/* Part 6 of 8. */
(2) Party to the Transaction-The Corporation

Transaction by what entity? In the usual case, the transaction in question would be by X Co. But assume that X Co. is the controlling corporation of 5 Co. (i.e., it controls the vote for directors of 5 Co.). D wishes to sell a building he owns to X Co. and X Co. is willing to buy it. As a business matter, it will often make no difference to X Co. whether it takes the title itself or places it with its subsidiary S Co. or another entity that X Co. controls. The applicability of subchapter F cannot be allowed to depend upon that formal distinction. The subchapter therefore includes within its operative framework transactions by a subsidiary or controlled entity of X Co. See the Note on Parent Companies and Subsidiaries below.

(3) Party to the Transaction-The Director

Subdivision (1)(i) and subdivision (1)(ii) differ as to the persons covered and as to the threshold of transactional significance. Subdivision (1)(i), addressed to D and related persons of D, includes as directors' conflicting interest transactions all transactions that meet the substantive criteria prescribed. By contrast, subdivision (1)(ii), addressed to transactions involving other designated persons, excludes from its coverage transactions that are not sufficiently significant to the corporation to warrant decision at the boardroom level.

As a generalization, the linkage between a director and a "related person" is closer than that between the director and those persons and entities specified in subdivision (1)(ii). Correspondingly, the threshold of conflicting interest under subdivision (1)(i) is lower than that set for subdivision (1)(ii). Thus, all routine transactions of X Co. are excluded from the definition of director's conflicting interest transaction unless they fall within subdivision (1)(i). If Y Co., a computer company of which D is also an outside director, sells office machinery to X Co., the transaction will not normally give rise to a conflicting interest for D from the perspective of either company since the transaction is a routine matter that would not come before either board. If, however, the transaction is of such significance to one of the two companies that it would come before the board of that company, then D has a conflicting interest in the transaction with respect to that company.

Implicit in subdivision (1)(ii) is a recognition that X Co. and Y Co., particularly if large enterprises, are likely to have routine, perhaps frequent, business dealings with each other as they buy and sell goods and services in the marketplace. The terms of these dealings are dictated by competitive market forces and the transactions are conducted at personnel levels far below the boardroom. The fact that D has some relationship with Y Co. is not in itself sufficient reason to open these smaller scale impersonal business transactions to challenge if not passed through the board in accordance with section 8.62 procedures. It would be doubly impractical to do so twice where X Co. and Y Co. have a common director.

Subchapter F takes the practical position. The definition in subdivision (1)(ii) excludes most such transactions both by its "knowledge" requirement and by its higher threshold of economic significance. In almost all cases, any such transaction, if challenged, would be easily defensible as being "fair." In respect of day-to-day business dealings, the main practical risk of impropriety would be that a director having a conflicting interest might seek to exert inappropriate influence upon the interior operations of the enterprise, might try to use his status as a director to pressure lower level employees to divert their business out of ordinary channels to his advantage. But a director's affirmative misconduct goes well beyond a claim that he has a conflicting interest, and judicial action against such improper behavior remains available. See also the Official Comment to section 8.62(b) regarding common directors.

The absence of the significance threshold in subdivision (1)(i) does not impose an inappropriate burden on directors and related persons. The commonplace and oftentimes recurring transaction will involve purchase of the corporation's product line; it will usually not be difficult for D to show that the transaction was on commercial terms and was fair, or indeed, that he had no knowledge of the transaction. As a result, these transactions do not invite harassing lawsuits against the director. A purchase by D of a product of X Co. at a usual "employee's discount," while technically assailable as a conflicting interest transaction, would customarily be viewed as "fair" to the corporation as a routine incident of the office of director. For other transactions between the corporation and the director or those close to him, D can, and should, have the burden of establishing the fairness of the transaction if it is not passed upon by the arm's length review of qualified directors or the holders of qualified shares. If there are any reasons to believe that the terms of the transaction might be questioned as unfair to X Co., D is well advised to pass the transaction through the safe harbor procedures for subchapter F.

Note on Parent Companies and Subsidiaries

If a subsidiary is wholly owned, there is no outside holder of shares of the subsidiary to be injured with respect to transactions between the two corporations.

Transactions between a parent corporation and a partially-owned subsidiary may raise the possibility of abuse of power by a majority shareholder to the disadvantage of a minority shareholder. Subchapter F has no relevance as to how a court should deal with that claim.

If there are not at least two outside directors of the subsidiary, the subsidiary and the board of directors must operate on the basis that any transaction between the subsidiary and the parent that reaches the significance threshold in subdivision (1 Xii) may, as a technical matter, be challengeable by a minority shareholder of the subsidiary on grounds that it is a director's conflicting interest transaction. In that case, the directors of the subsidiary will have to establish the fairness of the transaction to the subsidiary. In practice, however, the case law has dealt with such claims under the rubric of the duties of a majority shareholder and that is, in reality, the better approach. See the Official Comment to section 8.61(b).

3. Related Person

Two subcategories of "related person" of the director are set out in subdivision (3). These subcategories are specified, exclusive, and preemptive.

The first subcategory is made up of closely related family, or near-family, individuals, trusts, and estates as specified in clause (i). The clause is exclusive insofar as family relationships are concerned. The references to a "spouse" are intended to include a common law spouse or unrelated cohabitant.

The second subcategory is made up of persons specified in clause (ii) to whom or which the director is linked in a fiduciary capacity as, for example, in his status as a trustee or administrator. (Note that the definition of "person" in the Model Act includes both individuals and entities. See section 1.40(16).) From the perspective of x Co., D's fiduciary relationships are always a sensitive concern. A conscientious director may be able to control his own greed arising from a conflicting personal interest. And he may resist the temptation to assist his wife or child. But he can never escape his legal obligation to act in the best interests of another person for whom he is a trustee or other fiduciary.

4. Required Disclosure

Two separate elements make up the defined term "required disclosure. They are disclosure of the existence of the conflicting interest and then disclosure of the material facts known to D about the subject of the transaction.

Subdivision (4) calls for disclosure of all facts known to D about the subject of the transaction that an ordinarily prudent person would reasonably believe to be material to a judgment by the person acting for the corporation as to whether to proceed or not to proceed with the transaction. If a director knows that the land the corporation is buying from him is sinking into an abandoned coal mine, he must disclose not only that he is the owner and that he has an interest in the transaction but also that the land is subsiding; as a director of x Co. he may not invoke caveat emptor. But in the same circumstances the director is not under an obligation to reveal the price he paid for the property ten years ago, or that he inherited it, since that information is not material to the corporation's business judgment as to whether or not to proceed with the transaction. Further, while material facts that pertain to the subject of the transaction must be disclosed, a director is not required to reveal personal or subjective information that bears upon his negotiating position (such as, for example, his urgent need for cash, or the lowest price he would be willing to accept). This is true despite the fact that such information would obviously be relevant to the corporation's decision-making in the sense that, if known to the corporation, it could equip the corporation to hold out for terms more favorable to it.

Underlying the definition of the twin components of "required disclosure" is the critically important provision contained in subdivision (1) that a basic precondition for the existence of a "conflicting interest" is that the director know of the transaction and also that he know of the existence of his conflicting interest.

5. Time of Commitment

The time of the commitment by the corporation (or its subsidiary or other controlled entity) to the transaction is defined in operational terms geared to change of economic position.

8.61 Judicial Action

(a) A transaction effected or proposed to be effected by a corporation (or by a subsidiary of the corporation or any other entity in which the corporation has a controlling interest) that is not a director's conflicting interest transaction may not be enjoined, set aside, or give rise to an award of damages or other sanctions, in a proceeding by a shareholder or by or in the right of the corporation, because a director of the corporation, or any person with whom or which he has a personal, economic, or other association, has an interest in the transaction.

(b) A director's conflicting interest transaction may not be enjoined, set aside, or give rise to an award of damages or other sanctions, in a proceeding by a shareholder or by or in the right of the corporation, because the director, or any person with whom or which he has a personal economic, or other association, has an interest in the transaction, if:

(1) directors' action respecting the transaction was at any time taken in compliance with section 8.62;

(2) shareholders' action respecting the transaction was at any time taken in compliance with section 8.63;

(3) the transaction, judged according to the circumstances at the time of commitment, is established to have been fair to the corporation.

/* A rather flexible definition. */

Official Comment

Section 8.61 is the operational section of subchapter F as it prescribes the judicial consequences of the other sections.

Speaking generally:

(i) If the procedure set forth in section 8.62 or in section 8.63 is complied with, or if the transaction is fair to the corporation, then a director's conflicting interest transaction is immune from attack on any ground of a personal interest or conflict of interest of the director. However, the narrow scope of subchapter F must again be strongly emphasized; if the transaction is vulnerable to attack on some other ground, subchapter F does not make it less so for having been passed through the procedures of subchapter F.

(ii) If a transaction is not a director's conflicting interest transaction as defined in section 8.60, then the transaction may not be enjoined, rescinded, or made the basis of other sanction on the ground of a conflict of interest of a director, whether or not it went through the procedures of subchapter E In that sense, subchapter F is specifically intended to be both comprehensive and exclusive.

(iii) If a transaction that is a director's conflicting interest transaction was not at any time the subject of action taken in compliance with section 8.62 or section 8.63, and it is attacked on grounds of a director's conflicting interest and is not shown to be fair to the corporation, then the court may grant such remedial action as it considers appropriate under the applicable law of the jurisdiction. If the attack is on other grounds, subchapter F has no relevance to the issue(s) before the court.

1. Section 8.61(a)

Section 8.61(a) is a key component in the design of subchapter F. It draws a bright-line circle, declaring that the definitions of section 8.60 wholly occupy and preempt the field of directors' conflicting interest transactions. Of course, outside this circle there is a penumbra of director interests, desires, goals, loyalties, and prejudices that may, in a particular context, run at odds with the best interests of the corporation, but section 8.61(a) forbids a court to ground remedial action on any of them. If a plaintiff charges that a director had a conflict of interest with respect to a transaction of the corporation because the other party was his cousin, the answer of the court should be: "No. A cousin, as such and without more, is not included in section 8.60(3) as a related person-and under section 8.61(a), I have no authority to reach out farther." If a plaintiff contends that the director had a conflict of interest in a corporate transaction because the other party is president of the golf club the director wants desperately to join, the court should respond: "No. The only director's conflicting interest on the basis of which I can set aside a corporate transaction or impose other sanctions is a financial interest as defined in section 8.60."

2. Section 8.61(b)

Section 8.61(b) is the heart of subchapter F the fundamental section that provides for the safe harbor.

Clause (1) of subsection (b) provides that if a director has a conflicting interest respecting a transaction, neither the transaction nor the director is legally vulnerable if the procedures of section 8.62 have been properly followed. Subsection (b)(1) is, however, subject to a critically important predicate condition.

The condition -an obvious one- is that the board's action must comply with the care, best interests and good faith criteria prescribed in section 8.30(a) for all directors' actions. If the directors who voted for the conflicting interest transaction were qualified directors under subchapter F, but approved the transaction merely as an accommodation to the director with the conflicting interest, going through the motions of board action without complying with the requirements of section 8.30(a), the action of the board would not be given effect for purposes of section 8.61(b)(1).

Board action on a director's conflicting interest transaction provides a context in which the function of the "best interests of the corporation" language in section 8.30(a) is brought into clear focus. Consider, for example, a situation in which it is established that the board of a manufacturing corporation approved a cash loan to a director where the duration, security and interest terms of the loan were at prevailing commercial rates, but (i) the loan was not made in the course of the corporation's ordinary business and (ii) the loan required a commitment of limited working capital that would otherwise have been used in furtherance of the corporation's business activities. Such a loan transaction would not be afforded safe-harbor protection by section 8.62(b)(1) since the board did not comply with the requirement in section 8.30(a) that the board's action be, in its reasonable judgment, in the best interests of the corporation-that is, that the action will, as the board judges the circumstances at hand, yield favorable results (or reduce detrimental results) as judged from the perspective of furthering the corporation's business activities.

If a determination is made that the terms of a director's conflicting interest transaction, judged according to the circumstances at the time of commitment, were manifestly unfavorable to the corporation, that determination would be relevant to an allegation that the directors' action was not taken in good faith and therefore did not comply with section 8.30(a).

Note on Fair Transactions

(1) Terms of the Transaction. If the issue in a transaction is the "fairness" of a price, "fair" is not to be taken to imply that there is a single "fair" price, all others being "unfair." It has long been settled that a "fair" price is any price in that broad range which an unrelated party might have been willing to pay or willing to accept, as the case may be, for the property, following a normal arm's-length business negotiation, in the light of the knowledge that would have been reasonably acquired in the course of such negotiations, any result within that range being "fair." The same statement applies not only to price but to any other key term of the deal.

Although the "fair" criterion applied by the court is a range rather than a point. the width of that range is only a segment of the full spectrum of the directors' discretion associated with the exercise of business judgment under section 8.30(a). That is to say, the scope of decisional discretion that a court would have allowed to the directors if they had acted and had complied with section 8.30(a) is wider than the range of "fairness" contemplated for judicial determination where section 8.61(b)(3) is the governing provision.

(2) Benefit to the Corporation. In considering the "fairness" of the transaction, the court will in addition be required to consider not only the market fairness of the terms of the deal, but also, as the board would have been required to do, whether the transaction was one that was reasonably likely to yield favorable results (or reduce detrimental results) from the perspective of furthering the corporation's business activities. Thus, if a manufacturing company that is short of working capital allocates some of its scarce funds to purchase a sailing yacht owned by one of its directors, it will not be easy to persuade the court that the transaction is "fair" in the sense that it was reasonably made to further the business interests of the corporation; the fact that the price paid for the yacht was stipulated to be a "fair" market price will not be enough alone to uphold the transaction. See also the discussion above regarding section 8.30(a).

(3) Process of Decision. In some circumstances, the behavior of the director having the conflicting interest can itself affect the finding and content of "fairness," The most obvious illustration of unfair dealing arises out of the director's failure to disclose fully his interest or hidden defects known to him regarding the transaction. Another illustration could be the exertion of improper pressure by the director upon the other directors. When the facts of such unfair dealing become known, the court should offer the corporation its option as to whether to rescind the transaction on grounds of "unfairness" even if it appears that the terms were "fair" by market standards and the corporation profited from it. If the corporation decides not to rescind the transaction because of business advantages accruing to the corporation from it, the court may still find in the director's misconduct a basis for judicially imposed sanction against the director personally. Thus, the course of dealing -or process- is a key component to a "fairness" determination under subsection (b)(3).

8.62 Directors' Action

(a) Directors action respecting a transaction is effective for purposes of section 8.61(b((1) if the transaction received the affirmative vote of a majority (but no fewer than two) of those qualified directors on the board of directors or on a duly empowered committee of the board who voted on the transaction after either required disclosure to them (to the extent the information was not known by them) or compliance with subsection (b); provided that action by a committee is so effective only if (1 all its members are qualified directors, and (2) its members are either all the qualified directors on the board or are appointed by the affirmative vote of a majority of the qualified directors on the board.

(b)If a director has a conflicting interest respecting a transaction, but neither he nor a related person of the director specified in section 8.60(3)(i) is a party to the transaction, and if the director has a duty under law or professional canon, or a duty of confidentiality to another person, respecting information relating to the transaction such that the director may not make the disclosure described in section 8.60(4)(ii), then disclosure is sufficient for purposes of subsection (a) if the director (1) discloses to the directors voting on the transaction the existence and nature of his conflicting interest and informs them of the character and limitations imposed by that duty before their vote on the transaction, and (2) plays no part, directly or indirectly, in their deliberations or vote.

(c) A majority (but no fewer than two) of all the qualified directors on the board of directors, or on the committee, constitutes a quorum for purposes of action that complies with this section. Directors' action that otherwise complies with this section is not affected by the presence or vote of a director who is not a qualified director.

(d) For purposes of this section, "qualified director" means, with respect to a director's conflicting interest transaction, any director who does not have either (1) a conflicting interest respecting the transaction, or (2) a familial, financial, professional, or employment relationship with a second director who does have a conflicting interest respecting the transaction, which relationship would, in the circumstances, reasonably be expected to exert an influence on the first director's judgment when voting on the transaction.

/* Therefore if sufficient directors who are independent are included in the vote, the transaction is accpeted. */

Official Comment

Section 8.62 provides the procedure for action of the board of directors under subchapter F. In the normal course, this section, taken together with section 8.61(t), will be the key provision for dealing with directors' conflicting interest transactions.

All discussion of section 8.62 must be conducted in light of the overarching provisions of section 8.30(a) prescribing the criteria for decisions by directors. Board action that does not comply with the requirements of section 8.30(a) will not, of course, be given effect under section 8.62. See the Official Comment to section 8.61(b).

1. Section 8.62(a)

A transaction in which a director has a conflicting interest is approved under section 8.62 if and only if it is approved by qualified directors, as defined in subsection 8.62(d). Action by the board of directors as a whole is effective if approved by the affirmative vote of a majority (but not less than two) of the qualified directors on the board. Action may also be taken by a duly authorized committee of the board but, to be effective, all members of the committee must be qualified directors and the committee must either contain all of the qualified directors on the board or must have been appointed by the affirmative vote of a majority of the qualified directors on the board. The effect of the limitation on committee action is to make it impossible to handpick as committee members a favorably inclined minority from among the qualified directors.

Except to the limited extent provided in subsection (b), approval by the board or committee must be preceded by required disclosure.

Action complying with subsection 8.62(a) may be taken by the board of directors at any time, before or after the transaction, and may deal with a single transaction or a specified category of similar transactions.

2. Section 8.62(b)

Subsection (b) is a new provision designed to deal, in a practical way, with situations in which a director who has a conflicting interest is not able to comply fully with the disclosure requirement of subsection (a) because of an extrinsic duty of confidentiality. The director may, for example, be prohibited from making full disclosure because of restrictions of law that happen to apply to the transaction (e.g., grand jury seal or national security statute) or professional canon (e.g., lawyers' or doctors' client privilege). The most frequent use of subsection (b), however, will undoubtedly be in connection with common directors who find themselves in a position of dual fiduciary obligations that clash. If D is also a director of Y Co., D may have acquired privileged confidential information from one or both sources relevant to a transaction between X Co. and Y Co. that he cannot reveal to one without violating his fiduciary duty to the other. In such circumstance, subsection (b) makes it possible for such a matter to be brought to the board for consideration under subsection (a) and thus enable X Co. to secure the protection afforded by subchapter F for the transaction despite the fact that D cannot make the full disclosure usually required.

To comply with subsection (b), D must disclose that he has a conflicting interest, inform the directors who vote on the transaction of the nature of his duty of confidentiality (e.g., inform them that it arises out of an attorney-client privilege or his duty as a director of Y Co. that prevents him from making the disclosure called for by clause (ii) of section 8.60(4)), and then play no personal part in the board's deliberations. The point of subsection (b) is simply to make clear that the provisions of subchapter F may be employed with regard to a transaction in circumstances where an interested director cannot, because of enforced fiduciary silence, make disclosure of the facts known to him. Of course, if D invokes subsection (b) and then remains silent before leaving the boardroom, the remaining directors may decline to act on the transaction if troubled by a concern that D knows (or may know) something they do not. On the other hand, if D is subject to an extrinsic duty of confidentiality but has no knowledge of facts that should be disclosed, he would normally so state and disregard subsection (b), and (having disclosed the existence and nature of his conflicting interest) thereby comply with section 8.60(4). .

Subsection (b) is not available to D if the transaction is directly between the corporation and D or his related person- if, that is, the director or a related person is a party to the transaction. If D or a related person is a party to the transaction, D's only options are required disclosure on an unqualified basis, abandonment of the transaction, or acceptance of the risk of establishing fairness in a court proceeding if the transaction is challenged.

Whenever D proceeds as provided in subsection 8.62(b), the board should recognize that he may well have information that in usual circumstances he would be required to reveal to the board-information that may well indicate that the transaction is a favorable or unfavorable one for X Co. .

4. Section 8.62(d)

Obviously, a director's conflicting interest transaction and D cannot be provided safe harbor protection by fellow directors who themselves have conflicting interests; only "qualified directors" can provide such safe harbor protection pursuant to subsection (a). "Qualified director" is defined in subsection (d). The definition is broad. It excludes not only any director who has a conflicting interest respecting the matter, but also going significantly beyond the persons specified in the subcategories of section 8.60(1)(ii) for purposes of the "conflicting interest" definition any director whose familial or financial relationship with D or whose employment or professional relationship with D would be likely to influence the director's vote on the transaction.

The determination of whether there is a financial, employment or professional relationship should be based on the practicalities of the situation rather than formalistic circumstances. For example, a director employed by a corporation controlled by D should be regarded as having an employment relationship with D.

8.63 Shareholders' Action

(a) Shareholders' action respecting a transaction is effective for purposes of section 8.61(b)(2) if a majority of the votes entitled to be cast by the holders of all qualified shares were cast in favor of the transaction after (1) notice to shareholders describing the director's conflicting interest transaction, (2) provision of the information referred to in subsection (d), and (3) required disclosure to the shareholders who voted on the transaction (to the extent the information was not known by them).

(b) For purposes of this section, "qualified shares" means any shares entitled to vote with respect to the director's conflicting interest transaction except shares that, to the knowledge, before the vote, of the secretary (or other officer or agent of the corporation authorized to tabulate votes), are beneficially owned (or the voting of which is controlled) by a director who has a conflicting interest respecting the transaction or by a related person of the director, or both.

(c) A majority of the votes entitled to be cast by the holders of all qualified shares constitutes a quorum for purposes of action that complies with this section. Subject to the provisions of subsections (d) and (e), shareholders' action that otherwise complies with this section is not affected by the presence of holders, or the voting, of shares that are not qualified shares.

/* A provisions which is similar to that for directors. */

(d) For purposes of compliance with subsection (a), a director who has a conflicting interest respecting the transaction shall, before the shareholders' vote, inform the secretary (or other office or agent of the corporation authorized to tabulate votes) of the number, and the identity of persons holding or controlling the vote, of all shares that the director knows are beneficially owned (or the voting of which is controlled) by the director or by a related person of the director, or both.

(e) If a shareholders' vote does not comply with subsection (a) solely because of a failure of a director to comply with subsection (d), and if the director establishes that his failure did not determine and was not intended by him to influence the outcome of the vote, the court may, with or without further proceedings respecting section 8.61(b)(3), take such action respecting the transaction and the director, and give such effect, if any, to the shareholders' vote, as it considers appropriate in the circumstances.

Official Comment

1. Section 8.63(a) .

Note that section 8.63 does not contain a provision comparable to section 8.62(b). Thus, the safe harbor protection of subchapter F cannot be made available through shareholder action under section 8.63 in a case where D remains silent because of an extrinsic duty of confidentiality. This is advertent. While it is
/* Adverent is the opposite of inadvertent. It pays to imporve your word power. */

believed that the section 8.62(b) procedure is workable in the collegial setting of the boardroom, one must have reservations whether the same is true vis-a-vis the shareholder body. especially in larger corporations where there is heavy reliance upon the proxy mechanic. In most situations no opportunity exists for shareholders to quiz D about his duty and to discuss the implications of acting without the benefit of D's knowledge concerning the transaction. In a case involving a closely-held corporation where section 8.63 procedures are followed, but with D acting as provided in section 8.62(b), a court could, of course, attach significance to a favorable shareholder vote in evaluating the fairness of the transaction to the corporation.

2. Section 8.63(b)

The category of persons whose shares are excluded from the vote count under subsection (b) is not the same as the category of persons specified in section 8.60(1)(ii) for purposes of defining D's "conflicting interest" and-importantly-is not the same as the category of persons excluded for purposes of the definition of non-qualified directors under section 8.62(d). The distinctions among these three categories are deliberate and carefully drawn.

The definition of "qualified shares" excludes shares owned by D or a related person as defined in section 8.60(3). If D is an employee or director of Y Co., Y Co. is not prevented by that fact from exercising its usual voting rights as to any shares it may hold in X Co. D's linkage to a related person is close. But the net of section 8.60(1)(ii) specifying other persons and entities for purposes of the "conflicting interest" definition is cast so wide that D will never be able to know whether, nor have a reason to try to monitor whether, some person within those subcategories holds X Co. shares. Typically, moreover, D will have no control over those persons and how they vote their x Co. shares. There is, in reality. no reason to strip those persons of their voting rights as shareholders, for in the usual commercial situation they will vote in accordance with their own interests, which may well not coincide with the personal interest of D.

To illustrate the operation of subsection (b), consider a case in which D is also a director of Y Co., and to his knowledge: thirty percent of Y Co.'s stock is owned by X Co.; D, his wife, a trust of which D is the trustee, and a corporation he controls, together own ten percent of X Co.'s stock but not stock of Y Co.; and x Co. and Y Co. wish to enter into a transaction that is of major significance to both.

From the perspective of X Co., D has a conflicting interest since he is a director of Y Co. If X Co. submits the transaction to a vote of its shareholders under section 8.63, the shares held by D his wife, the trust of which he is the trustee, and the corporation he controls are not qualified shares and may not be counted in the vote.

From the perspective of Y Co., D has a conflicting interest since he is a director of X Co. If NT Co. submits the transaction to a vote of its shareholders under section 8.63, the thirty percent of Y Co. shares held by X Co. are qualified shares and may be counted for purposes of section 8.63. The same would be equally true if X Co. were the majority shareholder of Y Co., but as emphasized elsewhere, the vote under section 8.63 has no effect whatever of exonerating or protecting x Co. if X Co. fails to meet any legal obligation that, as the majority shareholder of Y Co., it may owe to the minority shareholders of Y Co.

3. Section 8.63(c) .

The fact that certain shares are not qualified and are not countable for purposes of subsection (a) says nothing as to whether they are properly countable for other purposes such as, for example, a statutory requirement that a certain fraction of the total vote or a special majority vote be obtained.

4. Section 8.63(d)

In most circumstances, the secretary of X Co. will have no way to know whether certain of X Co.'s outstanding shares should be excluded from the teller's count because of the identity of the owners or of those persons who control the voting of the shares. Subsection (a) together with subsection (d) therefore impose on a director who has a conflicting interest respecting the transaction, as a prerequisite to safe harbor protection by shareholder vote, the obligation to inform the secretary, or other officer or agent authorized to tabulate votes, of the number and holders of shares known by him to be owned by him or by a related person of his. Thus, a director who has a conflicting interest respecting the transaction, because he stands to make a commission from it, is obligated to report shares owned or the vote of which is controlled by him and by all related persons of his; a director who has a conflicting interest respecting the transaction because his brother stands to make a commission from it has the same reporting obligation. The tabulator may also, of course, have other independent knowledge of shares that are owned or controlled by a related person of the director.

If the tabulator of votes knows that particular shares should be excluded but fails to exclude them from the count and their inclusion in the vote does not affect its outcome, subsection (c) governs and the shareholders' vote stands. If the improper inclusion determines the outcome, the shareholders' vote fails to comply with subsection (a). If the tabulator does not know that certain shares are owned or controlled by the director who has the conflicting interest or a related person of his, the shares are "qualified" pursuant to the definition in subsection (b), and the vote cannot be attacked on that ground for failure to comply with subsection (a); but see subsection (e).

5. Section 8.63(e)

If D did not provide the information required under subsection (d), on the face of it shareholders' action is not in compliance with subsection (a) and D has no safe harbor under subsection (a). In the absence of such safe harbor D can be put to the challenge of establishing the fairness of the transaction under section 8.61(b)(3).

That result is the proper one where D's failure to inform was determinative of the vote or, worse, was part of a deliberate effort on D's part to influence the outcome of the vote. But if D's omission was essentially an act of negligence, if the number of unreported shares was not determinative of the outcome of the vote, and if the omission was not motivated by D's effort to influence the integrity of the voting process, the court should be free to fashion an appropriate response to the situation in the light of all the considerations at the time of trial. The court should not be automatically forced by the mechanics of the subchapter to a lengthy and retrospective trial on "fairness." Subsection (e) grants the court that discretion in those circumstances and permits it to accord such effect, if any, to the shareholders' vote, or grant such relief respecting the transaction or D, as the court may find appropriate.

Chapter 10

AMENDMENT OF ARTICLES OF INCORPORATION AND BYLAW

Subchapter A

Amendment of Articles of Incorporation

10.01 Authority to Amend

(a) A corporation may amend its articles of incorporation at any time to add or change a provision that is required or permitted in the articles of incorporation or to delete a provision not required in the articles of incorporation. Whether a provision is required or permitted in the articles of incorporation is determined as of the effective date of the amendment.

(b) A shareholder of the corporation does not have a vested property right resulting from any provision in the articles of incorporation, including provisions relating to management, control, capital structure, dividend entitlement, or purpose or duration of the corporation.

10.02 Amendment by Board of Directors

Unless the articles of incorporation provide otherwise, a corporation's board of directors may adopt one or more amendments to the corporation's articles of incorporation without shareholder action:

(1) to extend the duration of the corporation if it was incorporated at a time when limited duration

was required by law;

(2) to delete the names and addresses of the initial directors;

(3) to delete the name and address of the initial registered agent or registered office, if a statement of change is on file with the secretary of state;

(4) to change each issued and unissued authorized share of an outstanding class into a greater number of whole shares if the corporation has only shares of that class outstanding;

(5) to change the corporate name by substituting the word "corporation," "incorporated," "company," "limited," or the abbreviation "corp." "inc." "co.," or "ltd.," for a similar word or abbreviation in the name, or by adding, deleting, or changing a geographical attribution for the name; or

(6) to make any other change expressly permitted by this Act to be made without shareholder action.

10.03 Amendment by Board of Directors and Shareholders

(a) A corporation's board of directors may propose one or more amendments to the articles of incorporation for submission to the shareholders.

(b) For the amendment to be adopted:

(1) the board of directors must recommend the amendment to the shareholders unless the board of directors determines that because of conflict of interest or other special circumstances it should make no recommendation and communicates the basis
for its determination to the shareholders with the amendment; and

(2) the shareholders entitled to vote on the amendment must approve the amendment as provided in subsection (e).

(c) The board of directors may condition its submission of the proposed amendment on any basis.

(d) The corporation shall notify each shareholder, whether or not entitled to vote, of the proposed shareholders' meeting in accordance with section 7.05. The notice of meeting must also state that the purpose, or one of the purposes, of the meeting is to consider the proposed amendment and contain or be accompanied by a copy or summary of the amendment.

(e) Unless this Act, the articles of incorporation, or the board of directors (acting pursuant to subsection (c)) require a greater vote or a vote by voting groups, the amendment to be adopted must be approved by:

(1) a majority of the votes entitled to be cast on the amendment by any voting group with respect to which the amendment would create dissenters' rights; and

(2) the votes required by sections 7.25 and 7.26 by every other voting group entitled to vote on the

amendment.

10.04 Voting on Amendments by Voting Groups

(a) The holders of the outstanding shares of a class are entitled to vote as a separate voting group (if shareholder voting is otherwise required by this Act) on a proposed amendment if the amendment would:

(1) increase or decrease the aggregate number of authorized shares of the class;

(2) effect an exchange or reclassification of all or part of the shares of the class into shares of another class;

(3) effect an exchange or reclassification, or create the right of exchange, of all or part of the shares of another class into shares of the class;

(4) change the designation, rights, preferences, or limitations of all or part of the shares of the class;

(5) change the shares of all or part of the class into a different number of shares of the same class;

(6) create a new class of shares having rights or preferences with respect to distributions or to dissolution that are prior, superior, or substantially equal to the shares of the class;

(7) increase the rights, preferences, or number of authorized shares of any class that, after giving effect to the amendment, have rights or preferences with respect to distributions or to dissolution that are prior, superior, or substantially equal to the shares of the class;

(8) limit or deny an existing preemptive right of all or part of the shares of the class; or

(9) cancel or otherwise affect rights to distributions or dividends that have accumulated but not yet been declared on all or part of the shares of the class.

(b) If a proposed amendment would affect a series of a class of shares in one or more of the ways described in subsection (a), the shares of that series are entitled to vote as a separate voting group on the proposed amendment.

(c) If a proposed amendment that entitles two or more series of shares to vote as separate voting groups under this section would affect those two or more series in the same or a substantially similar way, the shares of all the series so affected must vote together as a single voting group on the proposed amendment.

(d) A class or series of shares is entitled to the voting rights granted by this section although the articles of incorporation provide that the shares are nonvoting shares.

10.05 Amendment Before Issuance of Shares

If a corporation has not yet issued shares, its incorporators or board of directors may adopt one or more amendments to the corporation's articles of incorporation.

10.06 Articles of Amendment

A corporation amending its articles of incorporation shall deliver to the secretary of state for filing articles of amendment setting forth:

(1) the name of the corporation;

(2) the text of each amendment adopted;

(3) if an amendment provides for an exchange, reclassification, or cancellation of issued shares, provisions for implementing the amendment if not contained in the amendment itself;

(4) the date of each amendment's adoption;

(5) if an amendment was adopted by the incorporators or board of directors without shareholder action, a statement to that effect and that shareholder action was not required;

(6) if an amendment was approved by the shareholders:

(i) the designation, number of outstanding shares, number of votes entitled to be cast by each voting group entitled to vote separately on the amendment, and number of votes of each voting group indisputably represented at the meeting;

(ii) either the total number of votes cast for and against the amendment by each voting group entitled to vote separately on the amendment or the total number of undisputed votes cast for the amendment by each voting group and a statement that the number cast for the amendment by each voting group was sufficient for approval by that voting group.

10.09 Effect of Amendment

An amendment to articles of incorporation does not affect a cause of action existing against or in favor of the corporation, a proceeding to which the corporation is a party, or the existing rights of persons other than shareholders of the corporation. An amendment changing a corporation's name does not abate a proceeding brought by or against the corporation in its former name.

Subchapter B

Amendment of Bylaws

10.20 Amendment by Board of Directors or Shareholders

(a) A corporation's board of directors may amend or repeal the corporation's bylaws unless:

(1) the articles of incorporation or this Act reserve this power exclusively to the shareholders in whole or part; or

(2) the shareholders in amending or repealing a particular bylaw provide expressly that the board of directors may not amend or repeal that bylaw.

(b) A corporation's shareholders may amend or repeal the corporation's bylaws even though the bylaws may also be amended or repealed by its board of directors.

10.21 Bylaw Increasing Quorum or Voting Requirement for Shareholders

(a) If authorized by the articles of incorporation, the shareholders may adopt or amend a bylaw that fixes a greater quorum or voting requirement for shareholders (or voting groups of shareholders) than is required by this Act. The adoption or amendment of a bylaw that adds, changes, or deletes a greater quorum or voting requirement for shareholders must meet the same quorum requirement and be adopted by the same vote and voting groups required to take action under the quorum and voting requirement then in effect or proposed to be adopted, whichever is greater.

(b) A bylaw that fixes a greater quorum or voting requirement for shareholders under subsection (a) may not be adopted, amended, or repealed by the board of directors.

10.22 Bylaw Increasing Quorum or Voting Requirement for Directors

(a) A bylaw that fixes a greater quorum or voting requirement for the board of directors may be amended or repealed:

(1) if originally adopted by the shareholders, only by the shareholders;

(2) if originally adopted by the board of directors, either by the shareholders or by the board of directors.

(b) A bylaw adopted or amended by the shareholders that fixes a greater quorum or voting requirement for the board of directors may provide that it may be amended or repealed only by a specified vote of either the shareholders or the board of directors.

(c) Action by the board of directors under subsection (a)(2) to adopt or amend a bylaw that changes the quorum or voting requirement for the board of directors must meet the same quorum requirement and be adopted by the same vote required to take action under the quorum and voting requirement then in effect or proposed to be adopted, whichever is greater.

Chapter 11

MERGER AND SHARE EXCHANGE

11.01 Merger

(a) One or more corporations may merge into another corporation if the board of directors of each corporation adopts and its shareholders (if required by section 11.03) approve a plan of merger.

(b) The plan of merger must set forth:

(1) the name of each corporation planning to merge and the name of the surviving corporation into which each other corporation plans to merge;

(2) the terms and conditions of the merger; and

(3) the manner and basis of converting the shares of each corporation into shares, obligations, or other securities of the surviving or any other corporation or into cash or other property in whole or part.

(c) The plan of merger may set forth:

(1) amendments to the articles of incorporation of the surviving corporation; and

(2) other provisions relating to the merger.

Official Comment

2. Equivalent Nonstatutory Transactions

A transaction may have the same economic effect as a statutory merger even though it is cast in the form of a nonstatutory transaction. For example, assets of the disappearing corporations may be sold for consideration in the form of shares of the surviving corporation, followed by the distribution of those shares by the disappearing corporations to their shareholders and their subsequent dissolution. Transactions have sometimes been structured in nonstatutory form for tax reasons or in an effort to avoid some of the consequences of a statutory merger, particularly appraisal rights to dissenting shareholders. Faced with these transactions, a few courts have developed or accepted the "de facto merger" concept which, to some uncertain extent, grants to dissenting shareholders the rights they would have had if the transaction had been structured as a statutory merger. See Folk, "De Facto Mergers in Delaware: Hariton v. Arco Electronics, Inc.," 49 Va.L.Rev. 1261 (1963). These problems should not occur under the Model Act since the procedural requirements for authorization and consequences of various types of transactions are largely standardized. For example, dissenters' rights are granted not only in mergers but also in share exchanges, in sales of all or substantially all the corporate assets, and in amendments to articles of incorporation that significantly affect rights of shareholders.

11.02 Share Exchange

(a) A corporation may acquire all of the outstanding shares of one or more classes or series of another corporation if the board of directors of each corporation adopts and its shareholders (if required by section 11.03) approve the exchange.

(b) The plan of exchange must set forth:

(1) the name of the corporation whose shares will be acquired and the name of the acquiring

corporation;

(2) the terms and conditions of the exchange;

(3) the manner and basis of exchanging the shares to be acquired for shares, obligations, or other securities of the acquiring or any other corporation or for cash or other property in whole or part.

(c) The plan of exchange may set forth other provisions relating to the exchange.

(d) This section does not limit the power of a corporation to acquire all or part of the shares of one or more classes or series of another corporation through a voluntary exchange or otherwise.

11.03 Action on Plan

(a) After adopting a plan of merger or share exchange, the board of directors of each corporation party to the merger, and the board of directors of the corporation whose shares will be acquired in the share exchange, shall submit the plan of merger (except as provided in subsection (g)) or share exchange for approval by its share holders.

(b) For a plan of merger or share exchange to be approved:

(1) the board of directors must recommend the plan of merger or share exchange to the shareholders, unless the board of directors determines that because of conflict of interest or other special circumstances it should make no recommendation and communicates the basis for its determination to the shareholders with the plan; and

(2) the shareholders entitled to vote must approve the plan.

(c) The board of directors may condition its submission of the proposed merger or share exchange on any basis.