

H G & G U P D A T E

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Recent Amendments to the New York Business Corporation Law Affect Small Corporations

For years, Delaware's favorable corporate laws have made it the state of choice for businesses seeking to incorporate. New York's legislators recently set out to

revise the Business Corporation Law ("BCL") to make New York a more hospitable and attractive state for incorporation. While the majority of the BCL revisions are intended to attract large corporations,

small corporations will also find benefits in the new laws which became effective on February 22, 1998 (the "Effective Date"). As a result, many of the burdens which New York corporations were formerly forced to endure have been eliminated under the new laws.

Officers and Directors

Some of the most significant amendments relate to the officers and directors of a corporation and are particularly beneficial to the small corporation. Corporations previously were required to have a minimum of three directors on the board of directors if there were three or more shareholders. This requirement often forced small corporations to scramble for qualified individuals to serve as directors. Under the amended

provision, the three-director minimum has been replaced with a requirement that the board simply have at least one director. Corporations will no longer be forced to elect additional directors for the sole purpose of complying with the BCL's three-director minimum. In addition, the offices of president and secretary were formerly required to be held by different individuals, and, therefore, a corporation could not have a single officer. As the legislators no longer found a meaningful rationale for such a requirement, the law was amended to permit the offices of president and secretary to be held by the same person. Finally, recognizing the cost and difficulty in assembling all of a corporation's directors at a single place, the board of directors may now hold meetings via telephone conference call, in the absence of a provision to the contrary in a corporation's certificate of incorporation.

Shareholder Action

New York has long permitted shareholder action to be taken without a meeting if a written consent setting forth the action is signed by the holders of all outstanding shares entitled to vote. As a result, unless all shareholders consented, no shareholder action could be taken without a meeting. A particularly notable amendment to the BCL enables a corporation to include in its certificate of incorporation

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a provision permitting shareholder action without a meeting if a written consent is signed by the holders of a majority of the outstanding shares entitled to vote, so long as prompt notice of the action is given to all nonconsenting shareholders. Accordingly, shareholder action may now be taken by obtaining the consent of a simple majority of shareholders. Permitting shareholder action by majority consent rather than unanimous consent can be particularly beneficial to the typical small corporation in which management owns a majority of the outstanding common stock.

Amending the Certificate of Incorporation

Two significant amendments promise to facilitate amending certain provisions of a corporation's certificate of incorporation. Previously, amending a provision of a corporation's certificate of incorporation which restricts the board of directors' management of the corporation or affects the directors' quorum or voting requirements required a two-thirds vote of all of the outstanding shares entitled to vote. Now, corporations formed after the Effective Date need only obtain authorization of such amendment by a majority of the votes cast, unless provided otherwise in the certificate of incorporation or by a shareholder agreement, and a corporation in existence prior to the Effective Date can amend its certificate of incorporation, by approval of two-thirds of the votes cast, to provide that any amendments be authorized by a majority of the votes cast.

To provide a New York corporation with greater latitude in determining its appropriate capital structure in connection with future financings, the

revised BCL allows the board of directors to increase or decrease the number of shares in any series of preferred shares without shareholder approval, unless otherwise provided in the certificate of incorporation. Because obtaining shareholder approval can be unduly burdensome and does not provide meaningful protection to shareholders, as preferred shareholders traditionally do not have voting rights except with respect to matters which directly affect their own interests, this amendment provides a corporation with a simple manner of modifying its capital structure to suit its changing needs.

Consideration

Small corporations may also benefit from another amendment which allows corporations to issue shares of stock in exchange for a binding obligation to pay cash or perform future services. Previously, a corporation was only permitted to issue shares in exchange for cash or services rendered. This enhanced flexibility is not expected to compromise the corporation's well-being since its directors have stringent fiduciary obligations to the corporation as well as to stockholders which require them to act in good faith and in a diligent, prudent manner.

Sale of Assets/Dissolution

Finally, a corporation may find itself in circumstances under which it would be in the best interests of the corporation to dispose of all, or substantially all, of the corporation's assets or even to dissolve the corporation entirely. Previously, either of these actions required a vote of two-thirds of all outstanding shares entitled to vote. For corporations formed after the Effective Date or when the

certificate of incorporation so provides, such actions may be taken by a majority of the shareholder votes cast, thereby eliminating the significant burden of the super-majority requirement.

These amendments to the BCL have eliminated significant burdens on New York corporations. Now, New York

corporations can experience much of the flexibility enjoyed for years by their neighbors in Delaware.

■ If you would like to consult us on this topic, please call your attorney at the firm or Richard Klein or Louis Sherman.

Best Efforts versus Reasonable Efforts in Licensing Contracts

Licensing contracts are a prevalent method of doing business. They are the means of testing and developing new inventions and drug discoveries and are used as a method to manufacture and market clothing, accessories, jewelry, household items, perfumes and even identities. As with any contractual business relationship, the more explicit and definitive the contract and its provisions, the less likely it is that an unresolvable or difficult dispute, expensive to resolve, will arise.

One element in negotiating a licensing agreement is whether the licensee will undertake a "best efforts" obligation to exploit the invention or product or only some lesser obligation. A licensee will obviously prefer agreeing to a "reasonable efforts," rather than a "best efforts," obligation. Alternatively, a licensee which takes only a non-exclusive license or which pays significant minimum royalties may avoid any legal obligation to develop the licensed invention.

What is the distinction between "best efforts" and "reasonable efforts?" What does a licensee gain by refusing a

licensor's request for a "best efforts" change? The answer to these questions, in the words of one court, is muddled. In the context of litigation, the difference between "best efforts" and "reasonable efforts" is one of nuance.

The words used by courts to describe "best efforts" provide little guidance. One such definition is "active exploitation in good faith." A more helpful guideline is that "best efforts" requires the licensee to treat the licensed product in a manner similar to that in which it treats its other products. A small pharmaceutical company can exploit the licensed invention as it does its remaining products, not in the manner that a major pharmaceutical company would exploit the licensed invention. "Best efforts," at the minimum, is an obligation not to discriminate against an adopted child.

A second, and not entirely consistent benchmark, is that "best efforts" be read in terms of trade practice and usage. This more expansive definition could obligate a licensee to follow the industry standard, even if that standard is superior to the effort that the licensee normally employs for its other products.

A "reasonable efforts" requirement, rather than a "best efforts" standard, will better protect a licensee.

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