Business Corporations Committee of the Business Law Section of the North Carolina Bar Association

Summary of 2018 Amendments to the North Carolina Business Corporation Act (Session Law 2018-45; Senate Bill 622)

July 10, 2018

Overview of the 2018 NCBCA Amendments.

The General Assembly of North Carolina recently approved changes to the North Carolina Business Corporation Act, Chapter 55 of the General Statutes (the "NCBCA"), which the Governor signed into law on June 22, 2018 (referred to below as the "Act") and take effect on October 1, 2018.[1] The NCBCA is based upon the Model Business Corporation Act (the "Model Act"), which is the work of the Corporate Laws Committee of the ABA Business Law Section ("the ABA Committee"). The bill resulting in the Act was drafted by the Business Corporations Committee (the "Committee") of the Business Law Section of the North Carolina Bar Association and approved as "Association-sponsored legislation" by the North Carolina Bar Association Executive Committee in January 2017.

Summary Listing of the Amendments Enacted in the Act.

The amendments in the Act cover nine principal topics as follows:

- Sections 2, 10 and 12 authorize inclusion of a provision in the articles of incorporation to limit or eliminate, in advance, the duty of a director, officer or other person to bring specified business opportunities to the corporation and create a related safe harbor from liability [based on Model Act].
- Sections 1 and 3 provide that defects in share issuances and other corporate acts shall not be void or voidable solely as a result of a failure of authorization if a prescribed ratification process is followed [based on Model Act].

[1] Senate Bill 622 (Session Law 2018-45), https://www.ncleg.net/Sessions/2017/Bills/Senate/PDF/S622v5.pdf

- Section 4 requires that the holders of two or more series of a class of shares affected in the same or a substantially similar way by a proposed plan of merger or proposed plan of conversion vote together as a single voting group on the proposed plan of merger or conversion [based on Model Act].
- Sections 5, 6, 14 and 15 modernize the treatment of voting trusts and shareholder agreements, including removing the statutory 10-year limits on duration and clarifying the circumstances under which a purchaser of shares without notice of the shareholder agreement can nevertheless be bound by it [based on Model Act].
- Sections 7, 8, 9, 10, 11 and 13 make the discharge of Board duties more efficient and reduce negatives that deter qualified candidates from serving on Boards by requiring a challenger to the Board's compensation to overcome a presumption of fairness [based on Nevada], authorizing the appointment of alternate committee directors [based on Model Act] and the creation of subcommittees [based on Delaware], and prohibiting the retroactive impairment of rights to indemnification and advancement of expenses [based on Model Act].
- Sections 16, 20, 23, 29, 30, 31 and 32 clarify that a plan of merger under various entity merger statutes may provide for cancellation of shares or interests at merger closing where, for example, those shares or interests are not entitled to any merger consideration.
- Sections 17, 25, 26 and 27 establish a procedure that allows a corporation to consummate a merger without a shareholder vote if the merger follows a tender offer in which the tender offeror obtains sufficient shares that would permit it to approve the merger if it were submitted to a vote at a meeting of shareholders [based on Model Act].
- Sections 18, 23, 24, 25, 26 and 28 permit "short form" mergers of subsidiary corporations into the parent entity without a shareholder vote where the parent

is an entity other than a corporation that owns ninety percent (90%) or more of the shares of the subsidiary [based on Delaware].

- Sections 25, 26, 27 and 28 provide appraisal rights to shareholders with non-voting shares and provide a procedure whereby shareholders with non-voting shares must provide notice of intent to demand appraisal rights prior to the effective time of the corporate action [based on Model Act].

Detailed Summary of the Amendments as Enacted in the Act.

Overview of Advance Action to Limit or Eliminate Duties Regarding Business Opportunities

The corporate opportunity doctrine, derived from an officer or director's duty of loyalty to the corporation, prohibits such a person from usurping an opportunity that belongs to the corporation. North Carolina precedent requires that an officer or director accused of usurping a corporate opportunity must establish that the transaction was "just and reasonable" to the corporation because it was not an opportunity the corporation would have wanted. In determining whether a corporation would have wanted an opportunity, courts look at a number of factors, including the ability of the corporation to take advantage of the opportunity, whether the officer or director was made aware of the opportunity by virtue of his or her fiduciary position, whether the corporation was made aware of (and subsequently rejected) the opportunity, and whether corporate facilities were used to acquire the opportunity. Courts also analyze both whether the disputed opportunity is functionally related to the corporation's business and whether the corporation has an interest or expectancy in the opportunity.

The Delaware General Corporation Law (the "DGCL") and the Model Act were amended in 2000 and 2014, respectively, to explicitly allow corporations to renounce in advance any interest in specified corporate opportunities. Permitting the corporation to determine in advance whether a specified business opportunity is a corporate opportunity, rather than addressing opportunities as they arise, eliminates much of the uncertainty underlying when to report certain opportunities to the corporation. Certain investors, such as private equity sponsors who make investments in, and appoint nominees to serve as directors for, multiple

portfolio companies in a single industry, tend to favor organizing their portfolio companies in states that expressly authorize advance waivers. The Report of the ABA Committee approving the Model Act changes also noted that such provisions are frequently used in joint ventures and spin-offs. The Committee believed adopting the Act's provisions would eliminate any perceived advantage certain jurisdictions may have over North Carolina concerning the application of the corporate opportunity doctrine and will also serve to attract and retain businesspersons as officers or board members of North Carolina corporations, individuals who might otherwise avoid such service due to potential conflicts of interest. Section 2 of the Act (adding new subsection N.C. Gen. Stat. 55-02-02(b)(4)) is modeled on Section 2.02(b)(6) of the Model Act as approved in 2014 by the ABA Committee.

Ratification of Defective Corporate Acts and Shares

It is not uncommon for a North Carolina corporation to discover that all corporate formalities were not observed and/or documented in connection with share issuances or other corporate acts. For example, the board of directors might have issued more shares than are authorized under the corporation's charter or might have failed to secure a required shareholder vote necessary to issue certain shares, and the defectively issued shares might have changed hands a number of times since the original defective issuance. Or the corporation may have failed to secure the approval of a particular shareholder whose authorization was required for the election or appointment of a specified director.

The usual remedy under such circumstances would be to have the current directors or shareholders ratify the defective action. Case law, however, suggests courts are likely to conclude that the failure to follow requisite formalities cannot be cured by ratification, particularly with respect to defective share issuances, and that the original action was void from inception. Such a finding can have a harsh effect on persons who relied and made economic decisions upon the action being valid—for example, a long-time shareholder may suddenly find that he or she is not an owner of the corporation. While the corporation would likely be required to return the consideration received for shares of stock, that would be cold comfort if the shares had appreciated in value from the date of original purported issuance. A defective

appointment or election of a director can have a domino effect, calling into question every decision of the board of directors taken at meetings in which the defectively appointed or elected director participated.

In response to such harsh results, the DGCL and the Model Act each provide a non-exclusive procedure whereby defects in share issuances and other defects in corporate authorization may be ratified and confirmed as valid with retroactive effect from the time the defective corporate act was originally taken. The change to the NCBCA, which is modeled on the Model Act provision, provides North Carolina corporations a non-exclusive, clear method for curing defects in share issuances and other corporate acts.

The basic policy of the change is stated in N.C. Gen. Stat. 55-1-61(a): "A defective corporate action shall not be void or voidable if ratified in accordance with N.C. Gen. Stat. 55-1-62 or validated in accordance with N.C. Gen. Stat. 55-1-67." Ratification requires that (i) the board adopt resolutions meeting the requirements of N.C. Gen. Stat. 55-1-62 and (ii) the resolution also be adopted by the shareholders if action by the shareholders also would be required under current law, the current organizational documents, or other requirements applicable to the corporation in effect at the time the ratification action is taken requires shareholder approval or would have required shareholder approval at the date of the occurrence of the defective corporate action. The changes in N.C. Gen. Stat. §§ 55-1-62 through 55-1-64 provide specific requirements regarding director and shareholder votes, quorums and notices needed to adopt a ratification resolution. If the ratification resolution is adopted by the directors and, if required, by the shareholders, and if the original defective action would have required under any other section of the NCBCA a document to be filed with the Secretary of State, then, the corporation officially records such adoption of the ratification resolution by filing articles of validation with the Secretary of State pursuant to N.C. Gen. Stat. 55-1-66. The corporation must provide notice that the ratification resolution was adopted to all actual or putative shareholders, both current ones as well as those who were shareholders as of the time of the defective corporate act, together with a notice to actual or putative shareholders that any claim that the defective corporate act or putative shares ratified thereunder should not be effective, or should be effective only on certain conditions, must be brought within 120 days

from the validation effective time. N.C. Gen. Stat. 55-1-61(b) clarifies that the new ratification procedure is a non-exclusive means of validating defective corporate acts, and does not affect the validity or effectiveness of any corporate act properly ratified under common law or otherwise, nor does a corporation's resort to the ratification procedure create a presumption that any act or transaction is or was a defective corporate act or void or voidable.

New section N.C. Gen. Stat. 55-1-67 provides that disputes regarding actual or alleged defective corporate acts, including matters regarding the new ratification procedure in N.C. Gen. Stat. 55-1-62, will be heard before the Superior Court or, if designated a mandatory complex business case pursuant to N.C. Gen. Stat. 7A-45.4, the Business Court. Any claim that the defective corporate act or putative shares ratified under N.C. Gen. Stat. 55-1-62 should not be effective or should be effective only on certain conditions must be brought within 120 days from the validation effective time or will be time-barred pursuant to N.C. Gen. Stat. 55-1-67(d).

Voting on Plans of Merger and Plans of Conversion by Series of Shares That Are Similarly Affected

Currently, the NCBCA requires separate voting by voting groups on a plan of merger or a plan of conversion if the plan contains a provision that, if contained in a proposed amendment to articles of incorporation, would require action by one or more separate voting groups on the proposed amendment under N.C. Gen. Stat. 55-10-04, except where the consideration to be received in exchange for the shares of that group consists solely of cash. Currently, the NCBCA provides that two or more series of a class of shares that are affected by an amendment to the articles of incorporation in the same or a substantially similar manner are required to vote together. Consistent with a 2011 amendment to the Model Act, the Act in Section 4 also clarifies that two or more series of a class of shares that are similarly affected are required to vote together on a plan or merger or a plan of conversion.

Removing Automatic 10-Year Limits on Duration of Voting Trust Agreements and Shareholder Agreements, and Making Other Updating Changes

N.C. Gen. Stat. 55-7-30 and N.C. Gen. Stat. 55-7-31, last amended in 1989, provide for automatic 10-year limits on the duration of voting trusts and shareholder agreements. Automatic sunset provisions were intended to address concerns that (i) voting trusts separated voting power from ownership in a manner that was inconsistent with corporate law principles or that conflicted with public policy, (ii) shareholders' agreements could impermissibly circumscribe the authority of the board of directors, and (iii) shareholders' agreements sometimes failed to abide by customary corporate norms as reflected in the corporate statutes. Courts have become more accepting of such agreements, recognizing them as legitimate private ordering mechanisms for closely held corporations. In response, many jurisdictions have eliminated automatic sunset provisions and, like the Model Act, added other clarifying provisions including ones requiring notice to prospective purchasers of shares, granting a rescission right if a purchaser buys shares without notice of a shareholder agreement, and modifying the duties of directors where a shareholder agreement limits the discretion or powers of the board of directors. The Model Act was substantially amended in 1990 to facilitate and clarify appropriate usage of shareholder agreements. The DGCL (in 1994) and the Model Act (in 2013) were amended to eliminate automatic statutory limits on duration for both voting trusts and shareholder agreements.

The amendments to N.C. Gen. Stat. 55-7-30 and N.C. Gen. Stat. 55-7-31 are based on the current Model Act. The changes to N.C. Gen. Stat. 55-7-30 are limited to removing the 10-year limits on duration of voting trusts created after the effective date of the amendments. A voting trust in existence on the effective date of the amendment will continue to be subject to the 10-year limit unless amended after such effective date by all the parties to the voting trust. The amendments to N.C. Gen. Stat. 55-7-31 are more extensive and are intended to materially conform the NCBCA to the Model Act's current language regarding shareholder's agreements including, among other things, the following clarifications and additions: (i) all the shareholders of the corporation generally must approve the shareholders' agreement as an initial matter and any future amendments must be approved by all shareholders at the time of the amendment

unless the shareholders' agreement expressly permits amendment by less than all current shareholders, (ii) the existence of a shareholders' agreement must be set forth on share certificates or, if the shares are uncertificated, on the information statement required by N.C. Gen. Stat. 55-7-26(b), (iii) if a corporation does not provide the required disclosure, a purchaser without knowledge of a shareholders' agreement may commence an action to rescind the share purchase within the earlier of 90 days after discovery of the existence of the agreement or two years after the share purchase, (iv) a shareholders' agreement entered into while a corporation was private will automatically terminate upon an initial public offering, (v) a shareholders' agreement that limits the discretion or powers of the board of directors shall relieve the directors of, and impose upon the person or persons in whom such discretion or powers are vested, liability for acts or omissions imposed by law on directors to the extent that the discretion or powers of the directors have been limited, and (vi) limits, if any, on duration of a shareholders' agreement shall be set forth in the agreement except that an agreement in force and effect on the effective date of the amendment will continue to be subject to the 10-year limit unless the agreement provided otherwise by its terms.

Authority of Board of Directors to Fix its Compensation

North Carolina's "business judgment rule" prevents courts from second-guessing a business decision of directors absent proof of bad faith, conflict of interest, or disloyalty, so long as the decision is the product of a rational process, making use of all material and reasonably available information, and the directors reasonably believed they were acting in the best interest of the corporation.

The intent of the business judgment rule is to give directors a presumption that their loyal and informed decisions, even if erroneous in hindsight, will not be overturned by a court unless the decision cannot be attributed to any rational business purpose. Accordingly, a director will not be personally liable for losses suffered by the corporation or the shareholders resulting from actions made reasonably and in good faith. Without the business judgment rule, directors would be less inclined to make changes or take risks if they knew that they will be

second-guessed if the business decision turns out poorly. It would also discourage qualified individuals from serving as directors.

In cases challenging business decisions of directors of a North Carolina corporation, the business decision is presumed to be valid, and the challenger bears the burden of presenting facts showing that the directors' decision was not made in good faith. Unless sufficient facts are alleged, the court may apply the business judgment rule and dismiss a lawsuit before trial, saving the corporation legal fees and allowing officers and directors to return full attention to running the business sooner.

On the other hand, if a court finds that a majority of directors were "interested directors" with respect to the particular business decision, the court might allow the case to continue to trial. In that case, the corporation must decide whether to continue with the costs, risks, and management attention inherent in any dispute, or pursue a settlement with the plaintiffs. Even if the corporation has a winning case, the corporation nevertheless may settle a suit to avoid the costs and risks of further litigation.

The NCBCA in N.C. Gen. Stat. 55-8-11 expressly allows the board of directors of a corporation to fix the compensation of directors, even though the directors arguably have a conflict of interest in doing so. N.C. Gen. Stat. 55-8-31(a) provides that conflict of interest transactions involving directors are not invalid if approved by disinterested directors or by the shareholders or if they are fair to the corporation. Disinterested director approval or shareholder approval of director compensation is often not feasible, particularly for public corporations, and subjecting directors to litigation in which they are required to prove the fairness of their compensation encourages frivolous claims.

To avoid possibly frivolous challenges to director compensation, Section 7 of the Act, which is modeled on Section 78.140(5) of the Nevada Revised Statutes, amends N.C. Gen. Stat. 55-8-11 to confirm that in the case of a public corporation or of a private corporation that so provides in its articles of incorporation if the board of directors fixes the compensation of directors, then regardless of their personal interest in that decision, the amount of compensation is presumed fair to the corporation and the challenger would be required to allege facts, that if proven true, would be sufficient to overcome the presumption in order to

avoid dismissal at the summary judgment stage of any proceeding. In effect, the amendment confirms that the decision of a board regarding its compensation is subject to review under the business judgment rule, but the amendment does not preclude meritorious challenges where a board of directors has awarded itself compensation that is proven not to be fair to the corporation.

Authorizing Alternative Committee Members

The Model Act (in 1999) was amended to authorize the board of directors or other committee members to replace an absent or disqualified committee member with an alternate director. The Model Act change parallels Section 141(c)(1)–(2) of the DGCL amended in 1995. New York, California, Ohio, and Texas also allow alternate directors to be named to committees.

N.C. Gen. Stat. 55-8-25(a) of the NCBCA provides that a board of directors may create committees and appoint one or more members of the board of directors to serve on the committees, but does not address the use of substitute committee members. The change in N.C. Gen. Stat. 55-8-25(h) would empower board committees to continue operating despite a member's absence or disqualification by allowing the full board to designate another board member who would be available to act without delay in committee meetings if a regular committee member was disqualified or unable to be present at a committee meeting.

Unless otherwise required by committee governing documents, replacement of an absent or disqualified member is not necessary to permit the other committee members to continue to perform their duties (provided that a quorum is present). Rather, the provision is intended to allow committees to operate most effectively despite the absence of a committee member. Alternates may maintain a quorum when board numbers are small, and may provide objective expertise in special committees, such as securities pricing committees. For national or international corporations with global board members representing local subsidiaries, alternate directors may ensure the interests of local subsidiaries are represented if residence overseas or pressures from other duties prevent the attendance of a primary director in committee meetings. N.C. Gen. Stat. 55-8-25(b) of the NCBCA already allows a majority of all the directors

then in office to appoint committee members. However, appointing alternate committee members in advance is intended as an expedient temporary solution, allowing a committee to continue effectively accomplishing its duties despite an absent or disqualified committee member and without necessity of convening a special meeting of the full board to make a short-fuse replacement. The alternate director owes the same fiduciary duties and is subject to the same liabilities as any other director.

Creating and Delegating to Subcommittees

The adoption of the Sarbanes-Oxley Act in 2002 increased the need for boards of directors of public corporations to conduct many activities at the committee level, rather than at the full board level. After the Sarbanes-Oxley Act, the New York Stock Exchange and NASDAQ formally required public company boards of directors to use committees of independent directors for many essential areas, including audit, nominating, and compensation committees. As a result, workloads and pressure increased for independent directors in key committees. One method of dealing with increased workload in committees has been to divide the work among subcommittees of smaller groups of directors.

Considering issues by full committee results in less time and attention available for review and study of each matter on the agenda with the result that no member of the committee is able to gain the deeper expertise and insight that could be developed with more time and detailed attention on particular topics. In contrast, subcommittee consideration allows certain directors to spend more time on matters within their assigned purview, to thereby develop deeper expertise on such issues, and, where appropriate, to knowledgably advise other committee members concerning such delegated matters. By handling routine matters pursuant to delegated authority, subcommittees also can maximize the effectiveness of the full committee, whose meeting agenda can focus on the significant matters appropriate for review and decision by the entire committee, including, where appropriate, action based on the recommendations of a subcommittee.

Prior to the Act, North Carolina corporations could informally create a subcommittee model by subordinating one committee to another in the relevant committee charter

documents but the NCBCA did not expressly authorize boards of directors or committees to create subcommittees to exercise the power of a full committee.

In 2003, the Delaware legislature amended § 141(c)(3) of the DGCL to authorize a committee to delegate any of its responsibilities to subcommittees of at least one director. The Delaware statute provides that a corporation can limit the power of subcommittees in its articles of incorporation, in its bylaws, or in the board resolution that created the relevant committee.

The Act provides authority to create subcommittees in an amendment to N.C. Gen. Stat. 55-8-25(a) (Section 9 of the Act), which is modeled on the DGCL provision. The provision allows committees to create subcommittees with all power and authority of the committee on an ad hoc basis to efficiently complete all tasks before the board committee. Conforming changes to the NCBCA referencing "committees and subcommittees" are included in Sections 8, 10 and 11 of the Act.

Retroactive Amendment of Indemnification and Advancement Rights

Under the NCBCA, corporations may indemnify officers or directors for liabilities incurred in a legal proceeding as long as the individual acted in good faith, reasonably believed his or her conduct was in the corporation's best interest (or, at least, not opposed to the corporation's best interests in some cases), and he or she had no reasonable cause to believe the conduct was unlawful. Corporations may also advance expenses incurred by an officer or director prior to the final disposition of the proceeding, provided that the individual undertakes to repay the corporation if it is ultimately determined the officer or director is not entitled to indemnification. Prior to the amendments implemented in the Act, the NCBCA was silent as to any limitations on a corporation's power to retroactively carve back these rights. The DGCL and the Model Act were amended in 2009 and 2011, respectively, to clarify that a right to indemnification or advancement of expenses under articles of incorporation, bylaws, board resolution, or contract may not be eliminated or impaired by subsequent amendments to the articles of incorporation, bylaws, or board or shareholders resolutions afterwards, unless the

original action that created the right to indemnification or advancement of expenses specifically authorized retroactive amendment.

Delaware and the Model Act were amended following a highly publicized case where the Delaware Chancery Court held that a former director's advancement right did not vest until the director was named in a legal proceeding, and thus the amendment to the bylaws eliminating the right of advancement (adopted after the director had left the board) applied to the former director as well. In response to this ruling, many individuals joining a corporation have been advised by their legal advisors to seek individualized indemnification agreements that cannot be unilaterally amended by the company. Negotiating agreements with all directors and officers is inefficient and, in public companies, such agreements must be filed with the Securities and Exchange Commission (the "SEC"). Given the high cost of legal proceedings, the rights to indemnification and advancement of expenses are essential tools to recruiting and retaining qualified officers and directors. The amendment in the Act is modeled on the Model Act provision and will ensure that individuals who agree to serve as an officer or director of a North Carolina corporation, in reliance on, among other things, the corporation's commitment in its charter, bylaws, or board resolution to indemnify them and advance their expenses can rest assured that the corporation will be required to fulfill its promises. By strengthening the availability of promised indemnification and advancement, the Act will assist North Carolina corporations in attracting and retaining competent and effective officers and directors.

Cancellation of Shares or Interests in a Plan of Merger

Currently, the NCBCA, the NC Nonprofit Corporation Act (N.C. Gen. Stat. N.C. Gen. Stat. Chapter 55A), the NC LLC Act (N.C. Gen. Stat. Chapter 57D), the NC Uniform Partnership Act (N.C. Gen. Stat. Chapter 59), and NC Revised Uniform Limited Partnership Act (N.C. Gen. Stat. Chapter 59) each requires that a plan of merger set forth the manner and basis of converting shares or interests into interests, obligations, securities of the surviving business entity or into cash or other property in whole or in part. However, in a merger, it is frequently the case that shares or other interests are merely cancelled. For example, particular shares or interests might not be entitled to any merger consideration due to indebtedness of the merging business entity

or to the preferences of more senior equity holders, or a parent business entity might be merging a wholly-owned subsidiary business entity into itself. The Act clarifies that articles of merger with respect to a merging corporation or other business entity may simply indicate that certain shares or interests will be cancelled upon consummation of a merger. In addition to amending the NCBCA, the Act makes conforming changes to Chapter 55A, Chapter 57D, and Chapter 59.

Second-Step Mergers Following a Tender Offer in Which Offeror Gains Control.

In public company acquisitions, cash tender offers provide advantages in cost and speed that often make such offers the preferred acquisition structure. Tender offers can be completed as quickly as 20 business days from launch (about 5-6 weeks from signing), compared to several months for a merger which has to be approved by shareholders at a special meeting following SEC review of proxy materials. Tender offers also benefit from a shorter 15-day waiting period (versus 30 days for a merger) for pre-merger review by federal antitrust authorities under the Hart-Scott-Rodino Antitrust Improvements Act of 1976.

Cash tender offers are typically made at a significant premium to the most recent trading price of the public company stock to incentivize shareholders to tender their shares in response to the tender offer. If the acquiring company obtains at least 90% of the outstanding shares following the tender offer, then the acquirer can immediately execute a short-form merger without shareholder consent to acquire the remaining shares that it does not own following the closing of the tender offer. Shareholders in the short-form merger who do not exercise their appraisal rights (if available) are paid the same amount per share that they would have received had they tendered their shares in response to the tender offer.

Unfortunately, even if the price offered is a premium price, it is often difficult to get the attention of retail investors to tender their shares, and stock brokers generally are not authorized to tender shares on behalf of their clients who hold shares in the public company without their clients' consents. Additionally, some index mutual funds as a matter of policy will not sell shares so long as they are part of the particular index (which the public company would be a part of at least until the closing of the tender offer). If, as a result of this inertia in the

shareholder base, the acquiring company does not hold following the tender offer 90% or more of the outstanding shares, then the cost and speed advantage of the cash tender offer structure is lost as the acquirer is forced to call and hold a special meeting of shareholders to vote on a second-step merger pursuant to which it would cash out the remaining shareholders. Because the acquiring company typically includes as a condition to the closing of the tender offer that it acquire sufficient shares in the tender offer to approve a merger agreement at a meeting at which all shares are voted, the approval of the second-step merger at a shareholder meeting would be a foregone conclusion but nevertheless would require a significant amount of time and expense that was otherwise unnecessary.

Each of the Model Act and the DGCL recently have been amended to permit a public company target to enter into a "two-step" merger agreement, where the first step is a tender offer by the acquiror for the public company shares and the second step is a merger in which the public company shares not tendered are converted into the same merger consideration offered in the tender offer. Appraisal rights generally would not be available with respect to a merger involving public company shares pursuant to N.C. Gen. Stat. 55-13-02(b)(1), but if the transaction was an interested transaction, appraisal rights would be available pursuant to N.C. Gen. Stat. 55-13-02(b)(4). Under the "two-step" merger agreement procedure, shareholders who do not tender their shares would have the same rights to seek appraisal under Article 13 of the NCBCA that they would in a merger that was approved at a meeting of shareholders.

For shareholders who believe the price offered is a good price but who for whatever reason failed to accept the tender offer, the "two-step" merger agreement allows them to be paid simultaneously with the shareholders who accepted the tender offer since the second-step merger can close immediately following the closing of the tender offer without a shareholder vote under the applicable statutory procedure. By comparison, if the acquiror has to call a shareholder vote, proxy materials must be prepared, filed with the SEC (including the possibility of receiving and having to respond to comments from the SEC), and then mailed to shareholders, the shareholder meeting must be held, and only then can closing of the merger occur, resulting in a merger closing approximately a month or more following the filing of proxy materials with the SEC. Thus, shareholders who like the price offered but who failed to timely

accept the tender offer would receive their money a month or more after shareholders who accepted the tender offer. Similarly, shareholders who did not like the price and who intentionally withheld their shares in the hope that the acquiror would not acquire enough shares to gain control nevertheless would be paid at the same time as shareholders who did tender their shares.

If appraisal rights are available in a particular transaction, even a shareholder who did not want to accept the price offered would benefit from the "two-step" merger agreement. Under N.C. Gen. Stat. 55-13-20, the corporation is required to provide notice of appraisal rights within ten days following the relevant merger closing. The quicker merger closing under the "two-step" merger agreement means that those shareholders can perfect their appraisal rights sooner and receive payment for their shares sooner through the appraisal process.

Short-Form Mergers for Non-Corporation Parent Companies

Under the NCBCA, the general rule is that a North Carolina corporation may merge with another corporation upon approval by the boards of directors and shareholders of each constituent corporation. However, where a parent corporation holds at least 90% of each class of outstanding stock of a subsidiary corporation, the parent corporation and subsidiary corporation may merge without a vote of the board of directors or shareholders of the subsidiary and, where the parent is the surviving corporation of the merger and its articles of incorporation are not being amended in connection with the merger, without a vote of the shareholders of the parent corporation. This simplified merger approval process for 90% or more owned subsidiaries permitted by the NCBCA is commonly referred to as a "Short-Form Merger." Prior to the amendments in the Act, the NCBCA only permitted Short-Form Mergers when the parent is a corporation.

The Act extends the Short-Form Merger process to any parent business entity, which permits North Carolina businesses the same flexibility in Short-Form Mergers found in Delaware. The language is conceptually similar to Section 267 of the DGCL, adopted in 2010, which permits Short-Form Mergers for any parent business entity, foreign or domestic. Adopting similar language promotes efficient reorganizations of North Carolina businesses and

demonstrates North Carolina's commitment to maintaining a pro-business environment for companies choosing to organize under North Carolina law.

Appraisal Rights of Shareholders Who Are Not Entitled to Vote on a Merger Transaction and Provision of Appraisal Rights Notices in Corporate Actions Approved by Shareholder Written Consent.

Consistent with earlier changes to the Model Act, the NCBCA was amended in 2011 to remove appraisal rights for non-voting shareholders, and afford appraisal rights only to voting shareholders, for significant corporate actions such as a merger. The Model Act official commentary at that time argued that the "linkage between voting and appraisal rights is justified because the right to a shareholder vote is a good proxy for assessing the seriousness of the change contemplated by the corporate action." The Model Act has since been revised to restore appraisal rights for non-voting shareholders based on a contrary determination that the right to a shareholder vote is not a good proxy for assessing the seriousness of a change contemplated by a corporate action on non-voting shares. Consistent with the current form of the Model Act, the amendments in the Act provide appraisal rights to voting and non-voting shareholders on an equal basis, including to minority shareholders of a subsidiary corporation in a short-form merger with an unincorporated parent company under new N.C. Gen. Stat. 55-11-12 (created by Section 23 of the Act). In order to allow a determination of how much of a cash payment may be required by the exercise of appraisal rights upon closing a corporate action that is approved by shareholder written consent, the amendments in the Act provide that the shareholder must provide a notice of intent to demand payment before the corporate action becomes effective provided notice of the corporate action was given to the shareholder at least 25 days before the effective time. Other changes to Article 13 provide appraisal rights and the procedures for exercising those rights to non-tendering shareholders in second-step mergers following a tender offer in which offeror gains control under new N.C. Gen. Stat. 55-11-03(j) (created by Section 17 of the Act).

Committee Members Involved in these NCBCA Amendments.

The following are the Committee members who participated in drafting the proposed bill resulting in the Act:

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