and/or shareholder bylaw amendments that would provide for a form of majority voting in director elections.<sup>6</sup> The Committee believes that these amendments are consistent with its views of the principles that should underpin state corporate law, maintain its vibrancy and ensure that the Model Act remains responsive to the needs of corporations and investors.

In 2007, the Committee created a task force to take an in-depth look at the relationship between boards and shareholders of publicly owned corporations, focusing on (i) the extent to which shareholders should have more authority to direct the board in the exercise of its

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<sup>4</sup> Model Business Corporation Act § 8.01(c).

<sup>5</sup> Id. at § 8.42(b). The Model Act imposes fiduciary duties on officers similar to those imposed on directors. See id. at § 8.42(a). The Delaware Supreme Court recently confirmed that officers of Delaware corporations owe fiduciary duties like directors. Gantler v. Stephens, 2009 WL 188828 (Del. 2009).

<sup>6</sup> Model Business Corporation Act § 10.22.

responsibility for managing or directing and overseeing the management of the corporation's business and affairs, (ii) the closely related issue of shareholder participation in the process of determining the composition of the board, (iii) if shareholders are to have greater authority, the extent to which shareholders should have fiduciary responsibilities or other governors on their actions, and (iv) the responsibilities of, and potential for, members of boards to communicate with shareholders. Through the work of the task force and after extensive deliberations, the Committee has achieved substantial consensus with respect to a number of basic principles and has been considering whether additional changes should be made to the Model Act to reflect some of its conclusions.

### **The Corporate Model**

As noted above, the Committee has reaffirmed its view that the deployment of diverse investors' capital by centralized management maximizes corporate America's ability to contribute to long-term wealth creation. The ability of central management to innovate and pursue appropriate risk-taking strategies is protected by state corporate law's adoption of a model of governance that charges the board of directors with responsibility for supervising the corporation's business and affairs.<sup>7</sup> Under this model shareholders have the regular opportunity to elect the members of the board, but during the directors' terms, the board has the power, informed by each director's decisions in the exercise of his or her fiduciary duties, to direct and oversee the pursuit of the board's vision of what is best for the corporation.<sup>8</sup> The Model Act,

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<sup>7</sup> Section 8.01 of the Model Act states that all corporate powers "shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors" subject to any limitation in the articles of incorporation. See also Del. Gen. Corp. Law § 141(a).

<sup>8</sup> See, e.g. *Paramount Communications, Inc.*, 1989 Del. Ch. LEXIS 77 at 88-90 (Del. Ch. 1989) aff'd 571 A.2d 1140 (Del. 1990) ("that any, presumably most, shareholders would prefer the board to do otherwise than it has  
(continued...)

which embodies this model, vests the power to direct and oversee the management of the corporation in the board of directors, rather than in the shareholders.<sup>9</sup> That power is subject to shareholder veto rights (in the form of a required vote) over certain transactions that could end or fundamentally transform the entity and, thus, the shareholders' investment therein.<sup>10</sup>

For diversified long-term investors, the benefits of this model are considerable. Through diversification, firm-specific risk is reduced and investors can benefit from the dedicated pursuit of sustainable profits by various management teams. If corporations were directly managed by shareholders, and the actions of management were the subject of frequent shareholder review and decision-making, the ability to rely on management teams would be diluted and the time and attention of managers could, in many cases, be diverted from activities designed to pursue sustainable economic benefit for the corporation.<sup>11</sup> For example, valuable board time might have to be diverted to address referenda items propounded by particular shareholders who may have interests that diverge from those of other shareholders or interests other than sustainable economic benefit. In addition, since shareholders generally do not owe fiduciary duties to each other or the corporation, such power would not be accompanied by corresponding accountability.

While the Committee supports a model that gives the board of directors primary

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done does not, in the circumstances of a challenge to this type of transaction, in my opinion, afford a basis to interfere with the effectuation of the board's business judgment.")

<sup>9</sup> In support of this model, the Committee has amended the Model Act to eliminate a provision that could be construed to permit shareholders to adopt a bylaw that limits the board's power to direct and oversee the management of the corporation. See the amendments following this report (§ 2.06(b)).

<sup>10</sup> See, e.g., Model Business Corporation Act § 11.04 (shareholder vote on mergers and share exchanges).

<sup>11</sup> See, Bainbridge, The Case for Limited Shareholder Voting Rights, 53 UCLA L. Rev. 601, 622-25(2006) ("Even if one could overcome the seemingly intractable collective action problems plaguing shareholder decisionmaking, active shareholder participation in corporate decisionmaking would still be precluded by the shareholders' widely divergent interests and distinctly different levels of information"). (Professor Bainbridge is a member of the Committee).

responsibility for the corporation and its business, it also recognizes that the increased shareholder scrutiny resulting from increased institutional ownership and sometime shareholder dissatisfaction with board and management performance necessitate a reconsideration of the relationship between the board and the shareholders within the framework of the basic corporate model described above. The Committee recognizes that historically, and consistent with the limited liability afforded to shareholders by the corporate form, shareholders have had limited roles within this model. It also recognizes that, in a rapidly changing, increasingly complex and global business environment, the demands on a board of directors are substantial. In that context, directors may be inclined to view a greater role for shareholders as an additional burden. Nonetheless, the Committee believes that, as a general proposition, boards of public corporations need to be receptive to certain forms of increased shareholder involvement, as described below.

### **Selection of Directors**

The Committee believes that shareholders should have the right, as owners of the enterprise, to participate in a meaningful way in the selection of the individuals who will have responsibility for directing the management of the enterprise. The Committee recognizes that a governance model in which the board has broad authority and oversight responsibility gives shareholders a compelling interest in the quality of the board selection process. The resulting director election process constitutes the model's ultimate accountability mechanism. In this connection, the Committee notes the significant shift to a majority vote requirement to elect directors, to which the Committee contributed through its adoption of an opt-in bylaw provision<sup>12</sup> as described above. The Committee believes the widespread changes in the vote required to elect directors provides an excellent example of the effectiveness of a private

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<sup>12</sup> See Model Business Corporation Act § 10.22.

ordering approach.<sup>13</sup>

The Committee also believes that the shareholders should have not only the right to elect but also the right to have a meaningful role in the process of selecting the candidates for election. In reaching this conclusion, the Committee considered several different models for shareholder involvement in the director selection process. In addition to shareholders conducting their own proxy solicitations, there are at least three possible models of shareholder participation in director selection. The first is the voluntary/discretionary model, through which shareholders can recommend director nominees for the board's consideration. In turn, the board can exercise its discretion in considering whether to accept a shareholder's recommendation when putting together the board's slate of nominees.

The second is the policy and procedures model, which is the dominant model today. To comply with listing requirements, boards have a nominating/corporate governance committee comprised of independent directors. That committee must have a written charter which addresses the committee's responsibilities for identifying individuals qualified to become board members and for recommending director nominees. The federal securities laws, by requiring certain types of disclosure about the nomination process, add to this model by promoting conformance and enhancement of corporate policies and procedures. Recent changes to the SEC's disclosure rules also require corporations to disclose for each director and any nominee for director the particular experience, qualifications, attributes or skills that qualify that person to serve as a director of the corporation.<sup>14</sup>

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<sup>13</sup> See Claudia H. Allen, Study of Majority Voting in Director Elections (2007), available at [http://www.ngelaw.com/files/upload/majority\\_study\\_111207.pdf](http://www.ngelaw.com/files/upload/majority_study_111207.pdf). (Ms. Allen is a member of the Committee).

<sup>14</sup> See SEC Release Nos. 339089; 34-61175; IC-29092 (December 16, 2009).

The third model of participation is the mandatory model, in which the company is obligated to include a shareholder's nominee in its proxy materials pursuant to a contractual provision, the company's charter or bylaws, or a federal or state requirement. For example, a corporation could be legally required by a contract or charter provision to provide shareholders with the ability to nominate (or even elect directors) — such as pursuant to a shareholder agreement or preferred stock rights. Alternatively, or in addition, the shareholders or the board of directors could adopt, consistent with the recent amendments to the Delaware corporation law<sup>15</sup> and the amendments to the Model Act hereinafter discussed, a bylaw relating to the inclusion of shareholder nominees in company proxy materials. Finally, a federal proxy rule has been proposed that would require the inclusion of shareholder nominees in company proxy materials under certain conditions.<sup>16</sup>

In addition to their right to elect the board of directors, shareholders historically also have had the state-law right to nominate director candidates. At the same time, however, no provision in the Model Act requires shareholders to participate in the nomination of director candidates or their election to the board of directors. As a general matter, shareholder participation in the nomination and election of the directors is entirely voluntary.<sup>17</sup>

Federal rules regulating the proxy solicitation process are an overlay on state corporate law designed to ensure that shareholders in a public corporation can exercise their voting

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<sup>15</sup> Del. Gen. Corp. Law § 112.

<sup>16</sup> See SEC Release Nos. 33-9046; 34-60089; IC-28765 (June 10, 2009).

<sup>17</sup> Fiduciaries of certain employee benefit plans are expected to take steps to cause shares held in that capacity to be voted. See, e.g., 29 CFR § 2509.08-2.



franchise on an informed basis.<sup>18</sup> However, under the current policies and rules of the Securities and Exchange Commission (“SEC”), companies can exclude from their proxy materials proposals that relate to the election of directors. Proponent shareholders cannot use management’s proxy to effectuate a proxy contest.<sup>19</sup> That position remains in effect despite proposals to modify it in 2003 and 2007; indeed the SEC strengthened this exclusion in 2007 in response to a judicial decision.<sup>20</sup> As noted above, current SEC proposals would reverse this position and also provide for the mandatory model described above.

The Committee has concluded that it is important to clarify the Model Act to confirm that shareholders can adopt bylaws providing for both (i) access to management’s proxy statement and proxy forms to nominate candidates and (ii) reimbursement of reasonable expenses incurred in nominating and promoting candidates. Based on that recommendation, the Committee has now approved Model Act amendments in the form following this Report. This approach enables application of a “private ordering”, company-by-company model. The Model Act approach also is consistent with the position expressed in the comment letter to the SEC of the ABA Committee on Federal Regulation of Securities dated August 31, 2009. The comment letter argues a one-size-fits-all approach to proxy access, as set forth in one of the SEC proposals, should not be mandated.<sup>21</sup>

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<sup>18</sup> See, e.g., *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) (Proxy solicitations are, after all, only communications with potential absentee voters. The goal of federal proxy regulation was to improve those communications and thereby to enable proxy voters to control the corporation as effectively as they might have by attending a shareholder meeting.”)

<sup>19</sup> See Rule 14a-8(i)8 under the Securities Exchange Act of 1934 (the “Exchange Act”).

<sup>20</sup> See *AFSME v. AIG*, 462 F.3d 121 (2d Cir. 2006).

<sup>21</sup> See, <http://www.sec.gov/rules/proposed.shtml>.

The Committee recognizes the importance of shareholders' ability to elect directors, while also recognizing that a good process for one enterprise may not be advantageous for another. For example, the factors that make up a good board, or that lead to a good board selection process, are complex. Assembling a team with requisite expertise and diversity and with the chemistry to work in a productive, independent and collaborative manner is challenging. Nonetheless, the Committee accepts as a core principle that shareholders must have the opportunity to participate in a fair and sensible manner in the board selection process, and should have the ability to adopt a mandatory model for their involvement in that process if they so choose.<sup>22</sup> A more open election system will further encourage boards to confer with shareholders about important corporate issues, including the board's process for selecting its nominees. By being more open about the qualities that the nominating committee considers crucial — such as business acumen, integrity, diversity, substantive expertise, and experience in key areas<sup>23</sup> — and seeking input from interested shareholders on the important issue of board composition and chemistry, boards will foster greater understanding, provide a less adversarial avenue for selecting and changing board members and reduce the likelihood of proxy fights.

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<sup>22</sup> See CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227 (Del. 2008).

<sup>23</sup> See SEC Release Nos. 33-9089; 34-61175; IC-29092 (Dec. 16, 2009).

## **Board Communications With Shareholders.**

As indicated by the prior discussion, an important element in director/shareholder relations is communication between the two groups. This communication goes beyond conferring with shareholders regarding director selection, extending to other aspects of the relationship between boards and shareholders. Because the corporate model vests managerial and oversight power of the corporation in directors during their terms, shareholders reasonably expect boards to be attentive to shareholders' interests, communicate with them about important corporate issues and listen to and assess their feedback and suggestions for improving the performance of the corporation and the board itself. A corollary of this ability of shareholders to communicate with boards is that shareholders should understand that the role of the board, after it has considered the views of shareholders, is to exercise its best judgment to act in the interests of the corporation and all of the shareholders.

In its deliberations, the Committee concluded that current practice leaves considerable room for improvement in board/shareholder communications, while recognizing that establishing an effective communications program requires a corporation to overcome a number of challenging issues, including:

- Identifying shareholders with whom communications would be most beneficial to the corporation;
- Identifying subjects on which directors might speak – for example, governance, need for new directors, director and executive compensation and appropriately broad strategic and oversight matters, rather than ongoing or short-term results or projects<sup>24</sup>;

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<sup>24</sup> Such an approach, which would seem sensible in any event, should ease concerns about what is often considered a major hurdle - that statements by directors might trigger broad disclosure requirements under Regulation FD under the Exchange Act .

- Identifying the director or directors who should communicate with shareholders;
- and
- Accommodating the additional burdens on directors of a communications program.

Effective communications is not a subject that is ripe for statutory definition or mandate. Rather, it is an inherent part of implementing the board's role in acting in the best interests of the corporation and its shareholders. The Committee will consider expanding the commentary to the Model Act to highlight the importance of communication as a key element of the board's performing its duties.

### **Shareholder Roles and Responsibilities**

The Committee has also focused on whether shareholders should have responsibilities to one another (or to the corporation), particularly if they are to have a larger role. At the margin, courts have been willing to find that controlling shareholders have fiduciary duties,<sup>25</sup> but the Committee believes that expansion of that concept should occur only in limited situations and, accordingly, should be left to the courts.<sup>26</sup> While some advocate fiduciary duties for activist or large shareholders, the Committee is not supporting that position.

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<sup>25</sup> See, e.g., Kahn v. Lynch Communication Systems, Inc., 638 A.2d 1110, 1113-16 (Del. 1994) (setting forth a standard for establishing controlling shareholder status and concomitant fiduciary duties. See also Iman Anabawi & Lynn Stout, Fiduciary Duties for Activist Shareholders, 60 Stan. L. Rev. 1255 (2008).

<sup>26</sup> While the Committee has focused on the relationship between the board and the shareholders, in its deliberations the Committee recognized that the continuing shift to institutional ownership coupled with the significant losses experienced in the last several years also bring into question another concern, namely the effective delineation and enforcement of fiduciary duties presented when most shares of publicly owned corporations are owned and/or managed by fiduciaries for the benefit of others. See Remarks of John C. Bogle, Building a Fiduciary Society (Mar. 13, 2009). While some of these relationships raise serious concerns about conflicts of interest and lack of incentives or even disincentives for agents to act in the interests of their principals, they may not be within the domain of the Committee and the Model Act.

A related issue exists when a major shareholder or group of shareholders promotes a particular director. The Committee believes that such a director owes the same duties to the corporation and all shareholders as all other board members. This position is consistent with the Model Act, and the Committee is revisiting the commentary to the Act with the objective of adding clarity on this issue.

The Committee also has considered the situation in which a shareholder or group of shareholders advocates corporate action that the board determines is not in the best interest of the corporation and the shareholders, taken as a whole, – – for example, when a shareholder favors or opposes a line of business or a country of operations or advances a position in respect of particular environmental, social, labor or other concerns. Another example involves the dichotomy in interests of investors with short-term investment horizons compared to those with long-term horizons. Consistent with the positions taken above, the Committee supports the fundamental premise that the board’s duty in evaluating the proposals or views put forward by shareholders, is to manage in the best interests of the corporation and the shareholders taken as a whole. Given that premise, the Committee intends to consider whether further direction or clarification in the Model Act of a board’s duty is necessary or appropriate in situations in which the board’s view of the best interests of the corporation and its shareholders taken as a whole diverge from the avowed interests or preferences of shareholders advocating a particular course of action.

No discussion of the roles and responsibilities of shareholders would be complete without considering the significant differences among shareholders and their respective interests. In this connection, the Committee also has considered whether the Model Act should play a greater role in addressing shareholder roles, shareholder responsibilities and constraints on shareholder

activities. The Committee believes that it would be impractical and unwise to view the Model Act as being a principal governor of shareholder activities. First, the Committee does not believe that its expertise or its mandate extends to pronouncing the direction that governance initiatives by shareholders should take. Next, as noted above, participation in governance by shareholders generally is voluntary. Many institutional investors elect not to participate or do so only marginally for reasons including managing costs (for example, at index funds), or a perception that their economic interests are better served by trading than pursuing governance initiatives (for example, at some mutual funds). Most significantly, there are too many variations of types of shareholders and differences in focus, interests and investment strategies to fashion a statutory default approach that would accommodate the myriad of alternatives. For example, the agenda of some shareholders involve governance initiatives directed at a particular corporation that are intended to produce gain for or satisfy other objectives of shareholders, but do not necessarily increase the potential for sustainable long-term economic wealth creation. One example would be a proposal that increases leverage of the corporation to fund higher current returns.

Although the Model Act may not be the vehicle for governing shareholder activities, the Committee nevertheless believes it is appropriate for it to be alert to changes in the nature of shareholdings and shareholder concerns in order to be able to continue to assess the vitality of the corporate model reflected in the Model Act and consider whether any adaption is desirable. In this regard, it appears to the Committee that, until recently, initiatives that focus on enhancing the potential for sustainable long-term wealth creation, such as initiatives directed at improving

risk management or fostering compensation systems that encourage such wealth creation rather than shorter term increases in stock price, have been less common.<sup>27</sup>

In addition, a number of factors signal that pursuit of short-term objectives by certain shareholders is common, including, to name only a few, automated trading strategies, the 100% or thereabouts annual turnover of shares in corporations, evaluation and selection of money managers by institutional investors based on quarterly results, and evaluations of governance by a leading proxy adviser based on a two-year time horizon. The current state law corporate model operates within an environment in which pressures from significant and vocal shareholders create pressures that boards cannot be expected to, and as a practical matter will not, ignore even though the proposed course of action runs counter to the directors' view of long-term wealth creation.

There are legal regimes outside that of corporate law that have some applicability, including the framework of the Investment Company Act of 1940, the Investment Advisers Act of 1940, state and federal regimes governing pension funds, and other bodies of law, such as ERISA, that define the fiduciary duties of investment managers to ultimate beneficiaries, and others that direct the actions of institutional investors. The Committee is not taking a position as to how these fiduciary and other duties are best fulfilled. There are also broader and more fundamental social and economic issues as to how shareholders of public corporations as a whole are best served. As these matters evolve, the Committee expects to continue to assess the basic corporate model and to be alert to any attempts to weaken that model, recognizing that its operation is likely to be impacted by developments in other areas.

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<sup>27</sup> This perception could be skewed by the nature of the public proposals since it may be that shareholders advocating more substantive changes may be inclined to take a more private approach by communicating directly with the board and/or management.

The Committee does note that some of the issues involving the role of shareholders and their relationship to the board could be addressed at least in part by provisions of state corporate law, including the Model Act. Examples include possible time-based provisions regarding shareholder voting, rights to select director candidates or rights to call meetings. Indeed, it has been suggested both by an ABA task force and the SEC that time based conditions be imposed on shareholder rights to promote nominees for director.<sup>28</sup> Examples also include possible provisions more closely tying the economic interests of share ownership with voting interests that address various aspects of the so-called “empty voting” issue.<sup>29</sup> The Committee is considering the appropriate role of the Model Act in addressing these issues, including the desirability of focusing on or expanding the ability of corporations to engage in private ordering, and may have further proposals.

January 21, 2010

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<sup>28</sup> See Report of the Task Force of the ABA Section of Business Law Corporate Governance Committee, 65 Bus. Law. 107 (Nov. 2009); SEC Release Nos. 33-9046; 34-60089; IC-28765 (June 10, 2009).

<sup>29</sup> See Hu and Black, The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership, 78 So. Cal. L.Rev. 811 (2006).



## Exhibit A

### Amendments to the Model Business Corporation Act Relating to Proxy Access and Proxy Expense Reimbursement Adopted on December 12, 2009

*Amend section 2.06 and Official Comment as follows:*

#### **§ 2.06. BYLAWS**

- (a) The incorporators or board of directors of a corporation shall adopt initial bylaws for the corporation.
- (b) The bylaws of a corporation may contain any provision ~~for managing the business and regulating the affairs of the corporation~~ that is not inconsistent with law or the articles of incorporation.
- (c) The bylaws may contain one or both of the following provisions:
  - (1) A requirement that if the corporation solicits proxies or consents with respect to an election of directors, the corporation include in its proxy statement and any form of its proxy or consent, to the extent and subject to such procedures or conditions as are provided in the bylaws, one or more individuals nominated by a shareholder in addition to individuals nominated by the board of directors; and
  - (2) A requirement that the corporation reimburse the expenses incurred by a shareholder in soliciting proxies or consents in connection with an election of directors, to the extent and subject to such procedures or conditions as are provided in the bylaws, provided that no bylaw so adopted shall apply to elections for which any record date precedes its adoption.
- (d) Notwithstanding section 10.20(b)(2), the shareholders in amending, repealing, or adopting a bylaw described in subsection (c) may not limit the authority of the board of directors to amend or repeal any condition or procedure set forth in or to add any procedure or condition to such a bylaw in order to provide for a reasonable, practicable, and orderly process.

#### **OFFICIAL COMMENT**

The responsibility for adopting the original bylaws is placed on the person or persons completing the organization of the corporation. Section 2.06(b) ~~restates the accepted scope of bylaw provisions~~ permits any bylaw provision that is not inconsistent with the articles of incorporation or law. This limitation precludes provisions that limit the managerial authority of directors that is established by section 8.01(b). For a list of Model Act provisions that become effective only if specific reference is made to them in the bylaws, see Official Comment to

section 2.02. ~~Provisions set forth in bylaws may additionally be contained in shareholder or board resolutions unless this Act requires them to be set forth in the bylaws.~~

The power to amend or repeal bylaws, or adopt new bylaws after the formation of the corporation is completed, is addressed in sections 10.20, 10.21, and 10.22 of the Model Act.

Section 2.06(c) expressly authorizes bylaws that require the corporation to include individuals nominated by shareholders for election as directors in its proxy statement and proxy cards (or consents) and that require the reimbursement by the corporation of expenses incurred by a shareholder in soliciting proxies (or consents) in an election of directors, in each case subject to such procedures or conditions as may be provided in the bylaws. Expenses reimbursed under section 2.06(c)(2) must be reasonable as contemplated in the definition of expenses set forth in section 1.40(9AA).

Examples of the procedures and conditions that may be included in such bylaws include provisions that relate to the ownership of shares (including requirements as to the duration of ownership); informational requirements; restrictions on the number of directors to be nominated or on the use of the provisions by shareholders seeking to acquire control; provisions requiring the nominating shareholder to indemnify the corporation; limitations on reimbursement based on the amount spent by the corporation or the proportion of votes cast for the nominee; and limitations concerning the election of directors by cumulative voting. In that respect, the function of such bylaws in a corporation with cumulative voting may present unique issues.

Shareholder adoptions of proxy access and expense reimbursement bylaws do not infringe upon the scope of authority granted to the board of directors of a corporation under section 8.01(b). Section 2.06(c) underscores the model of corporate governance embodied by the Act and reflected in section 8.01, but recognizes that different corporations may wish to grant shareholders varying rights in selecting directors through the election process.

Section 2.06(d) limits the rule set forth in section 10.20(b)(2) that shareholder adopted bylaws may limit the authority of directors to amend bylaws, by specifying that such a limit will not apply absolutely to conditions and procedures set forth in access or reimbursement bylaws authorized by section 2.06(c). Section 2.06(d) allows directors to ensure that such bylaws adequately provide for a reasonable, practicable, and orderly process, but is not intended to allow the board of directors to frustrate the purpose of a shareholder-adopted proxy access or expense reimbursement provision.