

BILL ANALYSIS

C.S.H.B. 1873
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Business & Industry
Committee Report (Substituted)

BACKGROUND AND PURPOSE

The Business Organizations Code codified provisions of prior law found in numerous acts, which were repealed several years after the code took effect to provide a transition period for the various business entities regulated under those acts. That transition to exclusive use of the Business Organizations Code has been largely achieved. However, additional issues persist, including the effect of references to prior law in governing documents that were filed or adopted before the code took effect.

In addition to transition issues, other technical amendments are needed to correct errors, clarify certain provisions, fill gaps in coverage, eliminate antiquated provisions, and conform the language of the code to the language of the source statutes in certain instances where the code's language unintentionally deviated.

A number of substantive changes also have been identified by State Bar of Texas drafting groups and the secretary of state as necessary to keep the code current and competitive with the business organizations laws of other states.

C.S.H.B. 1873 seeks to address these issues through clarifying, substantive amendments to the Business Organizations Code.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

C.S.H.B. 1873 amends the Business Organizations Code to change the earliest record date that may be provided in advance by a domestic entity's governing authority for determining the entity's owners or members from the 60th day before the date the action requiring the determination of owners or members is taken to the 60th day before the date that action is originally to be taken. The bill removes the condition authorizing the substitution or use of any photographic, photostatic, facsimile, or similarly reliable reproduction of a written consent signed by an owner, member, or governing person of a filing entity in place of the original writing for any purpose for which the original writing could be used only if that reproduction is a complete reproduction of the entire original writing.

C.S.H.B. 1873 clarifies that, for purposes of indemnifying a person other than a governing person, an enterprise may pay or reimburse in advance of the final disposition of a proceeding expenses incurred by a former governing person, rather than a former managerial official, or delegate who was, is, or is threatened to be made a respondent in the proceeding in addition to a present or former employee, agent, or officer who is not a governing person of the enterprise and who was, is, or is threatened to be made a respondent in the proceeding. The bill specifies that, with respect to a limited partnership, a vote of a majority-in-interest of the limited partners

constitutes the owners' approval of an insurance or other arrangement made with an enterprise not regularly engaged in the business of insurance coverage that provides for payment of a liability not otherwise within the power of that enterprise to indemnify. The bill redefines "delegate" and "enterprise" and defines "majority-in-interest" with respect to limited partnerships for purposes of provisions relating to determining permissive indemnification and advancement of expenses to present governing persons or delegates.

C.S.H.B. 1873 clarifies that certain information included on the application for the registration of a foreign limited liability partnership reflects the partnership's initial registration or existence as a valid limited liability partnership under the laws of the jurisdiction in which the partnership is formed.

C.S.H.B. 1873 requires a plan of merger, plan of exchange, and plan of conversion to be in writing and requires a plan of merger to include, among other provisions, the identification of any of the ownership or membership interests of an organization that is a party to the merger that are to be canceled rather than converted or exchanged. The bill, in provisions relating to the information that must be provided in a plan of merger, requires the plan to include the manner and basis of exchanging an ownership or membership interest if the plan provides for an exchange in a manner or basis different than any other ownership or membership interest of the same class or series of the ownership or membership interest. The bill authorizes a plan of merger to provide for cancellation of an ownership or membership interest while providing for the conversion or exchange of other ownership or membership interests of the same class or series as the ownership or membership interest to be canceled. The bill expands provisions describing the effect of a merger to include the cancellation of certain ownership or membership interests as provided by the plan of merger.

C.S.H.B. 1873 removes being listed on a system similar to a national securities exchange and the Nasdaq Stock Market or a successor quotation system and being designated as a national market security on an interdealer quotation system by the National Association of Securities Dealers, Inc., or a successor system from the conditions applying to a class or series of ownership interests or depository receipts in respect of ownership interests incorporating an owner's ownership interest or depository receipt in respect of the ownership interest that prohibit an owner from dissenting from a plan of exchange or a plan of merger or conversion in which there is a single surviving or new domestic entity or non-code organization. The bill removes being approved for quotation as a national market security on an interdealer quotation system by the National Association of Securities Dealers, Inc., or a successor entity from the types of ownership interests or depository receipts in respect of ownership interests that make up a part of a class or series that, when the owner is not required by the terms of the plan of merger, conversion, or exchange, as appropriate, to accept in return for the owner's ownership interest, prohibit the owner from dissenting from the plan of exchange or plan of merger or conversion in which there is a single surviving or new domestic entity or non-code organization.

C.S.H.B. 1873 expands the conditions an owner must satisfy to perfect the owner's rights of dissent and appraisal by requiring an owner, if the proposed action is to be submitted to a vote of owners at a meeting, to give to the domestic entity a written notice of objection to the action that is addressed to the entity's president and secretary, states that the owner's right to dissent will be exercised if the action takes effect, provides an address to which notice of effectiveness of the action should be delivered or mailed, and is delivered to the entity's principal executive offices before the meeting. The bill, in provisions relating to the perfection of an owner's right to dissent, substitutes the phrase notice dissenting to the action with the phrase demand in writing. The bill establishes a deadline for the owner's delivery to the responsible organization of the owner's demand in writing, for payment of the fair value of ownership interest for which the rights of dissent and appraisal are sought, requiring delivery of such demand not later than the 20th day after the date the responsible organization sends to the owner the required notice that the action has taken effect, if the action was approved by a vote of the owners at a meeting, rather than requiring delivery before the action is considered if the action is to be submitted to

such a vote. The bill revises a similar deadline for delivery of the demand if the action was approved by the written consent of the owners so that the deadline is based on the date of the responsible organization's notice that the action has taken effect rather than that the action is to be undertaken on such written consent.

C.S.H.B. 1873 requires a dissenting owner, if the owner decides to accept the offer made by a responsible organization to pay the amount of an estimate of the fair value of the ownership interests, to provide to the organization notice of the acceptance of the offer not later than the 90th day after the date the action that is the subject of the demand took effect. The bill removes a provision requiring such an offer to remain open for a period of at least 60 days from the date the offer is first delivered to the dissenting owner. The bill extends the deadline for payment by the responsible organization to the dissenting owner of the agreed amount, if the dissenting owner accepts the organization's offer within 90 days or if the parties agree on the ownership interest's fair value, from the 60th day after the date the offer is accepted or the agreement is reached, as appropriate, to the 120th day after the date the action that is the subject of the demand took effect.

C.S.H.B. 1873 defines "majority-in-interest" for purposes of supplemental provisions for a domestic general partnership under provisions relating to the winding up of a domestic entity.

C.S.H.B. 1873 removes a provision making a for-profit corporation's shareholders' agreement cease to be effective when the corporation's shares are listed on a system similar to a national securities exchange or quoted on an interdealer quotation system of a national securities association or successor system. The bill specifies that the statutory provisions governing for-profit corporation's shareholders' agreements do not prohibit or impair any agreement between two or more shareholders, or between the corporation and one or more of the corporation's shareholders, permitted by general provisions of the Business Organizations Code, provisions relating to for-profit corporations, or another law. The bill specifies that certain provisions of law relating to shareholder rights and restrictions do not invalidate or impair a corporation's right or power to grant an enforceable nonstatutory preemptive right in a contract between the corporation and a shareholder or other person or in the governing documents of the corporation. The bill, in a provision establishing a deadline by which the directors of a for-profit corporation must provide a record date, specifies that the record date is for the purpose of determining shareholders entitled to notice of or to vote at a shareholders' meeting or any adjournment of the meeting and that the record date must be at least 10 days before the date of the shareholders' meeting, rather than 10 days before the date on which the particular action requiring the determination of shareholders is to be taken. The bill specifies that the quorum required for an act of the majority of the directors present at a meeting to be the act of the board of directors of the corporation is the quorum present at the time of the act.

C.S.H.B. 1873 makes provisions relating to contracts or transactions involving interested directors and officers of for-profit corporations applicable to a contract or transaction between a corporation and one or more affiliates or associates of one or more directors or officers of the corporation and to a contract or transaction between a corporation and an entity or other organization in which one or more affiliates or associates of one or more directors or officers of the corporation is a managerial official or has a financial interest. The bill establishes that an otherwise valid and enforceable contract or transaction is valid and enforceable, and is not void or voidable, notwithstanding the fact that the contract is between the corporation and certain individuals associated with both the corporation and the entity that is the object of the contract or transaction if one of several conditions is satisfied. The bill removes language that authorizes a director or officer of the corporation who is also associated with the object of the contract or transaction to participate in an action that approves the contract or transaction if a condition is satisfied. The bill authorizes a person who has the relationship or interest in both the corporation and the object of the contract or transaction, whether a director, officer, affiliate, associate, or other entity, to be present at or participate in and, if the person is a director or committee member, vote at a meeting of the board of directors or of a committee of the board that

authorizes the contract or transaction or to sign, in the person's capacity as a director or committee member, a unanimous written consent of the directors or committee members to authorize the contract or transaction. The bill specifies that if at least one of the conditions making a contract or transaction valid and enforceable is satisfied, neither the corporation nor any of the corporation's shareholders will have a cause of action against any of the persons involved in the contract or transaction for breach of duty with respect to the making, authorization, or performance of the contract or transaction because of the person's relationship or interest of an action taken by the person that the person is authorized to take. The bill makes similar changes relating to contracts and transaction involving interested directors, officers, members, governing persons, managers and their affiliates, associates, and other persons, as applicable, for contracts and transactions of nonprofit corporations, limited liability companies, and real estate investment trusts.

C.S.H.B. 1873 authorizes a plan of conversion for a for-profit corporation, if the corporation's board of directors adopts a resolution recommending the shareholders' approval of the plan of conversion and then determines that the plan is not advisable, to be submitted to the corporation's shareholders with a recommendation that the shareholders not approve the plan. The bill authorizes a plan of conversion for a corporation to include a provision requiring that the plan be submitted to the corporation's shareholders regardless of whether the board determines, after adopting a resolution or making a determination about the plan, that the plan is not advisable and recommends that the shareholders not approve the plan.

C.S.H.B. 1873, in provisions relating to beneficial ownership of shares or securities, clarifies that the other securities are not necessarily similar securities, limits the applicability of those beneficial ownership provisions to provisions governing affiliated business combinations, and makes nonsubstantive changes. The bill redefines "issuing public corporation" for purposes of provisions governing affiliated business combinations, with respect to a domestic corporation's ownership of voting shares qualified for trading on a national securities exchange, rather than in a national market system.

C.S.H.B. 1873 redefines "close corporation" to include a domestic corporation governed by provisions relating to close corporations because of the adoption of an amendment making an ordinary corporation a close corporation; because of a plan of merger, exchange, or conversion adopting close corporation status; or because of an election to become a close corporation before the mandatory application date of the Business Organizations Code.

C.S.H.B. 1873 prohibits the waiver or modification of the following provisions in the company agreement of a limited liability company: the enforceability of obligations and expenses incurred or existing with respect to a particular series against a limited liability company's assets and restrictions on a limited liability company's distribution with respect to a series. The bill removes a member's right, or that of the member's assignee or representative, to examine records and certain other information from the provisions that may not be waived or modified in such agreement, but prohibits the company agreement from unreasonably restricting a person's right of access to records and information.

C.S.H.B. 1873 establishes that a membership interest in a limited liability company may be community property under applicable law and specifies that a member's right to participate in the management and conduct of the business of the company is not community property. The bill establishes the following effects of death or divorce on membership interest in a limited liability company: on the divorce of a member, the member's spouse, to the extent of the spouse's membership interest, if any, is an assignee of the membership interest; on the death of a member, the member's surviving spouse, if any, and an heir, devisee, personal representative, or other successor of the member, to the extent of their respective membership interest, are assignees of the membership interest; and on the death of a member's spouse, an heir, devisee, personal representative, or other successor of the spouse, other than the member, to the extent of their respective membership interest, if any, is an assignee of the membership interest. The bill

specifies that the provisions governing limited liability companies do not impair an agreement for the purchase or sale of a membership interest at any time, including on the death or divorce of an owner of the membership interest.

C.S.H.B. 1873 clarifies that the option of a limited liability company manager or committee member to vote by a proxy rather than in person is contingent on an authorization by the company agreement. The bill exempts a limited liability company's distribution with respect to a classified series from a prohibition against making a distribution to a member if the company's total liabilities exceed the fair value of the company's total assets and removes the exemption from a provision granting a member who is entitled to receive a distribution the same status as a creditor of the company with an entitlement to the same remedy available to such creditor. The bill clarifies that receipt of notice by a general partner, rather than a partner, of a fact relating to the partnership is effective immediately as notice to the partnership with an exception.

C.S.H.B. 1873, under provisions relating to general partnerships, authorizes a court having jurisdiction, on application by a judgment creditor of a partner or of any other owner of a partnership interest, to charge the partnership interest of the judgment debtor to satisfy the judgment. The bill clarifies that all partners in a general partnership are jointly and severally liable for all obligations, rather than a debt or obligation, of the partnership, with certain exceptions. The bill specifies that, to the extent that the partnership interest is charged, the judgment creditor has only the right to receive any distribution to which the judgment debtor would otherwise be entitled in respect of the partnership interest. The bill establishes that a charging order constitutes a lien on the judgment debtor's partnership interest and prohibits the charging order lien from being foreclosed on under the Business Organizations Code or another law. The bill makes the entry of a charging order the exclusive remedy by which a judgment creditor of a partner or any other owner of a partnership interest may satisfy a judgment out of the judgment debtor's partnership interest. The bill establishes that these provisions of the bill relating to a partner's partnership interest being subject to a charging order do not deprive a partner or other owner of a partnership interest of a right under exemption laws with respect to the judgment debtor's partnership interest. The bill denies a creditor of a partner or of any other owner of a partnership interest the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the partnership.

C.S.H.B. 1873 revises the provisions that are applicable on the death of a partner, in a general partnership, by providing a distinction between the partnership interest, if any, of the deceased partner being subject to redemption under provisions of the law and not being subject to those provisions. The bill makes a partner's surviving spouse, heir, devisee, personal representative, or other successor, to the extent of their respective right to the redemption price, creditors of the partnership until the redemption price is paid and makes those individuals transferees of the partnership interest if the partnership interest is not subject to redemption. The bill removes language relating to the transfer of an ownership interest to a partner's surviving spouse, if any. The bill specifies that statutory provisions relating to general partnerships do not impair an agreement for the purchase or sale of a partnership interest at any time including on the divorce of an owner of the interest.

C.S.H.B. 1873 specifies that, in settling accounts among the partners, the partnership interest of a withdrawn partner that is redeemed on a deferred basis pending the partnership making a winding up distribution to the remaining partners, rather than an interest that is not redeemed, is credited with a share of any profits for the period after the partner's withdrawal but is charged with a share of losses for that period only to the extent of profits credited for that period.

C.S.H.B. 1873 establishes that a partner in a limited liability partnership is not personally liable to any person for any obligation of the partnership incurred while the partnership is a limited liability partnership by removing an exception that made such a partner personally liable for a debt or obligation of the partnership under certain conditions. The bill establishes, for purposes of a partner's liability, that an obligation is incurred while a partnership is a limited liability

partnership if the obligation relates to an action or omission occurring while the partnership is a limited liability partnership or the obligation arises under a contract or commitment entered into while the partnership is a limited liability partnership. The bill removes the definition of "representative" from the provisions relating to a partner's liability. The bill removes a requirement for a partnership, in order to become a limited liability partnership, to carry a specified minimum amount of liability insurance or establish another form of financial responsibility in an equivalent amount. The bill prohibits a limited partnership agreement from unreasonably restricting a partner's right of access to books and records.

C.S.H.B. 1873 establishes that a limited partner does not participate in the control of the business because the limited partner has engaged in proposing, approving, or disapproving an interest exchange with respect to a limited partnership.

C.S.H.B. 1873 establishes that a domestic entity formed before the effective date of the Business Organizations Code, a foreign filing entity registered with the secretary of state to transact business in Texas before the code's effective date that elected to adopt and become subject to the code, and an existing domestic or foreign entity that has not taken action to adopt the code are not considered to have failed to comply with applicable requirements because of certain omissions in their governing documents, certificates of formation, or registration applications, as applicable, and establishes that a reference in a government or filing instrument to a statute or a statute section that was repealed by a later statute is not considered to have failed to comply with provisions of law, and is considered a reference to the corresponding provision in the new statute.

C.S.H.B. 1873 authorizes a domestic filing entity whose existence has been voluntarily dissolved or involuntarily dissolved under prior law or whose certificate of formation or equivalent governing document has been canceled, revoked, suspended, or forfeited under prior law to reinstate the entity. The bill authorizes a foreign filing entity whose registration to do business has been canceled, revoked, suspended, or forfeited under prior law to reinstate its registration. The bill specifies that, for a domestic entity whose existence has been voluntarily dissolved under prior law or whose certificate of formation or equivalent governing document has been canceled under prior law, the reinstatement of the domestic filing entity that was filed in accordance with statutory provisions and the bill's provisions after December 31, 2005, and before January 1, 2010, is validated in all respects as of the date on which the reinstatement occurred. The bill defines "governing document" and "prior law" by reference to the code.

C.S.H.B. 1873 defines "majority-in-interest," "national securities exchange," "plan of conversion," "plan of exchange," and "plan of merger" and redefines "close corporation," "delegate," "enterprise," "issuing public corporation," and "person" for purposes of the Business Organizations Code. The bill makes nonsubstantive changes, conforming changes, and corrects a punctuation error.

C.S.H.B. 1873 repeals the following provisions of the Business Organizations Code:

- Section 21.001
- Section 152.802(i)
- Section 152.804

EFFECTIVE DATE

September 1, 2011.

COMPARISON OF ORIGINAL AND SUBSTITUTE

C.S.H.B. 1873 contains a provision not included in the original authorizing a plan of merger to

provide for cancellation of an ownership or membership interest while providing for the conversion or exchange of other ownership or membership interests of the same class or series as the ownership or membership interest to be canceled.

C.S.H.B. 1873 differs from the original by removing language limiting a provision relating to contracts or transactions involving interested individuals associated with a real estate investment trust, limited liability partnership, or corporation to apply only to a contract or transaction, whereas the original does not remove the limiting language.

C.S.H.B. 1873 differs from the original by authorizing a plan of conversion for a for-profit corporation, if the corporation's board of directors adopts a resolution recommending the shareholders' approval of the plan of conversion and then determines that the plan is not advisable, to be submitted to the corporation's shareholders with a recommendation that the shareholders not approve the plan, whereas the original authorizes the corporation's board of directors, under those circumstances, to submit the plan to the shareholders with the recommendation.

C.S.H.B. 1873 omits a provision included in the original providing an exception to the requirement for a nonprofit corporation to hold an annual meeting of its members if such exception is provided in the corporation's certificate of formation.

C.S.H.B. 1873, in provisions establishing the effects of death or divorce on membership interest in a limited liability company, differs from the original by specifying that, on the death of the member's spouse, the spouse's appropriate successor, other than the member, is an assignee of the membership interest, whereas the original, specifies that such a successor of the member's spouse is an assignee of the membership interest on the death of the member's spouse while the member is alive.

C.S.H.B. 1873 differs from the original by denying a creditor of a partner, or of any other owner of a partnership interest, the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to the partnership's property, whereas the original makes that denial with respect to the property of a limited partnership.

C.S.H.B. 1873 differs from the original by authorizing a domestic filing entity whose existence has been voluntarily or involuntarily dissolved or whose certificate of formation or equivalent governing document has been canceled, revoked, suspended, or forfeited under prior law to reinstate the entity, whereas the original authorizes such an entity whose certificate of formation or equivalent governing document has been canceled, revoked, voluntarily or involuntarily dissolved, suspended, or forfeited under prior law to reinstate its certificate of formation or equivalent governing document.

C.S.H.B. 1873 differs from the original in nonsubstantive ways by conforming to certain bill drafting conventions.