



NORTH DAKOTA CORPORATE GOVERNANCE COUNCIL

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April 5, 2007

Explanation of the North Dakota Publicly Traded Corporations Act

The North Dakota Publicly Traded Corporations Act provides a system of corporate governance that is designed to strengthen corporate democracy and improve the performance of publicly traded corporations. The Act adds a new chapter 10-35 to the North Dakota Century Code applicable to corporations incorporated after July 1, 2007 that elect to be subject to chapter 10-35.

Chapter 10-35 has two basic parts:

- **Corporate Governance Provisions.** Sections 10-35-01 through 10-35-27 establish the new system of corporate governance for publicly traded corporations.
- **Franchise Fee.** Sections 10-35-28 through 10-35-33 impose a franchise fee on the corporations subject to chapter 10-35, similar to the Delaware franchise tax, but at 50% of the rate imposed by Delaware.

Corporate Governance Provisions

The corporate governance provisions applicable to publicly traded corporations incorporated in North Dakota that elect to be subject to chapter 10-35 are as follows:

Citation (§ 10-35-01) The short title “North Dakota Publicly Traded Corporations Act” provides a convenient way of referring to chapter 10-35.

Definitions (§ 10-35-02) The definitions in this section are used throughout chapter 10-35.

“Beneficial owner” and “executive officer” have the same meanings in chapter 10-35 as they do in the rules of the SEC. By using the SEC definitions of those terms, the provisions of chapter 10-35 will stay consistent with federal law.

“Commission” and “Exchange Act” are standard ways of referring to the U.S. Securities and Exchange Commission and the principal Federal securities law applicable to publicly traded corporations.

“Poison pill” was originally coined as a pejorative term for the most effective antitakeover device developed during the 1980’s, which is sometimes referred to by the more formal name of a “shareholder rights plan.” This definition is used in sections 10-35-22 through 10-35-25 and is intended to be construed broadly to accomplish the purposes of those sections.

The definition of “publicly traded corporation” sets forth the characteristics of a corporation that is subject to chapter 10-35:

- it is a domestic corporation incorporated under the North Dakota Business Corporation Act, chapter 10-19.1 (the “BCA”), after July 1, 2007; and
- its articles of incorporation state that it is subject to chapter 10-35.

The requirement that a corporation include a provision in its articles electing to be subject to chapter 10-35 makes chapter 10-35 an optional choice that must be affirmatively elected by a corporation.

“Publicly traded corporation franchise fee” is the fee imposed by chapter 10-35 on corporations subject to its provisions.

“Qualified shareholder” is used in section 10-35-08 with respect to access to a corporation’s proxy statement.

“Required vote” is used in section 10-35-26 with respect to adoption of antitakeover provisions.

Application and Effect of Chapter 10-35 (§ 10-35-03)

As described above, the definition of “publicly traded corporation” in section 10-35-02 requires a corporation affirmatively to elect to be subject to chapter 10-35. Subsection 1 of section 10-35-03 confirms that chapter 10-35 only applies to those corporations.

Subsection 2 of section 10-35-03 makes clear that chapter 10-35 does not affect any statute or law applicable to a corporation that is not a domestic publicly traded corporation. Thus the rules in chapter 10-35 do not have any effect on North Dakota corporations that are not “publicly traded corporations.”

Subsection 3 of section 10-35-03 makes clear that the articles of incorporation or bylaws of a publicly traded corporation may not be inconsistent with the provisions of chapter 10-35. Subsection 6 of section 10-19.1-10 and subsection 1 of section 10-19.1-31 similarly require the articles and bylaws to be not inconsistent with the BCA.

Subsection 4 of section 10-35-03 provides a rule for computing percentage ownership of shares which should provide certainty when making those calculations since it is tied to public filings with the SEC.

Application of Chapter 10-19.1 (§ 10-35-04)

As noted in the discussion below, several of the provisions of chapter 10-35 vary the otherwise applicable rules in the BCA. Thus, subsection 1 of section 10-35-04 provides generally that the provisions of chapter 10-35 control over any inconsistent provision of the BCA.

Subsections 2 and 3 of section 10-35-04 make the definitions in the BCA applicable to chapter 10-35 as well.

Amendment of the Bylaws (§ 10-35-05)

The BCA limits the right of shareholders to propose amendments of the bylaws to shareholders who own 5% or more of the outstanding shares. Subsection 1 of section 10-35-05 adopts the more usual rule that any shareholder may propose a bylaw amendment. A similar change is made by subsection 3 of section 10-35-12 with respect to the right of a shareholder to demand the holding of a delinquent regular meeting.

Subsection 2 of section 10-35-05 reverses the otherwise applicable rule under BCA section 10-19.1-31 that the articles or bylaws may impose additional requirements on proposals by shareholders to amend the bylaws.

Board of Directors (§ 10-35-06)

BCA section 10-19.1-35 permits the articles or bylaws to provide a fixed term for directors of up to five years. Subsection 1 of section 10-35-06, in contrast, requires that the term of directors of a publicly traded corporation not exceed one year.

Subsection 2 of section 10-35-06 prohibits a publicly traded corporation from staggering its directors into different classes, with the result that all directors will be elected each year. This varies the rule in BCA section 10-19.1-35 which permits the articles or bylaws to provide for staggered terms for directors.

Subsection 3 of section 10-35-06 prohibits a publicly traded corporation from changing the size of its board of directors at a time when the board of directors knows or has reason to know that there will be a contested election of directors. This will keep the corporation from improperly interfering in the election contest and is consistent with the case law in Delaware. *See, e.g., MM Companies, Inc. v. Liquid Audio, Inc.*, No. 606 (Del. Supreme 2003); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).

Subsection 4 of section 10-35-06 requires the board of directors to elect a chair and prohibits the chair from serving as an executive officer of the corporation.

Nomination of Directors (§ 10-35-07) Section 10-35-07 permits a publicly traded corporation to adopt a requirement that a shareholder notify the corporation in advance if the shareholder plans to nominate a candidate for election as a director. But

section 10-35-07 adds time limits, the same as in section 10-35-14 with regard to advance notice of shareholder proposals, on how far in advance the notice may be required to be given. Subsection 2 of section 10-35-07 restricts the corporation from imposing burdensome requirements on the shareholder to provide information about the nominations.

Access to Corporation's Proxy Statement by Major Shareholders (§ 10-35-08) Section 10-35-08 gives a qualified shareholder (*i.e.*, a shareholder or group of shareholders who have held at least 5% of the outstanding shares for at least two years) the right to have candidates nominated by the qualified shareholder included in the corporation's proxy statement. This provision is similar to a proposal made by the SEC in 2003 which has not yet been adopted. The language of section 10-35-08 is patterned after portions of the SEC's proposal. The most significant differences between section 10-35-08 and the SEC proposal are that:

- the SEC proposal would give the shareholder the right to include only a limited number of nominees, while section 10-35-08 does not limit the number of nominations that may be made; and
- the SEC proposal would only apply after certain triggering events had occurred, while section 10-35-08 permits nominations without requiring any triggering events.

Election of Directors (§ 10-35-09)

Subsection 1 of section 10-35-09 prohibits a publicly traded corporation from adjourning a meeting at which directors are to be elected until the election has been completed. The purpose of this provision is to keep the incumbent directors from adjourning to solicit additional votes if they know their candidates are losing.

Currently under the BCA, shareholders do not have the right to vote against nominees for election as directors; they can only vote in favor of candidates or withhold their votes. Those candidates receiving the highest number of votes, up to the number of positions to be filled, are elected. In contrast to that plurality voting system, subsection 2 of section 10-35-09 provides for a true majority voting system under which shareholders in an uncontested election may vote "yes" or "no" on each candidate, and only those candidates receiving a majority of "yes" votes are elected. The definition of what constitutes an uncontested election in subsection 3 of section 10-35-09 is derived from Model Business Corporation Act § 10.22(b).

Subsection 4 of section 10-35-09 prohibits a publicly traded corporation from compensating an individual as the result of the individual not being elected as a director.

Subsection 5 of section 10-35-09 recognizes that directors may be elected by consent without a meeting and provides a rule on when an election of directors by consent will substitute for the holding of a regular meeting. Subsection 5 is patterned after Section 211(b) of the DGCL.

Reimbursement of Proxy Expenses (§ 10-35-10) Section 10-35-10 requires that a shareholder be reimbursed for the expenses of conducting a proxy contest for the election of directors to the extent the shareholder is successful. Thus, for example, if a shareholder nominates four candidates and three are elected, the shareholder will be reimbursed for 75% of the shareholder's expenses.

Supermajority provisions prohibited (§ 10-35-11) Subsection 1 of section 10-35-11 establishes a majority of the full board of directors as the maximum quorum and vote requirement that may be imposed by the articles or bylaws. Subsection 2 of section 10-35-11 similarly establishes a majority as the maximum quorum and vote requirement for shareholders.

Regular Meeting of Shareholders (§ 10-35-12)

Section 10-35-12 requires a publicly traded corporation to fix in its articles or bylaws the latest date by which the corporation's regular meeting must be held each year. This will keep a corporation from delaying its annual meeting to avoid being accountable to its shareholders.

BCA section 10-19.1-71 provides that if the regular meeting of a corporation is not held within six months after the end of its fiscal year 5% of the shareholders may demand the meeting be held at any time thereafter. Subsection 3 of section 10-35-12 changes that rule to permit any shareholder of a publicly traded corporation to demand that a delinquent meeting be held.

Subsection 5 of section 10-35-12 adopts the United Kingdom practice of having the shareholders vote on an advisory basis on a report of the compensation committee of the board of directors.

Call of Special Meeting of Shareholders (§ 10-35-13)

BCA section 10-19.1-72 permits the holders of at least 10% of the votes entitled to be cast on an issue to call a special meeting of shareholders to vote on the issue, except that a meeting called to consider a business combination may only be called by shareholders owning 25% or more of the outstanding shares. Section 10-35-13 eliminates the special rule for calling a meeting to consider a business combination with the result that 10% of the shares will be able to call a meeting for any purpose.

Subsection 2 of section 10-35-13 prevents the corporation from restricting the right to call a special meeting or the business that may be conducted at a special meeting.

Shareholder Proposals of Business (§ 10-35-14) Section 10-35-14 permits a publicly traded corporation to adopt a requirement that a shareholder notify the corporation in advance if the shareholder plans to propose any business at a regular meeting. But section 10-35-14 adds time limits on how far in advance the required notice must be given. Subsection 2 of section 10-35-14 restricts the corporation from imposing

burdensome requirements on the shareholder to provide information about the proposal.

Shareholder Proposals of Amendment of the Articles (§ 10-35-15) BCA section 10-19.1-19 gives shareholders owning 5% or more of the outstanding voting power the right to propose an amendment of the articles. Section 10-35-15 restricts the corporation from imposing on the proposing shareholders burdensome requirements to provide information about a proposed amendment. Subsection 3 of section 10-35-15 makes clear that approval by the board of directors of an amendment proposed by shareholders is not required.

Requirements for Convening Shareholder Meetings (§ 10-35-16)

Subsection 1 of section 10-35-16 requires a publicly traded corporation to make a public announcement of the date of a regular meeting far enough in advance of the meeting so that its shareholders can comply with an advance notice requirement adopted under section 10-35-07 or 10-35-14.

Brokers who hold shares in “street name” have the ability to vote those shares on routine matters without receiving instructions from the beneficial owner, but in instances where the broker is not permitted to vote on non-routine matters the broker may return a proxy card with a “broker non-vote.” Subsection 2 of section 10-35-16 makes clear how broker non-votes affect the existence of a quorum at a meeting of shareholders.

Approval of Certain Issuances of Shares (§ 10-35-17) Both the Model Business Corporation Act and the New York Stock Exchange require shareholder approval before a corporation may issue shares having more than 20% of the outstanding voting power. Section 10-35-17 adopts the same approach for all publicly traded corporations since not all publicly traded corporations are subject to the NYSE requirement.

Preemptive Rights (§ 10-35-18) BCA section 10-19.1-65 provides shareholders with certain preemptive rights unless those rights are denied or limited by the articles. Section 10-35-18 reverses that rule so that shareholders in a publicly traded corporation will have preemptive rights only if those rights are conferred by the articles.

Conduct and Business of Shareholder Meetings (§ 10-35-19) Section 10-35-19 is patterned after Section 7.08 of the Model Business Corporation Act and provide rules on how shareholder meetings are to be conducted.

Action by Shareholders Without a Meeting (§ 10-35-20) BCA section 10-19.1-75 permits shareholders to act by majority consent without a meeting if the articles authorize them to do so. Section 10-35-20 eliminates the requirement that action by majority consent be authorized in the articles, thus making action by majority consent available in all publicly traded corporations.

Financial Statements (§ 10-35-21) Since publicly traded corporations are

subject to the periodic reporting requirements of the Exchange Act, section 10-35-21 makes inapplicable to them the requirement in BCA section 10-19.1-85 that a corporation furnish a financial statement on request by a shareholder.

Restrictions on Poison Pills (§§ 10-35-22, 10-35-23, 10-35-24, and 10-35-25)

Chapter 10-35 does not prohibit the adoption of all poison pills because experience has shown that poison pills may be used to benefit shareholders by preventing a corporation from being sold at an inadequate price. But chapter 10-35 does place limitations on the use of poison pills to keep them from being used improperly to entrench incumbent management. The provisions dealing with poison pills are as follows:

- **Duration of Poison Pills (§ 10-35-22)** Section 10-35-22 prohibits a poison pill that was not approved by the shareholders from being in effect for longer than the shorter of one year or 90 days after a majority of the shareholders have indicated that they wish to accept an offer for the sale of their company. The 90 day period is based on the practice of the Ontario Securities Commission which requires the withdrawal of a poison pill under those circumstances. The one year period is increased for a poison pill approved by the shareholders to two years.
- **Prohibition of “Dead Hand” Poison Pills (§ 10-35-23)** Section 10-35-23 prohibits the use of “dead hand” and similar provisions in poison pills. Under that type of provision, only directors in office before an offer is made for the corporation (or successors that those directors approve) may redeem or otherwise disable the poison pill. “Dead hand” provisions have been invalidated by the Delaware courts. Since North Dakota does not have similar case law, section 10-35-23 confirms that the Delaware case law is also the rule in North Dakota. *See Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998); *Carmody v. Toll Brothers, Inc.*, 723 A.2d 1180 (Del. Ch. 1998)
- **Restriction on Poison Pill Triggering Level (§ 10-35-24)** Section 10-35-24 prohibits a corporation from adopting a poison pill that has a triggering level of less than 20%. The triggering level is the amount of shares that a party may acquire in a corporation without interference from a poison pill. When poison pills were first being adopted, they usually had triggering levels of between 20% and 30%, but recent poison pills have had triggering levels as low as 10% to 15%.
- **Optional Prohibition of Poison Pills (§ 10-35-25)** Section 10-35-25 makes clear that, if they choose to do so, the shareholders may prohibit the adoption of a poison pill by their corporation.

Adoption of Antitakeover Provisions (§ 10-35-26) Section 10-35-26 requires that any antitakeover provision included in the articles or bylaws of a publicly traded corporation must be approved by at least a two-thirds vote of the shareholders.

Liberal Construction (§ 10-35-27) Section 10-35-27 has been included to provide the courts with guidance as to the purpose of new chapter 10-35, as well as with regard to the general approach that should be taken when interpreting the BCA as it applies to publicly traded corporations.

Franchise Fee

Sections 10-35-28 through 10-35-33 imposes a franchise fee on publicly traded corporations. The fee will be paid only by those corporations subject to chapter 10-35 (*i.e.*, only those corporations that elect to be subject to chapter 10-35).

The fee is imposed based on the number of shares a corporation is authorized to issue, with a minimum fee of \$60 and a maximum fee of \$80,000 each year. The rate at which the fee is imposed is one-half the rate of the similar Delaware franchise tax. Compare DGCL § 503.