2020 REPORT OF THE COMMITTEE ON CORPORATION LAW
OF THE SECTION ON BUSINESS LAW OF THE MARYLAND STATE BAR ASSOCIATION
WITH RESPECT TO

SENATE BILL 469 / HOUSE BILL 668
"CORPORATIONS AND ASSOCIATIONS - CORPORATIONS AND REAL ESTATE INVESTMENT TRUSTS – MISCELLANEOUS"

I. INTRODUCTION AND BACKGROUND

For many years, the Committee on Corporation Law of the Section on Business Law of the Maryland State Bar Association has monitored the Maryland General Corporation Law (the "MGCL"), the Maryland REIT Law, and the application and utility of other Maryland business-related laws. To that end, the Committee on Corporation Law regularly proposes "Corporations and Real Estate Investment Trusts – Miscellaneous" Bills and, on occasion, Bills on specific topics to the General Assembly of the State of Maryland.

This Session's "Corporations and Associations - Corporations and Real Estate Investment Trusts – Miscellaneous" Bill, SB 469/HB 668, addresses several revisions, corrections, and clarifications.

II. "CORPORATIONS AND ASSOCIATIONS - CORPORATIONS AND REAL ESTATE INVESTMENT TRUSTS – MISCELLANEOUS" PROPOSALS

Enabling Board Committees Comprised of Disinterested Directors to Make Determinations whether Indemnification is Proper

From time-to-time, a board of directors may be called upon to make a determination whether the corporation should indemnify a director who was sued by reason of her or his service as a director. We propose to improve that process.

The proposed amendment to Section 2-418(e)(2) would enable a board of directors, needing to make a determination whether the corporation should indemnify a director, to delegate that determination to a committee of the board comprised of disinterested directors. Presently, this important determination may be made by either (a) the board of directors, (b) a committee of the board consisting solely of non-party directors designated by the full board (*but only "if a quorum of*

the board cannot be obtained"), (c) a special legal counsel, or (d) the stockholders. Process-wise, however, delegation to a board committee comprised of disinterested director may be preferable even if a quorum would be present for a meeting of the board of directors. This amendment would enable a board, if it chose to do so, to delegate the matter to a committee of directors (whether or not a quorum could be achieved at a meeting of the board) who were not parties to the proceeding that gave rise to the request for indemnification.

We note that Section 145(d) of the Delaware General Corporation Law and Section 8.55(b) of the Model Business Corporation Act (the basis for the general corporation statutes of approximately 30 states and the District of Columbia and Puerto Rico) each permit the board of directors to delegate its indemnification determination to a committee of the board without any reference to whether the board could achieve a quorum.

Harmonizing MGCL Approval Requirements for Open-end Investment Companies with Federal Investment Act of 1940

The proposed amendments to Sections 2-604(b), 3-105(a), and 3-403(b) of the MGCL relating to charter amendments, mergers by, or dissolutions of Maryland corporations registered as open-end investment companies (a/k/a mutual funds) under the Investment Company Act of 1940, as amended (the "Investment Company Act"), align the stockholder approval requirements under these provisions of the MGCL with the approval requirements for the same actions under the Investment Company Act. Under existing law, if these amendments are adopted, such charter amendments, mergers, and dissolutions would require (1) approval by "a majority of the entire board of directors" (which, *see* Section 1-101(n) of the MGCL, is a higher voting threshold than a majority of the directors at a meeting at which a quorum is present, as presently authorized by Section 2-408(a) of the MGCL) and (2) to the extent that the Investment Company Act may require, stockholder approval. Generally, charter amendments under the Investment Company Act do not require any stockholder-level approval, provided that those amendments generally comply with the Investment Company Act.

Maryland corporations registered as open-end investment companies under the Investment Company Act are unique in comparison to other Maryland corporations because open-end investment companies are regulated to a significant degree under the Investment Company Act. In other corporations, even a publicly traded corporation, the per-share value is dictated by market factors as generally determined by the secondary market. That is not the case with registered open-end investment companies. Open-end investment companies must provide to stockholders the right to have their shares redeemed by the company at any time at the net asset value per share (which is calculated on a daily basis). Stated otherwise, a stockholder of a mutual fund has the ability to "vote with her feet" by selling her shares of the mutual fund back to the mutual fund at any time for an amount proportionate to the net asset value of the company.

The purpose of the proposed amendments to Sections 2-604(b), 3-105(a), and 3-403(b) is to avoid imposing more restrictive stockholder approval requirements for such extraordinary actions or transactions on open-end investment companies under Maryland law than those requirements

imposed under federal law. These provisions are consistent with other existing provisions of Maryland law that provide, e.g., that open-end investment companies do not have to hold an annual meeting for the election of directors unless so required under the Investment Company Act (which has been in place for a number of years with no evidence that stockholder rights have not been protected). We are confident that federal law will continue to protect stockholders of open-end investment companies for these extraordinary actions and transactions. In any event, a stockholder of a Maryland corporation that is registered as an open-end investment company retains the right under the Investment Company Act to redeem her shares and exit the investment at any time.

The proposed amendment to Section 3-104(a) clarifies that a transfer of assets by an open-end investment company (which under the present Section 3-104(a) does not require shareholder approval) may occur between or among classes or series of stock of such a corporation.

NOTE: The foregoing testimony in support envisions a Sponsor's Amendment to SB 469/HB 668 whereby the approval requirement set forth in Sections 2-604(b), 3-105(c), and 3-403(b) would read: "…shall be approved by a majority of the entire board of directors and in the manner and by the vote required under the Investment Company Act of 1940." That is, such actions would require the heightened standard of approval for action by the board of directors and compliance with the Investment Company Act.

Clarifying Filing Requirements for Charter Amendments Associated with Mergers and Effective Date of Articles of Incorporation Associated with Articles of Conversion

The revisions to Sections 2-102(b) and 2-104 and Section 3-109 address two technical challenges under the MGCL:

- Presently, if one files Articles of Conversion to convert a Maryland limited liability company into a Maryland corporation or to convert an out-of-state corporation or other entity into a Maryland corporation, the Articles of Conversion are permitted to declare an effective date not later than 30 days after the Articles are accepted by the SDAT. The law governing a conversion into a Maryland corporation requires that the new Articles of Incorporation for the new Maryland corporation must be attached to the Articles of Conversion. However, there is no express provision in the MGCL enabling the attached Articles of Incorporation to have a later effective date. Previously, these filings (i.e., Articles of Conversion with a later effective date, to which Articles of Incorporation without a later effective date are attached) were accepted by the SDAT for filing, but the SDAT now rejects such filings in strict conformance with the statute. The revisions to Sections 2-102(b) and 2-104 would correct this anomaly.

- Presently, if one files Articles of Merger with a Maryland corporation being the successor entity and desires to amend the charter of the successor corporation upon the effective date of the merger, the desired amendment would be attached to or made part of the Articles of Merger. If there are several amendments, to avoid

confusion, attorneys often desire to attach an "as amended" restatement of the entire corporate charter (instead of attaching only the amendments). Previously, these filings (i.e., Articles of Merger with a full restatement attached) were accepted by the SDAT for filing, but the SDAT now rejects such filings in strict conformance with the statute. The revisions to Section 3-109 would correct this anomaly.

Prior to these amendments being proposed to the Sponsors of these Bills, our Committee met with the SDAT and we were advised that the SDAT has no objections to these changes. There was no "policy" reason to reject these filings, as the SDAT was accepting or rejecting these filings in accordance with its present interpretation of the MGCL.

Altering Inspection Rights of Holders of Preferred Stock

The Committee proposes that (unless the corporate charter provides otherwise) a holder of shares of a class or series of preferred stock not have the additional statutory rights of inspection that the Section 2-513 of the MGCL provides to record owners who have held at least five percent of shares or any class or series of stock for at least six months. No change, however, is proposed to the additional inspection rights of record owners of at least five percent of a corporation's common stock.

The MGCL provides (a) certain inspection rights under Section 2-512 for all stockholders and (b) additional inspection rights under Section 2-513 for record owners of at least five percent of shares of any class or series of stock who have held such stock for six months. Both the five-percent and six-month figures, while long-standing, are completely arbitrary. Thus, if a Maryland corporation issues a small amount of preferred stock, say $100,000, a holder of only $5,000 worth of this stock would have more extensive inspection rights than the holder of a larger dollar amount (but smaller percentage) in some other class of the corporation's stock. Typically, preferred stock is not issued by smaller corporations. More commonly, preferred stock is issued by large corporations with complex capital structures and the purchasers of the preferred stock may have negotiated the preferences, rights (including inspection rights), dividends, and voting powers unique to that particular series or class of preferred stock. The amendment would leave the matter of inspection rights for negotiation among the corporation and its preferred stockholders, instead of prescribing any fixed but arbitrary and not economically-based figures.

Importantly, so as not to affect the existing rights of holders of preferred stock, the amendment to Section 2-513 would apply only to stock of corporations formed after October 1, 2020 or to stock of existing corporations if such stock was classified or reclassified by Articles Supplementary or created by Articles of Amendment after such date.

Clarification of "Class or Series"

The rationale for the addition of "or series" in Sections 2-104(b), 2-418(b), and 3-109(d) of the MGCL is as follows: The words "series" and "class" are generally regarded as interchangeable (e.g., Class A Common Stock, Series A Preferred Stock) to describe a type of stock, but the MGCL occasionally uses the word "class" only or the word "series" only. In these three Sections, which use "class" only, we propose to add the words "or series" to conform with general usage in the business and legal communities.

In the 2019 General Assembly session, SB 137 (which was enacted as Chapter 289, Acts 2019) similarly added "or series" into Section 2-505 and Section 2-506. The Committee on Corporation Law has recommended these changes whenever a Section is being amended for other purposes.

Allocation of Powers among Members and Directors in a Non-Stock Corporation

The revisions to Section 5-202 of the Corporations and Associations Article, which is a provision affecting non-stock corporations (including non-profit corporations, e.g., many 501(c)(3) organizations), modernizes this Section to reflect the manner in which these corporations operate. The amendment, among other things, allows voting by email and clarifies that a non-stock corporation's charter or bylaws may regulate how the corporation is to be managed, including regulating the voting powers of the members and directors.

Permitting Reverse Stock Splits by REITs

The Maryland REIT Law, i.e., Title 8 of the Corporations and Associations Article, in part, incorporates various provisions of the MGCL (which pertains to corporations only). We propose to amend Section 8-601.1 to include reference to Section 2-309(a) and (e), providing express authority for the board of trustees of a REIT formed under Title 8 to conduct a reverse stock split. A reverse stock split enables an entity to increase its share price by combining its shares and is a particularly valuable tool during a financial crisis when share prices may plummet, some even into single digits and below investment minimums for many institutional investors, such as mutual funds and pension trusts.

Other Clarifications and Changes

SB 469/HB 668 also provides several other clarifications and corrections, including the following:

- Given that stockholders (not shares of stock) meet and vote whether to remove and replace directors, Section 2-406(b)(6) of the MGCL and Section 8-205(b)(1) of the

Maryland REIT Law, which suggest that a "class or series" of shares votes, should be revised to clarify how a director (under the circumstances addressed by these Sections) may be removed and replaced.

- While the provisions of the MGCL regarding approvals by the board of directors typically speak to approval by a majority (or higher percentage) of the directors present or a majority (or higher percentage) of the entire board of directors, a third voting threshold is imposed by Section 2-418(e) (discussed above) which requires approval by only a majority of the disinterested directors (which number may be less than a majority of the directors present at the meeting). Accordingly, we propose amending Section 2-408(a) to recognize that the MGCL may require "a different proportion" and not always a majority of the directors present.

- Presently, each of Section 3-903 of the MGCL regarding Articles of Conversion for corporations and Section 8-703 of the Maryland REIT Law regarding Articles of Conversion for real estate investment trusts provide for the ability to set a later effective date (not more than 30 days after acceptance), somewhat oddly, in THREE places in each Section, i.e., respectively, in Sections 3-903(c)(5), 3-903(d)(5), and 3-903(e) and in Sections 8-703(c)(5), 8-703(d)(5), and 8-703(e). Saying the same thing in three different ways can cause confusion. Accordingly, we propose to retain Sections 3-903(e) and Section 8-703(e) and delete the other provisions as extraneous.

- The change to Section 8-205 requires that a definition of "shareholder" (by new Section 8-101(e)) be added in the Maryland REIT Law.

Respectfully submitted,

MSBA Section of Business Law, Committee on Corporation Law

William E. Carlson, Chair
Scott R. Wilson, Vice Chair

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