



JONES DAY
COMMENTARY

AMENDMENTS TO OHIO'S BUSINESS ENTITY STATUTES EFFECTIVE IN OCTOBER 2006

Ohio House Bill 301, which will become law on October 9, 2006, is intended to improve Ohio's business entity laws and to make Ohio more user-friendly as a home for businesses. Existing corporations may need to amend their existing regulations to take advantage of some of the new flexibility. In particular, a public company that is submitting its preliminary proxy for SEC review should consider making changes (which should not be controversial) to take advantage of a number of these new provisions.

Most of the provisions of House Bill 301 were developed by the volunteer lawyers who serve on the Corporation Law Committee of the Ohio State Bar Association,¹ including Jones Day lawyers David Porter (vice chair), Jeanne Rickert (a past chair), Randy Walters, and Jennifer Lewis.

House Bill 301 contains provisions, discussed in more detail herein, that:

1. Give directors authority to amend regulations, with some limitations (existing corporations may need to opt in).
2. Allow spinoffs without a shareholder vote.
3. Permit holding company formations without a shareholder vote.
4. Allow conversions from one form of entity to another.
5. Clarify that directors may delegate option grant authority to officers.
6. Clarify that board committees may create sub-committees that have broad authority.
7. Allow SEC reports to serve as notice of board-adopted amendments to the articles.
8. Broaden the types of consideration for which shares and limited liability membership interests may be issued.
9. Allow corporate actions to be taken by bankruptcy court decree in liquidation proceedings as well as in reorganizations.

10. Limit the fiduciary duties of those who provide goods or services to business entities.²
11. Allow reliance on corporate good-standing certificates for up to seven days (helping to resolve legal opinion issues).
12. Require notice to the Ohio Division of Securities of material changes to tender offers.
13. Allow regulations of the Ohio Division of Securities to change automatically with SEC rule changes.
14. Clarify aspects of partnership law.

The text of the bill is available at http://www.legislature.state.oh.us/bills.cfm?ID=126_HB_301.

DIRECTORS' AUTHORITY TO AMEND REGULATIONS

Ohio has long stood apart from other states by requiring changes to the regulations (commonly called “bylaws” elsewhere) to be approved by shareholders. In a change that reflects a compromise between retention of Ohio’s historically shareholder-centric standards and a total shift to the more board-controlled practices common in other states, House Bill 301 allows shareholders to grant the directors authority to amend corporate regulations.³ However, directors cannot be authorized to amend provisions of the regulations that:

- Specify the percentage of shares a shareholder must hold in order to call a shareholders’ meeting.⁴
- Specify the length of the time period required for notice of a shareholders’ meeting.⁵
- Specify that shares that have not yet been fully paid can have voting rights.⁶
- Specify requirements for a quorum at a shareholders’ meeting.⁷
- Prohibit shareholder or director actions from being authorized or taken without a meeting.⁸
- Define terms of office for directors or provide for classification of directors.⁹
- Require greater than a majority vote of shareholders to remove directors without cause.¹⁰
- Establish requirements for a quorum at directors’ meetings, or specify the required vote for an action of the directors.¹¹
- Delegate authority to committees of the board to adopt, amend, or repeal regulations.¹²

- Remove the requirement that a control share acquisition of an issuing public corporation be approved by shareholders of the acquired corporation.¹³

These limitations restrict directors’ ability to enact amendments that, in the view of the drafters of House Bill 301, could significantly alter the relative power of the shareholders versus the directors in corporations, or among shareholder groups. On the other hand, directors can make amendments relating to important but primarily ministerial or procedural issues, such as allowing the use of electronic proxies, fixing the date and location of meetings, or requiring notice of nominations or shareholder proposals. In no event can directors make changes to regulations to restrict the shareholders’ authority to adopt, amend, or repeal regulations.¹⁴

Before relying on House Bill 301 to permit director amendments to the regulations, an Ohio corporation should check its regulations. Many will find that their regulations set forth amendment provisions that recite the pre-House Bill 301 statutory standard that limited amendments to those adopted by shareholders. Those provisions must themselves be amended by shareholders to opt in to the new authorization of director amendments.

New corporations may include provisions in their regulations to opt in to the new provisions.

SPINOFFS WITHOUT SHAREHOLDER VOTE

Spinoffs are popular capital markets transactions that allow a public corporation to become more focused on its core competencies by separating unlike businesses or maximizing shareholder value through higher valuations for the several business parts as opposed to the consolidated whole. The distribution of shares of a subsidiary to the shareholders of the parent company can raise issues under Ohio’s statutory provisions regulating the “sale of all or substantially all” of the corporation’s assets. Ohio’s asset sale provisions apply to any “transfer, or other disposition” of assets¹⁵ and could be read broadly to require shareholder approval of many spinoffs. The small number of cases construing the Ohio statute also made it hard to apply. This sometimes resulted in spinoffs being problematic for Ohio corporations.

House Bill 301 amends Section 1701.76 to allow an “issuing public corporation”¹⁶ to spin off a subsidiary business to holders of shares in the issuing public corporation without shareholder approval.¹⁷ Two exceptions could require shareholder approval: first, if a spinoff is part of a larger transaction that includes another change that would require approval by the shareholders,¹⁸ and second, if the issuing public corporation has more than one class of shares outstanding immediately prior to the spinoff.¹⁹

HOLDING COMPANY FORMATION WITHOUT SHAREHOLDER APPROVAL

A holding company restructuring transaction is a useful mechanism for facilitating the disposition of corporate assets, better matching asset ownership with asset management, or providing greater protection against liability exposure between operating subsidiaries. Under amendments to the Delaware General Corporation Law adopted several years ago, Delaware corporations were enabled to create new holding companies without shareholder approval and without triggering dissenters’ rights.²⁰ Like Delaware’s prior laws, Ohio’s merger provisions pre-House Bill 301 required shareholder approval and provided for dissenters’ rights for these transactions. This made it harder and more expensive for corporations to enter into holding company restructuring transactions in Ohio, putting Ohio corporations at a relative disadvantage.

After House Bill 301 becomes effective, Ohio corporations can effect a holding company reorganization without shareholder approval and without triggering dissenters’ rights, provided that five basic requirements intended to ensure continuity of shareholder rights are met.²¹ These requirements are comparable to those that apply in Delaware.

CONVERTING FROM ONE FORM OF ENTITY TO ANOTHER

At different stages of a business’s development, different business entity structures present various advantages and disadvantages. As limited liability companies have become more popular, states have sought to simplify the statutory mechanisms for changing from one form of entity to another.

Until now, Ohio required a merger to change the old entity into its new form. House Bill 301 provides procedures for business entities to convert between organizational forms. Conversions are specifically permitted for for-profit corporations,²² limited liability companies,²³ limited partnerships,²⁴ and partnerships.²⁵ No changes were made to chapter 1702, so there is no conversion mechanism into or from a nonprofit corporation.

Dissenters’ rights may apply, unless otherwise restricted, as permitted by the statute.²⁶ The legal consequences of conversion are the same as what occurs in a merger or consolidation.²⁷ Conversions are effected by filing with the Secretary of State’s office.²⁸ The provisions for fees chargeable for conversions do not become effective until April 10, 2007, but the Secretary of State’s office has committed to effect conversions prior to that on a temporary fee schedule.

CLARIFYING OPTION GRANT AUTHORITY OF OFFICERS

Delaware corporate law authorizes directors to delegate to officers the authority to grant employee stock options.²⁹ House Bill 301 amends Section 1701.17 to expressly authorize directors of Ohio corporations to delegate the authority to issue employee stock options. The directors must specify the total number of shares or options the officers may issue and the terms of those shares or options.³⁰ The authorized officer may not designate himself or herself as the recipient of any shares or options.³¹ These provisions parallel Delaware law.³² Corporations should take care when using these provisions, as abuse of this discretionary authority has been blamed for some cases of “option backdating” that raise serious accounting and legal issues.

BOARD SUBCOMMITTEES WITH BROAD AUTHORITY

House Bill 301 amends Section 1701.63 to allow a committee to subdivide itself into subcommittees with any or all of the committee’s power and authority. This power can be limited in the articles and regulations or by board resolution. This provision parallels a recent amendment to Delaware law.³³

SEC REPORTS CAN SERVE AS NOTICE OF BOARD-ADOPTED AMENDMENTS TO THE ARTICLES

If directors amend the articles of an Ohio corporation without a shareholder vote, the corporation is required under Section 1701.73 to send notice to all shareholders within 20 days of the amendment.³⁴ House Bill 301 allows companies that file periodic public reports with the SEC under Sections 13 and 15(d) of the Securities Exchange Act of 1934 (“’34 Act”) to meet these notice provisions through those filings.³⁵ For corporations with a large number of shareholders, this is more cost-effective than providing individual notice to each shareholder.

CONSIDERATION FOR SHARES AND LLC MEMBERS’ INTERESTS

Historically in Ohio, shares could not be issued in exchange for future services (a signing bonus) or the prospective value of a relationship. Ohio’s provisions were more restrictive than those of many other states.³⁶

House Bill 301 amends Section 1701.18 to allow for a broader range of acceptable consideration for shares. Accordingly, it allows “cash, property, services rendered, a promissory note, or any other binding obligation to contribute cash or property or to perform services; the provision of any other benefit to the corporation; or any combination of these” as valid consideration for shares.³⁷ Valuation of the benefit to the corporation is left to the directors.³⁸ Limited liability companies can also accept any of these forms of consideration in exchange for membership interests.³⁹

CORPORATE ACTIONS IN ACCORDANCE WITH BANKRUPTCY COURT ORDERS

Under Section 1701.75, companies undergoing reorganization in bankruptcy proceedings can accomplish director or shareholder actions under a plan of reorganization. House Bill 301 broadens Section 1701.75 to permit corporate activity under any order or decree from a U.S. bankruptcy court without director or shareholder approval, thus expanding Section 1701.75 to include liquidations as well as reorganizations.⁴⁰

LIMITATION OF FIDUCIARY DUTIES FOR SUPPLIERS OR SERVICE PROVIDERS TO BUSINESS ENTITIES

In *Arpadi v. First MSP Corp.*,⁴¹ the Ohio Supreme Court held that attorneys for a general partnership owe a fiduciary duty to the partnership’s limited partners.⁴²

House Bill 301 presents a direct legislative response to *Arpadi*.⁴³ Section 1782.65(A) provides that, absent an agreement to the contrary, a supplier of goods or services for a limited partnership owes no duty to the general partners, limited partners, or creditors of a limited partnership by reason of providing those goods or services. Similarly, Section 1782.65(B) provides that, absent an agreement to the contrary, a person supplying goods or services to a general or limited partner owes no duty to the limited partnership, any other general or limited partners of the limited partnership, or creditors of the limited partnership by reason of providing those goods or services. This amendment is consistent with the Restatement (Third) of the Law Governing Lawyers.⁴⁴

RELIANCE ON CERTIFICATES OF GOOD STANDING

House Bill 301 amends Section 1701.92 to define “good standing” and to allow reliance on a certificate of good standing issued by the Secretary of State.⁴⁵ It provides that a person may legally rely on a certificate of good standing for a period of seven days after the date on the certificate, provided the person had no knowledge that the corporation’s articles had been canceled⁴⁶ and the certificate is not presented as evidence against the state. This makes it easier to complete closings because it provides a window of time during which reliance on the certificate is legally justified, eliminating the possible need for constant checking with, and obtaining “bring-down” certificates from, the Secretary of State and the tax division.

NOTICE TO OHIO DIVISION OF SECURITIES OF MATERIAL CHANGE TO A TENDER OFFER

Existing Ohio law requires tender offerors to provide certain information to the Ohio Division of Securities upon commencement of the tender offer (control bid).⁴⁷ House Bill

301 requires an additional filing when, in connection with a control bid for any securities of a company, an offeror alters the percentage of the class of securities being sought, the consideration offered, or the dealer's soliciting fee, or makes any other change that triggers a federal law requirement to hold the offer period open for at least 10 business days from the date notice of such change is first published or sent to securityholders.⁴⁸ This information must be delivered to the Division of Securities and to the target company no later than the date the offeror informs offerees of the change.⁴⁹ If the Division of Securities finds the information given to offerees to be incomplete (within three calendar days of the date of filing), it may suspend the control bid.⁵⁰ If the division suspends the control bid, it is required to schedule and hold a hearing within three calendar days.⁵¹

ALLOWING OHIO SECURITIES RULES TO CHANGE AUTOMATICALLY WITH SEC RULE CHANGES

House Bill 301 incorporates aspects of Sections 15 and 17 of the '34 Act into Ohio securities law. If a dealer is required to be licensed,⁵² it must comply with requirements found in Sections 15 and 17 of the '34 Act and the rules of the SEC promulgated thereunder.⁵³ Any reports or documents required by Sections 15 and 17 of the '34 Act must also be filed with the Division of Securities,⁵⁴ unless the dealer has already filed the reports or documents with the SEC and the division has not otherwise ordered.⁵⁵ If a dealer is not required by federal or Ohio law to be registered with the SEC, the division may permit (but not require) the dealer: (1) to elect at least one alternative financial and reporting provision acceptable to the division, and (2) to elect an exemption of acceptable scope from all or part of the applicable requirements found in Sections 15 and 17 of the '34 Act and the rules of the SEC promulgated under those Sections.⁵⁶ In determining the acceptable scope of the exemption, the division must consider the size, scope, and type of business of the dealers and the protection of those dealers' customers.⁵⁷

In what proved to be the most controversial provision of the bill as it proceeded through the Legislature, the Division of Securities has been authorized to incorporate by reference any federal statute or any SEC (or any federal agency) rule, regulation, or form including future amendments to the federal statutes, rules, regulations, or forms.⁵⁸ Furthermore,

liabilities, penalties, sanctions, or disqualifications found in Sections 1707.01 through 1707.45 do not apply to good faith acts or omissions that conform with either: (1) provisions in Sections 1707.01 through 1707.45 that incorporate by reference federal provisions, or (2) any rule, form, or order of the division that incorporates federal provisions.⁵⁹ This "good faith exception" applies even if the incorporation by reference, or any application of the incorporated provision, is later found to be unconstitutional or otherwise invalid.⁶⁰

CLARIFYING ASPECTS OF PARTNERSHIP LAW

House Bill 301 amends the merger provisions of chapter 1775 to change the terms "general partner" and "general partnership" to "partner" and "partnership," respectively, to make it explicitly clear that the merger provisions are available to LLPs as well as traditional partnerships.⁶¹

House Bill 301 also expands protection for limited liability partnerships beyond malpractice liability protection to include protection for contractual liability, making Ohio a "full shield" state.⁶²

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NOTES

1. The provisions of House Bill 301 that address the decision of the Ohio Supreme Court in *Arpadi v. First MSP Corp.*, 68 Ohio St. 3d 453 (1994), discussed *infra* at note 41 and the accompanying text, and changing the LLP protection to “full shield” were not changes proposed by the Corporation Law Committee.
2. These provisions are intended to override the *Arpadi* decision.
3. Ohio Rev. Code Sec. 1701.10(A), 1701.11(A)(1).
4. Ohio Rev. Code Sec. 1701.40(A)(3). The default percentage of outstanding shares a shareholder or group of shareholders must hold in order to call a shareholders’ meeting is 25 percent but can be modified to as high as 50 percent by the articles or the regulations.
5. Ohio Rev. Code Sec. 1701.41(A).
6. Ohio Rev. Code Sec. 1701.44(B).
7. Ohio Rev. Code Sec. 1701.51.
8. Ohio Rev. Code Sec. 1701.54(A).
9. Ohio Rev. Code Sec. 1701.57(A), (B).
10. Ohio Rev. Code Secs. 1701.57 and 1701.58(A).
11. Ohio Rev. Code Sec. 1701.62.
12. Ohio Rev. Code Sec. 1701.63.
13. Ohio Rev. Code Sec. 1701.81.
14. Ohio Rev. Code Sec. 1701.11(B). The previous version of Section 1701.11(B)(10) allowed regulations to define, limit, or regulate the exercise of authority by the corporation, directors, officers, or all shareholders. The amendments remove shareholders from that group. New Section 1701.11(B)(11) permits regulations that define, limit, or regulate the exercise of authority by shareholders but provides that regulations that change or eliminate shareholder authority can be adopted only by shareholders.
15. Ohio Rev. Code Sec. 1701.76(A).
16. “ ‘Issuing public corporation’ means a domestic corporation with fifty or more shareholders that has its principal place of business, its principal executive offices, assets having substantial value, or a substantial percentage of its assets within this state, and as to which no valid close corporation agreement exists under division (H) of Section 1701.591 of the Revised Code.” Ohio Rev. Code Sec. 1701.01(Y).
17. Ohio Rev. Code Sec. 1701.76(F).
18. Ohio Rev. Code Sec. 1701.76(F)(1). Such a transaction might be a “reverse Morris Trust transaction,” in which a spinoff of a subsidiary occurs followed immediately by a merger of the spun-off entity with a third party.
19. Ohio Rev. Code Sec. 1701.76(F)(2).
20. See Delaware General Corporation Law § 251(g).
21. Ohio Rev. Code Sec. 1701.802(B). The five requirements are:
 - (1) The parent company and the wholly owned subsidiary are the only entities in the merger;
 - (2) Each outstanding share in the parent corporation before the merger is converted into a share in the holding company with the same material terms;
 - (3) The articles and regulations of the holding company after the merger are not materially different from the parent corporation’s;
 - (4) As a result of the merger, the parent becomes a wholly owned subsidiary of the holding company; and
 - (5) The parent corporation’s directors are the directors of the holding company after the merger.
22. Ohio Rev. Code Secs. 1701.782 (conversion from a business entity, other than a domestic corporation or nonprofit corporation, to a domestic corporation) and 1705.792 (conversion from a domestic corporation to a domestic or foreign business entity, other than a domestic corporation or nonprofit corporation).
23. Ohio Rev. Code Secs. 1705.361 (conversion from a domestic or foreign business entity (not a domestic limited liability company) to a domestic limited liability company) and 1705.371 (conversion from a domestic limited liability company to a domestic or foreign business entity (not a domestic limited liability company)).
24. Ohio Rev. Code Secs. 1782.438 (conversion from a domestic or foreign business entity (not a domestic limited partnership) to a domestic limited partnership) and 1782.439 (conversion from a domestic limited partnership to a domestic or foreign business entity (not a domestic limited partnership)).
25. Ohio Rev. Code Secs. 1775.53 (conversion from a domestic or foreign business entity (not a domestic partnership) to a domestic partnership) and 1775.54 (conversion from a domestic partnership to a domestic or foreign business entity (not a domestic partnership)).
26. Ohio Rev. Code Secs. 1701.84-85 (corporations), 1705.40-42 (limited liability companies), 1775.50-51 (partnerships), and 1782.435-437 (limited partnerships).

27. Ohio Rev. Code Secs. 1701.821 (corporations), 1705.391 (limited liability companies), 1775.56 (partnerships), and 1782.4311 (limited partnerships).
28. Ohio Rev. Code Secs. 111.16(D) (fee for filing and recording a certificate of conversion) and 111.16(K)(2) (fee for creating and affixing the seal of the Secretary of State); 1701.811 (corporation conversion certificate filing requirement); 1705.381 (limited liability company conversion certificate filing requirement); 1775.55 (partnership conversion certificate filing requirement); and 1782.4310 (limited partnership conversion certificate filing requirement).
29. See Delaware General Corporation Law § 157(c).
30. Ohio Rev. Code Sec. 1701.17(B).
31. Ohio Rev. Code Sec. 1701.17(C).
32. See Delaware General Corporation Law § 157(c).
33. See Delaware General Corporation Law § 141(c)(3).
34. Ohio Rev. Code Sec. 1701.73(A).
35. Ohio Rev. Code Sec. 1701.73(A)(3).
36. See Delaware General Corporation Law § 152.
37. Ohio Rev. Code Sec. 1701.18(A).
38. Ohio Rev. Code Sec. 1701.19(A), (B).
39. Ohio Rev. Code Sec. 1705.09 (contributions of “any . . . benefit to the limited liability company” suffice).
40. Ohio Rev. Code Sec. 1701.75(A).
41. 68 Ohio St. 3d 453 (1994).
42. *Id.* at 454.
43. The Ohio Legislature tried to address *Arpadi* when it amended Section 1782.08(B) (now Section 1782.08(C)), stating flatly that “[a] limited partnership is an entity[.]” Ohio courts, however, did not consider *Arpadi* overruled. See, e.g., *Geran v. Westfield Ins. Co.*, 2002 WL 360714 (Ohio App. Lucas Mar. 8, 2002) (citing *Arpadi* for the proposition that a partnership is an aggregation of individuals and not a separate entity).
44. See Restatement (Third) of the Law Governing Lawyers § 51 cmt. H, reporter’s note (2000).
45. House Bill 301 provides that the certificate of good standing is conclusive evidence that:
 - (1) A domestic corporation’s authority has not been limited under dissolution provisions, as long as:
 - (a) The person relying on the certificate had no knowledge that the articles had been canceled, and
 - (b) The certificate is not presented as evidence against the state; and
 - (2) A foreign corporation’s license to transact business in Ohio has not expired, been canceled, or been surrendered.
46. Ohio Rev. Code Sec. 1701.92(D).
47. Ohio Rev. Code Sec. 1707.041.
48. Ohio Rev. Code Sec. 1701.041(A)(5)(a).
49. Ohio Rev. Code Sec. 1707.041(A)(5)(b).
50. Ohio Rev. Code Sec. 1707.041(A)(6).
51. Ohio Rev. Code Sec. 1707.041(A)(7).
52. See Ohio Rev. Code Sec. 1707.14.
53. Ohio Rev. Code Sec. 1707.142(A).
54. Ohio Rev. Code Sec. 1707.142(B)(1).
55. Ohio Rev. Code Sec. 1707.142(B)(2).
56. Ohio Rev. Code Sec. 1707.142(C)(1) and (C)(2).
57. Ohio Rev. Code Sec. 1707.142(D).
58. Ohio Rev. Code Sec. 1707.20(A)(2).
59. Ohio Rev. Code Sec. 1707.20(E)(2).
60. *Id.*
61. Ohio Rev. Code Sec. 1775.45-52.
62. Ohio Rev. Code Sec. 1775.14.

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