



NORTH DAKOTA CORPORATE GOVERNANCE COUNCIL

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Overview of New Chapter 10-35, N.D.C.C.

Purpose of Chapter 10-35

- The ultimate goal in enacting Chapter 10-35 is to improve the performance of publicly traded companies. Academic studies are increasingly demonstrating a clear link between improved corporate governance and improved performance. Thus, enactment of Chapter 10-35 is fundamentally a pro-business initiative.
- Virtually everyone is a shareholder today – either directly or indirectly (through 401K's and similar plans, state or union pension funds, life insurance products, etc.). So we all have a stake in improved corporate performance.
- Continued attention to issues of corporate governance is needed – and inevitable – because the “Wall Street Walk” is no longer an option for many institutional investors.
 - Before the rise of large mutual funds, pension plans, and index funds, investors who were dissatisfied with a stock's performance sold out their position and invested in another company.
 - Today, investors with a large position are essentially locked into their investment and have no choice but to focus on improving governance. Index funds and funds with very specific investment strategies or narrow industry focuses also have very limited options other than using their governance rights to seek change and improved performance.
- Sadly, the Enron, WorldCom, Tyco, Adelphia, etc. scandals of a few years ago that produced the federal Sarbanes-Oxley law have not ended. The latest scandals and signs of continuing abuse include option backdating and the severance package for the recently departed CEO of Home Depot. The need for an alternative model of good corporate governance like Chapter 10-35 remains as important as ever.
- By providing a new model of corporate governance at the state level, Chapter 10-35 is a much less radical approach to corporate governance reform than if changes are imposed at the federal level on all publicly traded corporations.
 - Chapter 10-35 will hopefully avoid some of the problems caused by Sarbanes-Oxley which imposed its changes on all publicly-traded corporations.
 - By applying on a limited and voluntary basis, Chapter 10-35 will allow for “experimentation” to see what works and will permit future adjustment based on experience.

Chapter 10-35 is Optional

- Chapter 10-35 does not apply to existing corporations. It will apply only to

corporations that elect to incorporate under it after July 1, 2007.

- After a corporation becomes subject to chapter 10-35, it remains optional because the shareholders may elect to exempt their corporation from chapter 10-35 or to reincorporate under a different state law. Either of those actions will be able to be taken by a simple majority vote.

Benefits to North Dakota

- The franchise fee imposed by Chapter 10-35 should eventually produce substantial revenue.
 - According to the 2005 annual report of the Delaware Division of Corporations, which is available on its website, the Division collected \$491.1 million in corporation franchise taxes during fiscal year 2005.
- Chapter 10-35 will encourage infrastructure growth.
 - ND public corporations will need ND lawyers.
 - Having any substantial number of public corporations incorporated in ND will produce an increase in commercial litigation involving those corporations. (Which will be a good thing from the point of view of economic development in ND. Local counsel in ND will be needed; out-of-state lawyers coming for trials will need hotels, etc.)
- Enactment of Chapter 10-35 will give ND national visibility.
 - ND will be at the center of the national debate on corporate governance. No other state has a corporation law that is as focused on the concerns of shareholders. Other state laws reflect to a substantial degree the perspective of management (reflecting the fact that management has been much more active in the political process).
 - Enactment of Chapter 10-35 will be an opportunity for ND to portray itself as committed to the future of capitalism and to strengthening the economy for the benefit of everyone.

Significant Provisions (in decreasing order of importance)

- Majority voting in election of directors.
 - This is currently the biggest issue for activist shareholders and is already being proposed on a company-by-company basis.
 - Majority voting has been the rule in Europe for years.
 - Delaware and the Model Business Corporation Act have added provisions that provide for a partial form of majority voting, but Chapter 10-35 will be the first state law to require true majority voting.
- Advisory shareholder votes on compensation reports.
 - Controlling run-away CEO compensation is currently a major corporate governance issue, with even major CEOs such as Jeffrey Immelt of GE saying that CEO compensation should be more in-line with the compensation of a company's other senior management.
 - Advisory shareholder votes have been used successfully in Europe.
- Proxy access (right of large, long-term shareholders to include nominees in the corporation's proxy statement).
 - This was proposed by the SEC in 2003, but has been on hold.

- Reimbursement for successful proxy contests.
 - This has been proposed by academics, but has not been implemented to date.
 - The purpose is to provide a more level playing field for shareholders since management has the resources of the corporation to pay for its proxy solicitation.
- Separation of roles of Chair and CEO.
 - Many companies have already voluntarily adopted this restriction.
- Limitations on poison pills.
 - It is important to note that Chapter 10-35 does not prohibit all poison pills. Some activist shareholders would look to prohibit poison pills entirely, but experience has shown that poison pills can be valuable in keeping a company from being sold at less than full value. Chapter 10-35 strikes a balance that protects a corporation from being taken over “on the cheap” while not allowing a poison pill to be used improperly to entrench management.
- Limitations on supermajority provisions.
 - Supermajority provisions are becoming less common and many companies are already eliminating them from their governance documents when that is proposed by shareholders.
- Limitation on antitakeover provisions.
 - As with supermajority provisions, these provisions are becoming less common and are also the subject of shareholder proposals to eliminate them.