by Keith Paul Bishop

SILVER STANDARD

There are many benefits to incorporating in Nevada, but tax avoidance is not one of them

THE FIRST STEP in organizing any U.S. corporation is to decide where to incorporate—and with 50 states offering their charters, any systematic search for the best one quickly proves daunting. Lawyers and their clients most often limit their consideration to just a handful of states, and if they do consider a state other than the one in which they are resident, they most commonly choose a Delaware charter.[1] More recently, however, Nevada has waged an aggressive and successful campaign to attract corporate charters. By 1999, Nevada was second only to Delaware when ranked by the national percentage of out-of-state, publicly traded corporations.[2] For publicly traded corporations located in California, the order of preference for charters has been Delaware, California, and Nevada.[3]

Much has been written about the preeminence of Delaware as an importer of corporate charters. Much less has been written about Nevada. Practitioners seeking to assist their corporate clients should be aware of the key differences between California and Nevada corporate law.

California's relationship with the corporate form has been ambivalent at best. The drafters of the original 1849 Constitution imposed personal liability on stockholders by specifying that each stockholder of a corporation "shall be individually and personally liable for his proportion of all its debts and liabilities."[4] The 1879 Constitution substantially expanded the provisions relating to corporations.[5] In addition to continuing to place personal liability on stockholders for corporate debts, the 1879 Constitution made directors jointly and severally liable to creditors and stockholders for all moneys embezzled or misappropriated by the officers of the corporation during the directors' term of office.[6] The 1879 Constitution also prohibited corporations from holding any real estate for a period longer than five years except as necessary for carrying on their business.[7]

In 1930, voters approved the removal of several of these detailed provisions from the constitution. The following year, California enacted its first modern general corporation law. By that time, attitudes toward corporations had softened. More important, California had awakened to the fact that it was competing with other states for corporate charters. In fact, the draftsmen of the 1931 California General Corporation Law stated that their primary object was to "put California on a

Keith Paul Bishop is a partner in the Irvine office of Allen, Matkins, Leck, Gamble, Mallory & Natsis LLP and an adjunct professor of law at Chapman University Law School. He formerly served as California's commissioner of corporations.

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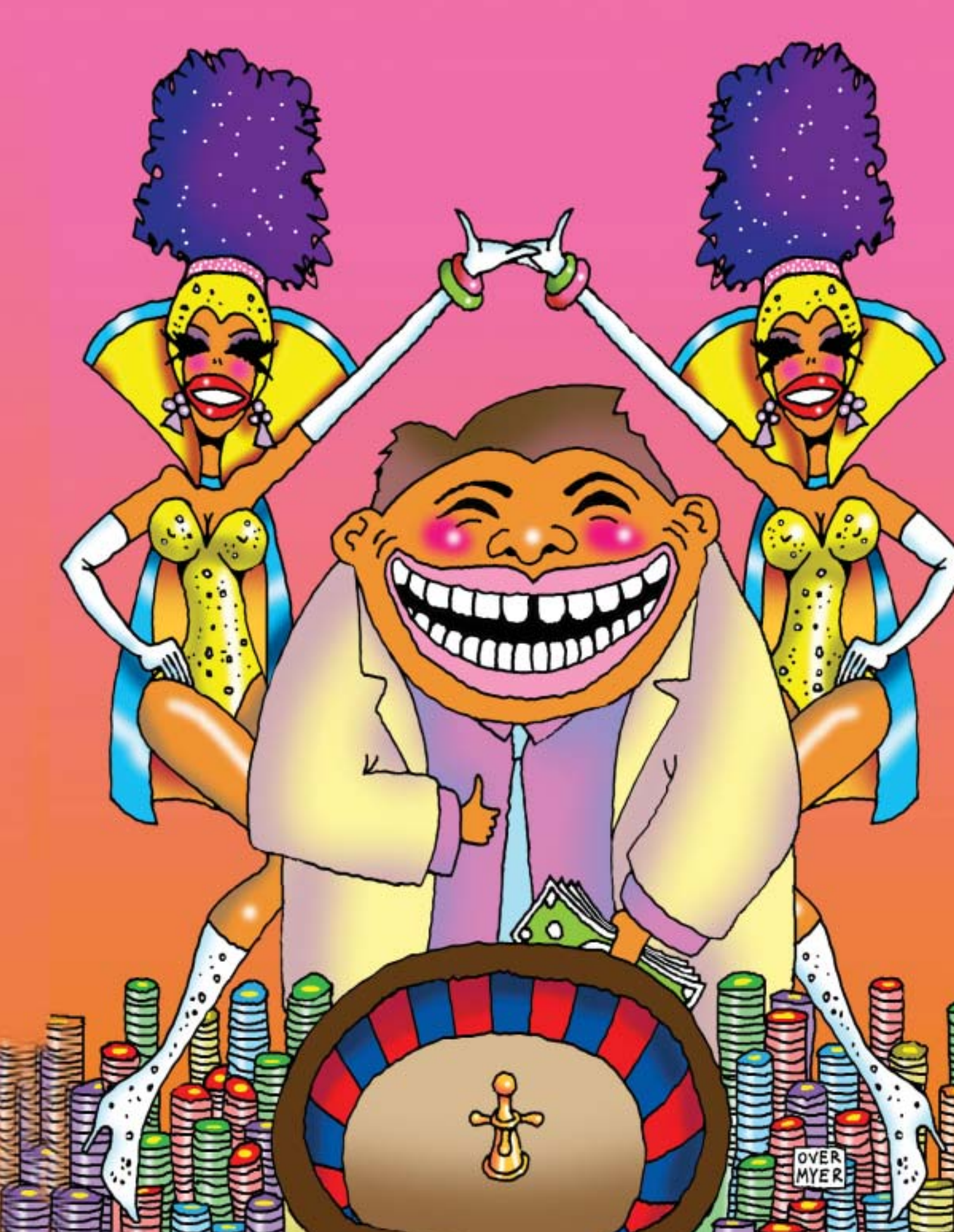
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competitive basis as to all legitimate corporate advantages and facilities with Delaware, Nevada and other incorporating states...."[8]

Nevada has been far friendlier to the corporate form. Nevada's constitution, adopted in 1864 and still in effect, provides that "corporators in corporations formed under the laws of this State shall not be individually liable for the debts or liabilities of such corporation."[9] In the last few decades, the Nevada Legislature has been proactive in its efforts to enact statutory provisions that are alluring to those in search of a corporate charter.

Each organizer of a corporation has specific priorities and objectives for the corporation and for its internal structure and governance. In many instances, lawyers may be inclined to go with what they know—the corporation law of the state in which they and their clients happen to be located. Indeed, to do otherwise would require a lawyer to expend time and effort in becoming familiar with the general corporation law of another jurisdiction. Moreover, lawyers are likely to believe that there is less risk of error or surprises due to their greater familiarity with their home state's law. Lawyers may also be concerned about the cost and inconvenience of litigation in another jurisdiction.

When lawyers do look out of state, they are likely to look for specific provisions such as manager liability, voting rights, and antitakeover provisions. The extent to which these provisions will be of interest or even available depends upon whether the corporation is publicly traded.

Managerial Conduct

Both California and Nevada establish the standard of care for directors by statute.[10] Beyond that similarity, California and Nevada share very little in their approaches to managerial conduct. In Nevada Revised Statutes Section 78.138(1), Nevada expresses a director's duty of care simply and succinctly: "Directors shall exercise their powers in good faith and with a view to the interests of the corporation." In 1999, the Nevada Legislature, at the behest of the Business Law Section of the State Bar of Nevada, amended Section 78.138 so that "directors and officers, in deciding upon matters of business, are presumed to act in good faith, on an informed basis and with a view to the interests of the corporation."[11]

On its face, Nevada's statutory standard is subjective—that is, it addresses only a director's state of mind rather than whether the director measures up against some external standard. The Nevada Supreme Court has not had occasion to explicate the meaning of "good faith" under Section 78.138. Thus, it remains to be seen to what extent an objective standard of conduct will be judicially read into the Nevada statute.

California, on the other hand, requires directors to act with due care in addition to good faith:

> A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, and in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.[12]

By requiring good faith and imposing an "ordinarily prudent person" standard, California imposes both subjective and objective components to a director's standard of care that contrasts with Nevada's overtly subjective standard.

California purports to afford directors the protection of the business judgment rule, which immunizes disinterested directors from liability for the decisions that are made by them in their capacity as directors.[13] Nevada, in contrast, has its statutory good faith presumption.[14] While the statute does not indicate whether this presumption can be rebutted, presumably a plaintiff would be permitted to make a contrary evidentiary showing.

Because of the dearth of decisions applying Nevada's unique statutory standard and presumption, it is not possible to conclude with any degree of certainty that directors in Nevada will be held to a lower standard than directors of California and Delaware corporations. However, Nevada's statute on its face offers the prospect of a lower standard.

California allows for the inclusion of a provision in a corporation's articles of incorporation that eliminates or limits the liability of directors. Until 2001, Nevada had also permitted such an exculpatory provision to be included in the articles. Thus, both states had followed an opt-in approach to limiting the liability of directors. Now, in a significant break with California, Nevada automatically relieves corporate directors and officers from liability to the corporation or its stockholders for damages unless it is proven that: 1) the act or failure to act constituted a breach of fiduciary duty, and 2) the breach involved intentional misconduct, fraud, or a knowing violation of the law.[15]

The Nevada law contains a number of very specific exceptions. Thus, liability is not excluded under Nevada Revised Statutes Sections 35.230 (liability for judgment of ouster), 90.660 (civil liability in connection with sales of securities), 91.250 (commodity law), 452.200 (unauthorized use of endowment funds), 452.270 (violation of laws pertaining to mausoleums, vaults, or crypts), 668.045 (receiving deposits of insolvent banks), and 698A.030 (insider trading in an insurer). In 2003, the Nevada Legislature amended Section 78.138(7) to permit a corporation to provide for greater liability in articles of incorporation or an amendment to the articles filed on or after October 1, 2003. Thus, Nevada now takes an opt-out approach, while California and Delaware continue to take an opt-in approach.[16]

In addition to avoiding the necessity of including an exculpatory provision in the articles of incorporation, Nevada's law offers broader exculpation than does California's. Perhaps most significantly, Nevada's law exculpates directors and officers, whereas California and Delaware permit exculpation only of directors.

California's General Corporation Law does not permit liability to be eliminated or limited for acts or omissions that:

- Involve intentional misconduct or a knowing and culpable violation of law.
- A director believes to be contrary to the best interests of the corporation or its shareholders.
- Involve the absence of good faith on the part of the director.
- Show a reckless disregard for the director's duty to the corporation or its shareholders in circumstances in which the director was aware, or should have been aware, in the ordinary course of performing a director's duties, of a risk of serious injury to the corporation or its shareholders.
- Constitute an unexcused pattern of inattention that amounts to abdication of the director's duty to the corporation or its shareholders.[17]

In addition, California's law prohibits absolving a director from liability for:

- Any transaction in which the director obtained an improper personal benefit.
- Contracts in which the director has a material financial interest.
- Improper distributions to shareholders or improper loans.[18]

Thus, California's statute permitting exculpation of directors includes far more exceptions than Nevada's statute.

Stockholder Voting Rights

Cumulative voting rights generally operate by giving each stockholder a number of votes equal to the number of shares multiplied by the number of directors to be elected. The stockholder may then distribute these votes among the directors in any manner in which the stockholder sees fit. The debate over the merits of cumulative voting in the election of directors has been longstanding. Proponents of cumulative voting typically argue that cor-

porate performance is enhanced when minority shareholders are able to attain some representation on the board of directors.[19] Opponents, on the other hand, argue that cumulative voting leads to divisiveness and special interest directors.[20]

California has a strong historical bias in favor of cumulative voting in the election of directors. In fact, California's 1879 Constitution enshrined cumulative voting as a constitutional right.[21] The 1931 California General Corporation Law continued mandatory cumulative voting.[22] When the current California General Corporation Law was introduced, it contained a provision allowing a corporation to opt out of cumulative voting, but the bill was amended to include mandatory cumulative voting.[23]

Nevada does not mandate cumulative voting in the election of directors. Instead, it permits a corporation to confer cumulative voting rights by including a provision in the certificate (articles) of incorporation.[24]

Because cumulative voting has been strongly disfavored by publicly traded corporations, California relaxed its cumulative voting mandate in 1989 by enacting an exception for "listed corporations."[25] The Corporations Code defines a "listed corporation" as a corporation with outstanding shares listed on the New York Stock Exchange, the American Stock Exchange, or the National Market System of the Nasdaq Stock Market (or any successor to that entity).[26] These corporations may eliminate cumulative voting by amending their articles of incorporation.[27]

Closely held corporations use supermajority voting power to balance the relative voting powers of investors. Supermajority voting requirements have also enjoyed popularity with publicly traded companies due to their utility as antitakeover devices. For example, a supermajority provision may require the affirmative vote of at least 90 percent of the outstanding shares to approve a merger.[28] Although the individual voting rights of each share remain unchanged under a supermajority voting provision, minority stockholders may have significantly increased power because a higher vote requirement will allow them to block certain corporate transactions.

Nevada allows supermajority voting provisions to be included in either the articles of incorporation or the bylaws.[29] Further, there is seemingly no limitation on these provisions.

California law is much more restrictive. The articles may include a provision requiring a supermajority vote of any class or series of stock for any or all corporation actions.[30] There are several exceptions, however, to this general rule. Thus, a supermajority vote cannot be imposed regarding the removal of directors, the election of directors, and voluntary dissolution.[31]

California imposes additional restrictions for widely held corporations that on or after January 1, 1989, filed or file an amendment to their articles or a certificate of determination containing a supermajority vote provision. If a corporation has outstanding shares held of record by 100 or more persons, the supermajority vote requirement cannot exceed 66⅔ percent of the outstanding shares, or

66⅔ percent of the outstanding shares of any class or series of those shares.[32] These limitations do not apply to a corporation that filed or files an amendment of articles or certificate of determination on or after January 1, 1994, if, at the time of filing, the corporation has 1) outstanding shares of more than one class or series of stock, 2) no class of equity securities registered under Section 12(b) or 12(g) of the Securities Exchange Act of 1934, and 3) outstanding shares of record held by fewer than 300 persons.[33]

Antitakeover Provisions

Takeover defense is an issue that primarily concerns widely held firms. In closely held firms there is often little or no separation of capital and management. Thus, there is less likelihood for the interests of the owners and the managers to diverge.

States can enhance or diminish the capacity of corporate managers to intervene in corporate control transactions in primarily two ways. First, states can adopt legal schemes that have the effect of validating or invalidating managerial actions. Examples of validating schemes include legislative or judicial endorsement of stockholder rights plans or deference to managerial decisions. Second, states can impose structural or procedural requirements that implicate management involvement. Control share and business combination laws are examples of these types of requirements. These laws operate by denying opportunities or rights to those who try to acquire a corporation without negotiating with the target's board of directors.

Stockholder rights plans or "poison pills" are takeover defenses that were first conceived over a quarter century ago but still remain popular.[34] They are not creations of statute but arrangements established by a company's board of directors—typically without the affirmative assent of the owners. The Delaware Chancery Court has provided an overview of the structure and operation of a stockholder rights plan:

> Under the Plan each shareholder receives one right for each share of common outstanding. The right, which has a term of ten years, entitles the holder to buy one hundredth of a share of a new series of participating preferred stock. The new preferred would be nonredeemable and subordinate to other series of the Company's preferred stock. Its dividend right is tied to the dividend for common at the rate of 100 times the dividend declared on common stock. Its liquidation preference is similarly linked to payment received by common shareholders. The exercise price for the preferred, $100 for 1/100 of a share, or $10,000 per share, is conceded to be "out of the money" in view of the current $1.75 dividend yield on Household common

which has traded in recent months in a range of $30 to $33. The real impact of the rights is to be found in their "triggering" and "flip-over" features which have led to their being labeled as "poison pills."

The rights detach and may be exercised only if certain triggering events, referred to as the 20% and 30% events, occur. Prior to the occurrence of any of these events the rights are not transferable apart from the common stock to which they are affixed. Thus if a person (a) acquires 20% of Household's common shares or (b) achieves the right to purchase 20% or (c) achieves the right to vote 20% or (d) announces the formation of a group of persons holding 20% to act together, the rights are triggered. The 30% triggering event occurs upon the announcement of a tender offer or exchange offer for 30% of Household's outstanding stock.

Once a triggering event has occurred the rights may be exchanged for the new preferred upon the payment of the exercise price. Moreover, if a merger or consolidation occurs under the terms of which Household's common shares are exchanged for securities of the acquiror, the right "flips-over" and enables the holder, at the then exercise price of the right, to purchase common stock of the acquiror at a price reflecting a market value of twice the exercise price of the right. Thus the right holder would be entitled to purchase $200 worth of the acquiror's common for $100. The resultant dilution of the acquiror's capital is immediate and devastating.[35]

The court's description makes it clear that shareholder rights plans are effective because they discriminate against specific shareholders. The discriminatory nature of a shareholder rights plan constitutes both its operative mechanism and its legal vulnerability.

Nevada has enacted several statutory provisions that directly address the legal viability of shareholder rights plans. The provisions of Nevada Revised Statutes Section 78.195(5), which apply to the issuance of shares of more than one class or series, "do not restrict the directors of a corporation from taking action to protect the interests of the corporation and its stockholders, including, but not limited to, adopting or signing plans, arrangements or instruments that grant rights to stockholders or that deny rights, privileges, power or authority to a holder of a specified number of shares or percentage of share ownership or voting power."[36]

A nearly identical statement is also found in Nevada Revised Statutes Section 78.350(4), which governs the voting rights of stockholders. Further, Section 78.378(3) provides that nothing in Nevada's control share law prohibits signing plans, arrangements, or instruments that deny rights, privileges, power, or authority to a holder of a specified number of shares or percentage of share ownership or voting power. While these provisions provide strong evidence of the Nevada Legislature's attempt to validate stockholder rights plans, they do not necessarily foreclose challenges to director action in adopting or implementing a plan. Further, Nevada is far from the only state to have statutorily endorsed shareholder rights plans.[37]

The status of stockholder rights plans is far less clear under the California Corporations Code, which is devoid of any analogue to the Nevada statutes that are applicable to the plans. A stockholder rights plan could be challenged on the basis of Corporations Code Section 203, which mandates equality of treatment: "Except as specified in the articles or in any shareholders' agreement, no distinction shall exist between classes or series of shares or the holders thereof."[38] Nonetheless, this has not prevented California corporations from implementing stockholder rights plans.[39] Section 203 as well as the absence of any judicial precedent upholding stockholder rights plans cast a significant shadow upon the enforceability of these plans.[40]

In a very influential decision, the Delaware Supreme Court in 1985 applied a heightened scrutiny standard to board actions taken in response to takeover threats. In *Unocal Corporation v. Mesa Petroleum Company*, the court held that a board of directors will be afforded the benefit of the business judgment rule if it can show that it had reasonable grounds for believing that a threat existed and that its response was proportional to the threat.[41] The Nevada Supreme Court has not applied the *Unocal* standard to boards of Nevada corporations. However, in 1997, a U.S. District Court in Nevada applied the *Unocal* standard to actions taken by the directors of ITT Corporation in response to a hostile tender offer made by Hilton Hotels Corporation.[42]

Shortly after the *Hilton* decision, the Nevada Legislature enacted S.B. 61, which codified but also limited the *Unocal* standard.[43] Nevada practitioners had been concerned about the possible broad application of *Unocal* to change-in-control situations involving Nevada corporations. Under Nevada Revised Statutes Section 78.139, the second prong of the *Unocal* standard, which requires a proportional response, will be applied if, and only if, the action impedes the exercise of the rights of stockholders to vote for or remove directors.[44] Thus, the proportionality prong of the *Unocal* standard does not apply to other antitakeover actions of the board of directors. These actions are subject to the general standard of care set forth in Section 78.138(1) and have the benefit of the business-judgment-rule presumption codified in Section 78.138(3).

In 1987, the Nevada Legislature adopted a control share law that was patterned after a similar law adopted the previous year by Indiana. This action closely followed the U.S. Supreme Court's decision to uphold the constitutionality of the Indiana statute.[45] Nevada's control share law operates by providing that an "acquiring person" and its associates obtain voting rights in "control shares" only to the extent conferred by a vote of the stockholders. The statute also provides for redemption of control shares in certain circumstances.

Nevada also has had a business combination law on the books since 1991. This law, like the control share law, is patterned after Indiana's statute. Generally, the law operates to prohibit certain combinations between a corporation and an interested stockholder for a three-year period. After this three-year moratorium, combinations with an interested stockholder are permitted if certain qualitative and quantitative conditions are met. California is among the minority of states that has not adopted either a control share or business combination law.[46]

California's Extraterritorial Reach

In deciding whether to advise clients to incorporate outside of California, practitioners must consider the California statutes that purport to impose various provisions of the state's General Corporation Law on foreign corporations. Corporations Code Section 2115, the most far-reaching of these statutes, has been a part of California's General Corporation Law since the law was enacted more than a quarter century ago. The logic behind Section 2115 is straightforward: If a foreign corporation has a majority of its contacts with California, then California has an interest in applying its corporate laws to the corporation even if that corporation has been organized in another state.[47]

The tests that California has established to implement this premise are also straightforward. Essentially there are two. The first test is met when persons having addresses in California hold more than 50 percent of the corporation's outstanding voting securities. The second test focuses on where a corporation does most of its business. This test is met when the average of the corporation's payroll, property, and sales factors are more than 50 percent for the latest full income year. These

factors are reported on the corporation's California franchise tax return.[48]

If both of these tests are met, then Section 2115 specifies numerous provisions of the General Corporation Law that will apply to the corporation "to the exclusion of the law of the jurisdiction in which it is incorporated." These include provisions relating to directors (i.e., annual election, removal, filling of vacancies, standard of care, indemnification, and liability for improper distributions to shareholders); limitations on corporate distributions; shareholders (i.e., liability for unlawful distributions, annual meeting requirement, cumulative voting, limitations on supermajority voting); corporate transactions (i.e., limitations on sales of assets, mergers and conversions, requirements for conversions, reorganizations, and dissenters' rights); records and reports; and rights of inspection. In addition, Section 2115 subjects a foreign corporation to the possibility of suit by the California attorney general for violations of specified provisions of the General Corporation Law.

While Section 2115 is the most expansive of California's outreach statutes, it is not the only provision of the General Corporation Law that requires the application of California law. Thus, California's statute governing inspection of the share register is available to shareholders of a foreign corporation that has its principal executive offices in California or that customarily holds meetings of its board of directors in California.[49] California extends to directors of the same foreign corporations the absolute right to inspect corporate records.[50] In addition, California provides shareholders of a foreign corporation the right to inspect accounting books and records and corporate minutes if the corporation maintains those records or its principal executive offices in California.[51] Finally, California's requirement that a corporation provide an annual report to its shareholders is applicable to a foreign corporation that either maintains its principal executive office in or customarily holds meetings of its board of directors in California.[52]

To the extent that any of these California outreach statutes applies, a corporation organized in Nevada may be subject to the very California law provisions that it is seeking to escape—including cumulative voting, for example. Recently, the Delaware Supreme Court refused to apply Section 2115 based on the "internal affairs doctrine,"[53] which requires that the law of the state of incorporation govern the internal affairs of a corporation. While this decision strongly suggests that the Delaware courts will pay little respect to California's outreach statutes, it is not the last word. Indeed, at least one legal scholar criticizes the Delaware Supreme Court's decision and argues that it is intended not so much to persuade but "to deter other states, such as California and New York, from seeking to regulate the affairs of Delaware entities, or, in the alternative, to create the very conditions which might convince federal actors to prevent other states from doing so."[54]

California courts are likely to be more deferential to California law. Moreover, it remains to be seen whether the courts will conclude that every California corporate statute imposed on a foreign corporation involves the corporation's "internal affairs."[55] In the meantime, practitioners should be braced for races to the courthouse.

In most cases, Section 2115 will be a source of concern for privately held corporations, for two reasons. First, a privately held corporation located in California will more likely satisfy the criteria for the application of the statute. Second, Section 2115 does not apply to corporations that either have outstanding securities listed on the New York Stock Exchange or the American Stock Exchange or are designated as qualified for trading on the Nasdaq National Market.[56]

Proponents of incorporating in Nevada often tout the fact that Nevada has no corporate income tax.[57] Accordingly, some business owners may be led to believe that they can avoid paying California franchise tax

simply by incorporating their California business in Nevada. However, this is pure codswallop. A business that has business income from sources both within and outside California is required to apportion its income and pay California tax. The portion of the corporation's total income that has its source in California is determined under Revenue and Taxation Code Sections 25120 through 25141. In addition, a corporation with a California "commercial domicile" is subject to California tax on any income that is not subject to apportionment.[58] Thus, a corporation that does business in California cannot escape California taxation by incorporating in another state. The California Franchise Tax Board is well aware of the use of Nevada corporations to avoid California tax and has even published a form titled "Don't Gamble with Your Taxes: Read the Fine Print about Incorporating in Nevada."[59]

California remains a popular chartering state for privately held firms located in California. However, it has proven remarkably ineffectual in retaining the charters of publicly traded corporations located in the state. While Delaware continues to attract an overwhelming percentage of these emigrant corporations, Nevada has established itself as a viable second choice. Because the reasons for going out of state will vary from firm to firm, there is no single right answer to the question of where a business should incorporate. For those firms looking for a significantly different approach to California, a Nevada corporate charter is worth considering. ■

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[1] Lucian Bebchuk & Alma Cohen, *Firms Decisions Where to Incorporate*, 46 J. LAW & ECON. 383, 392-93 (2003). The data produced by these two authors show that in the case of California headquartered, publicly traded corporations, Delaware as of the end of 1999 represented over 91 percent of the out-of-state charters.

[2] Despite achieving second place, Nevada still lags far behind Delaware. Nevada claims only 2.66% of out-of-state, publicly traded corporations. Yet, this places Nevada significantly ahead of California, which claims a minuscule .19% of out-of-state publicly traded corporations. *Id.* at 395. During the periods of 1980 to 1989 and 1990 to 1999, Nevada also ranked a distant second behind Delaware (and well ahead of California) in attracting incorporations among a sample of initial public offerings. Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1583 (2002).

[3] Bebchuk & Cohen, *supra* note 1, at 392-93.

[4] CAL. CONST. of 1849, art. IV, §36.

[5] Article XII of the 1879 Constitution devoted 16 sections specifically to corporations in general and another seven to railroad and transportation companies.

[6] CAL. CONST. of 1879, art. XII, §3.

[7] *Id.* at art. XII, §9.

[8] Henry W. Ballantine, *Questions of Policy in Drafting a Modern Corporation Law: California General Corporation Law (1931)*, 19 CAL. L. REV. 465, 466 (1931).

[9] NEV. CONST. art. 8, §3.

[10] California's General Corporation Law prescribes the standard of care for directors but not officers. HAROLD MARSH, JR., R. ROY FINKLE, & LARRY SONSINI, MARSH'S CALIFORNIA CORPORATION LAW §11.02 (4th ed. 2001) ("The statute does not purport to specify the duties of officers of a corporation…."). However, some statutory standards applicable to officers can be found in statutes governing the relationships between principal and agent. *See, e.g.*, LAB. CODE §§2850-66 (governing the obligations of employees to employers).

[11] 1999 Nev. Stat. ch. 357. *See* Minutes of the Nevada Senate Committee on Judiciary, Feb. 3, 1999, Exhibit D.

[12] CORP. CODE §309.

[13] *See* Gaillard v. Natomas Co., 208 Cal. App. 3d 1250, 1264 (1989) (incorrectly describing Corporations Code §309 as "codifying California's business judgment rule"); MARSH, FINKLE & SONSINI, *supra* note 10, at §11.03[A] ("[I]t is highly doubtful that the California courts will hold that [Section 309] was intended to abolish the business judgment rule…."). *See also* 1975 Assembly Committee Comment to Section 309: "It is intended that a person who performs his duties as a director in accordance with this standard shall have no liability by reason of being or having been a director."

[14] NEV. REV. STAT. §78.138(3).

[15] NEV. REV. STAT. §78.138(7), *added by* S.B. 577, 2001 Nev. Stat. ch. 601.

[16] 2003 Nev. Stat. ch. 485.

[17] CORP. CODE §§204(a)(10), 309(c).

[18] CORP. CODE §204(a)(10).

[19] Sanjai Bhagat & James A. Brickley, *Cumulative Voting: The Value of Minority Shareholder Voting Rights*, 27 J.L. & ECON. 339 (1984).

[20] Ralph E. Axley, *The Case against Cumulative Voting*, 1950 WIS. L. REV. 278 (1950).

[21] CAL. CONST. of 1879, art. XII, §12 (repealed).

[22] Ballantine, *supra* note 8, at 484.

[23] MARSH, FINKLE & SONSINI, *supra* note 10, at §12.02. California's attachment to cumulative voting is so strong that governmental bodies are statutorily obligated to vote for resolutions authorizing cumulative voting. GOV'T CODE §6900.

[24] NEV. REV. STAT. §78.360. Delaware takes a similar opt-in approach to cumulative voting. DEL. CODE ANN., tit. 8, §214.

[25] 1989 Cal. Stat. ch. 876, §2 (adding CORP. CODE §301.5).

[26] CORP. CODE §301.5(d). On January 13, 2006, the Securities and Exchange Commission issued an order approving the application of the Nasdaq Stock Market, Inc., to register one of its subsidiaries, The Nasdaq Stock Market LLC, as a national securities exchange. SEC Rel. No. 34-53128, 71 FR 3550 (Jan. 13, 2006). As the successor to the Nasdaq Stock Market, NASDAQ Stock Market LLC has operated as a national securities exchange since August 1, 2006. In addition, the Nasdaq National Market was renamed the NASDAQ Global Market effective July 1, 2006. The NASDAQ Global Market now contains two tiers: NASDAQ Global Market and NASDAQ Global Select Market. California has not yet amended the statute to reflect these changes.

[27] CORP. CODE §301.5(a).

[28] For an in-depth discussion of the history and role of supermajority voting rules, *see* Brett W. King, *The Use of Supermajority Voting Rules in Corporate America: Majority Rule, Corporate Legitimacy, and Minority Shareholder Protection*, 21 DEL. J. CORP. L. 895 (1996).

[29] NEV. REV. STAT. §78.320(1). However, there is some question about the effectiveness of placing supermajority voting provisions in the bylaws alone.

[30] CORP. CODE §204(a)(5).

[31] *Id.* A supermajority vote requirement (not to exceed 66⅔%) may be imposed for a class or series of preferred

shares designated as "preferred" or "preference" regarding voluntary dissolution. CORP. CODE §402.5.

[32] CORP. CODE §710. The determination of the number of persons holding shares of record must be made in accordance with Corporations Code §605.

[33] CORP. CODE §710(c). This exception was added at the request of the Business Law Section of the California State Bar for the purpose of allowing supermajority vote provisions in late round venture capital financings. S.B. 497 (Beverly), California Senate Floor Analysis, Apr. 13, 1993, *available at* http://www.leginfo.ca.gov/pub/93-94/bill/sen/sb_0451-0500/sb_479_cfa_930413_111241_sen_floor.

[34] Martin Lipton fathered the stockholder rights plan in 1982 with the publication of a memorandum titled "Warrant Dividend Plan." Martin Lipton & Paul K. Rowe, *Pills, Polls and Professors: A Reply to Professor Gilson*, 27 DEL. J. CORP. L. 1, 9 (2002).

[35] Moran v. Household Int'l, Inc., 490 A. 2d 1059, 1066 (Del. Ch. 1985).

[36] Over the years, the Nevada Legislature has made minor refinements to the wording of the statute. For example, the phrase "or grants rights" was added in 2001 for the apparent purpose of clarifying that discrimination could be either positive or negative. 2001 Nev. Stat. ch. 296, §10. In 2003, the legislature substituted the word "signing" for "executing," even though directors do not typically execute or sign stockholder rights plans qua directors. 2003 Stat. ch. 485, §27.

[37] *See* Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence of the "Race" Debate and Antitakeover Overreaching*, 150 U. PENN. L. REV. 1795, 1813-14 (2002) (listing 24 other states with statutory endorsement of shareholder rights plans).

[38] The reference in the statute to a "shareholders agreement" is not to any agreement among or with the shareholders. Rather, the term means a written agreement among all the shareholders of a close corporation, or if a close corporation has only one shareholder, between that shareholder and the corporation. CORP. CODE §186.

[39] For example, Cisco Systems, Inc., a California corporation, adopted a shareholder rights plan in 1998 that it terminated in 2005. Securities & Exchange Commission Form 8-K (filed Mar. 30, 2005).

[40] In 1997 Emeritus Corporation filed an action for injunctive and declaratory relief against ARV Assisted Living, Inc., challenging the validity of its shareholder rights plan. Among other things, the complaint alleged that the rights plan violated Corporations Code §§203 and 400 "in that under the terms of the pill [rights plan] all shares of ARV are not granted the same rights, preferences, privileges and restrictions." Emeritus Corp. v. ARV Assisted Living, Inc., O.C. Super. Ct. Case No. 787788 (Dec. 9, 1997), filed as an exhibit to Schedule 14d-1 by Emeritus Corporation with the Securities and Exchange Commission, Dec. 19, 1997, *available at*: http://www.sec.gov/Archives/edgar/data/949322/0000950103-97-000758.txt. The lawsuit did not result in a reported decision addressing the validity of shareholder rights plans.

[41] Unocal Corp. v. Mesa Petroleum Co., 493 A. 2d 946 (Del. 1985).

[42] Hilton Hotels Corp. v. ITT Corp., 978 F. Supp. 1342 (D. Nev. 1997). *See* Keith Paul Bishop, *Battle for Control of ITT Corporation Spotlights Nevada (and Delaware) Corporate Law: Did Nevada Law Get Stockholders a Better Deal?* 12 INSIGHTS 15 (1998).

[43] 1999 Nev. Stat. ch. 357, §58.

[44] *See* Minutes of the Nevada Senate Committee on Judiciary, Feb. 3, 1999 ("Both standards are established under Delaware law. Mr. Fowler [chairman, Business Law Section, State Bar of Nevada] stated they wanted to make sure that the directors did not have this higher duty in a take-over situation unless they take an action

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that might impede the right of stockholders to vote for or against their staying in office as directors. He said he thought the directors should have the benefit of the business judgment rule until they do something that might impede the right of stockholders to vote for directors.").

[45] CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 107 S. Ct. 1637 (1987). The Indiana statute is often referred to as a "second generation" of takeover statute. The "first generation" antitakeover statutes generally operated by requiring disclosure of specific information and slowing down the process. *See* Edgar v. MITE Corp., 457 U.S. 634 (1982) (striking down the first generation Illinois antitakeover law).

[46] *See* Subramanian, *supra* note 37, at 1813-14 (listing 27 states with control share laws).

[47] California's General Corporation Law establishes an elaborate taxonomy of corporations. A "domestic corporation" is a corporation formed under the laws of California. CORP. CODE §162. The term "foreign corporation" generally refers to any corporation other than a domestic corporation. CORP. CODE §171. The term "corporation" is also frequently used and defined to mean only a corporation organized under the California General Corporation Law (as opposed, for example, to corporations organized under California's nonprofit corporations law) and certain other domestic corporations. CORP. CODE §162.

[48] The factors are fractions defined in California's Revenue and Taxation Code that are used to apportion taxes when a corporation has business activities that are taxable in California as well as outside California. *See* text, *infra*. Thus, a corporation's "property factor" is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in California during the taxable year, and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the taxable year. A corporation's "payroll factor" is a fraction, the numerator of which is the total amount paid in California during the taxable year by the corporation for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year. REV. & TAX CODE §25132. A corporation's "sales factor" is a fraction, the numerator of which is the total sales of the corporation in California during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year. REV. & TAX CODE §25134.

[49] CORP. CODE §1600(d).

[50] CORP. CODE §1602.

[51] CORP. CODE §1601(a).

[52] CORP. CODE §1501(g).

[53] VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A. 2d 1108 (Del. 2005).

[54] Timothy Glynn, *Delaware's Vantagepoint: The Empire Strikes Back in the Post-Post-Enron Era*, 102 NW. U. L. REV. 91, 95 (2008).

[55] *See* Keith Paul Bishop, *The War between the States—Delaware's Supreme Court Ignores California's Corporate Outreach Statute*, 19 INSIGHTS 19 (July 2005).

[56] CORP. CODE § 2115(c). *See* note 26, *supra* (California has not yet updated the Corporations Code to reflect the conversion of Nasdaq to an exchange.).

[57] The Nevada Secretary of State Web site cites the lack of corporate income taxes in response to the question, "Why incorporate in Nevada?" *See* http://sos.state.nv.us/business/comm_rec/whyinc.asp.

[58] "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed. REV. & TAX. CODE §25120(b).

[59] *Available at* http://www.ftb.ca.gov/forms/misc/689.pdf.