

2019 Colorado Business Law Updates

Revising the Colorado Business Corporation Act and the Colorado Corporations and Associations Act

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This article reviews the salient provisions of Colorado Senate Bill 19-086, which amends Colorado laws governing business entities.

On May 9, 2019, the Colorado General Assembly passed Senate Bill (SB) 19-086, “Concerning Updates to the Laws Governing Business Entities,” which Governor Polis signed into law on May 13. SB 19-086 updates, corrects, and makes other changes to the Colorado Business Corporation Act (CBCA) and the Colorado Corporations and Associations Act (CCAA). This article summarizes the most significant and noteworthy changes, including those relating to directors’ fiduciary duties, forum selection clauses, and conflicting interest transactions.

The CBA and the Legislative Process

Since the Colorado Bar Association was organized, its attorney members have been involved in the legislative process on a wide range of bills, including SB 19-086. The complex legislative process, and the CBA’s participation in it, are described in a 2016 *Colorado Lawyer* article titled “How the Colorado General Assembly Works.”¹

History of SB 19-086

In 1952, the Corporate Laws Committee of the American Bar Association’s Business Law Section (the ABA Committee) published the Model Business Corporation Act (MBCA). Colorado adopted the MBCA with modifications in 1958 and significantly revised it in 1959.² The ABA Committee approved a substantial revision of the MBCA in 1969, and just 15 years later, the ABA Committee adopted what was then called the Revised Model Business Corporation Act (the 1984 RMBCA).

In 1987, CBA members Claude Maer, Dennis Jackson, and Anthony van Westrum organized the Colorado Corporation Code Revision Committee within the CBA’s Business Law Section to consider replacing Colorado’s corporation code with a new act based on the 1984 RMBCA. After almost four years of work, including many biweekly meetings, the Colorado Corporation Code Revision Committee proposed a bill, and the Colorado General Assembly agreed to substantially update Colorado’s corporation laws based on the 1984 RMBCA. The (then) new CBCA became effective July 1, 1994.³

In addition to the CBCA, there were numerous amendments to the CRS Title 7 laws governing entities through the

1990s, which prompted the adoption of the CCAA, effective June 3, 1997. The CCAA has occasionally been referred to as the “junction box” statute because it standardizes provisions in Title 7’s various entity statutes. For example,

- instead of different provisions dictating filing requirements, CRS § 7-90-301 of the CCAA details filing requirements for Colorado entities, and replaced similar provisions that previously appeared in the various entity acts; and
- instead of different and inconsistent provisions governing the filing of periodic reports by “reporting entities” under the various entity acts, all were consolidated in CRS § 7-90-501.

Over the years, the ABA Committee promulgated several updates to the RMBCA, most recently the 2016 Model Business Corporation Act (the 2016 MBCA) and amendments thereto in November 2018. In 2009, the Business Law Section formed a new committee (the CBA Committee) to consider whether updates to the CBCA were appropriate. The CBA Committee divided itself into subcommittees to address various provisions, and the subcommittees met regularly from 2009 through 2013 to consider changes and updates based in large part on the RMBCA as modified through 2008 (the 2008 RMBCA), subject to modifications for consistency with Colorado law.

After an unplanned delay and starting in mid-2016, the subcommittees’ recommendations were coordinated and compiled into a single statute, and the CBA Committee looked to the 2016 MBCA for additional guidance. Meeting occasionally through April 2018, the CBA Committee finalized its work and prepared a bill for consideration by the Colorado General Assembly. After vetting the bill through the CBA and other interested constituencies, primary sponsors Senator Pete Lee and Representative Shannon Bird presented SB 19-086 to the Colorado General Assembly in January 2019.

SB 19-086 does not drastically change the CBCA or the CCAA. Rather, it largely clarifies the law, consolidates and simplifies provisions, responds to court decisions interpreting the law, and reflects changes necessitated by changes in business practices. SB 19-086 becomes effective on July 1, 2020.

Significant Changes to the CBCA

SB 19-086 significantly affects CBCA provisions on directors' standards of care and standards of liability. It also amends CBCA provisions on remedies, damages, and forum selection. It further addresses conflicting interest transactions, dissenters' rights, and dissolution.

Duties of Care and Loyalty

Directors of Colorado corporations owe the duty of care and the duty of loyalty to the corporation. CRS § 7-108-401, as initially adopted and as amended by SB 19-086, prescribes standards of conduct for corporate directors and officers with discretionary authority. Under SB 19-086, CRS § 7-108-401(1) will require that directors and officers with discretionary authority discharge their duties

- in good faith,
- with care, and
- in a manner the director reasonably believes to be in the best interests of the corporation.

Currently, "with care" is defined as "with the care an ordinarily prudent person in a like position would exercise under similar circumstances."⁴ SB 19-086 modifies that obligation to be simply "with care" because Colorado courts, as a matter of common law, apply the business judgment rule in duty of care cases,⁵ with the result that the standard of care is gross negligence.⁶ The prior "ordinarily prudent person" standard is a tort standard for ordinary negligence and was not consistent with the common law in Colorado and elsewhere for the standard of care for corporate directors.⁷

Modifying the Directors' Standards of Care

Where the incorporators, or subsequently the shareholders, want to change the directors' standard of care, they are free to do so in the initial articles of incorporation or by amendment. Under CRS § 7-108-402(1)(c), liability can either be increased from gross negligence to ordinary negligence, or reduced to knowing misconduct or a knowing violation of law. As described below, the CBCA, in CRS § 7-102-102(2)(d), continues that ability where it is set forth in the corporation's articles of incorporation.

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Thus, SB 19-086 clarifies the meaning of a director's and officer's obligation to act with "care" and codifies the gross negligence standard consistent with Delaware and other jurisdictions.

Duties of Directors in the Zone of Insolvency (Actual Insolvency)

SB 19-086 amends CRS § 7-108-401(5) (renumbered as CRS § 7-108-401(4)). Section 7-108-401(5) was added to the CBCA in 2006 at the CBA's request and in response to the Court

of Appeals' decision in *Anstine v. Alexander (Anstine I)*.⁸ In *Anstine I*, a corporation's creditors filed breach of duty complaints after the corporation's president, Andrew Jelonkiewicz, with the advice of the corporation's attorneys, took various unsuccessful and unlawful actions in an attempt to regain the solvency of the business. The Court upheld a trial court judgment holding the corporation's lawyers liable for "aiding and abetting the breach of the fiduciary duty owed by Andrew Jelonkiewicz to [the corporation]"⁹ that Andrew controlled and to its creditors. It held, as other courts had in similar circumstances, that officers and directors owe duties to creditors (not shareholders) when the corporation is in the "zone of insolvency."¹⁰ The Colorado Supreme Court reversed in *Anstine II*,¹¹ stating:

Under our common law, the creditors of an insolvent corporation are not owed general fiduciary duties by the corporation's officers and directors. Officers and directors of an insolvent corporation owe creditors a duty to avoid favoring their own interests over creditors' claims.¹²

However, the Supreme Court then confused the intended standard of conduct when it stated in footnote (9):

A 2006 amendment to the Colorado Revised Statutes, which does not apply to this case, states that directors and officers of corporations owe no fiduciary duties to the corporation's creditors [citing CRS § 7-108-401(5)]. *We express no opinion on whether this provision applies where a corporation is insolvent.* (Emphasis added.)

To clarify the standard of care for the board of directors and to address footnote (9) of *Anstine II*, SB 19-086 amends CRS § 7-108-401(4) to state:

A director or officer of a corporation, in the performance of duties in that capacity, does not have any fiduciary duty to any creditor of the corporation arising only from the status as a creditor, *whether the corporation is solvent or insolvent.* (Emphasis added.)

Entities in financial straits frequently attempt various methods to regain solvency, and as long as their decisions are informed, made with care, and reasonably believed to be in the best interests of the corporation, there should be no fiduciary duty liability flowing from the

decision should it fail. Because the Colorado statutes now make it clear that directors and officers owe no fiduciary duties to creditors (even in insolvency), creditors (who always have the right to collateralize debt or to obtain personal guarantees) cannot bring a breach of duty action except where the creditors can show that the decision makers (the directors and officers) sought to favor their own interests over those of the creditors.¹³

Directors' Standard for Liability

Currently, both CRS §§ 7-108-401 and -402 address circumstances where a director or officer with discretionary authority may be liable to the corporation or its shareholders.¹⁴ The CBA Committee sought to clarify these circumstances by including director liability for failure to meet the standard of care in a single section, which is included in SB 19-086 as CRS § 7-108-402, "Standards of liability for directors." Again, the intention here was not to change Colorado law, but to clarify it.

As a threshold matter, CRS § 7-108-402 provides that the burden of establishing a director's liability¹⁵ is on the person asserting liability, typically the plaintiff. This approach is consistent with the burden imposed under current law.¹⁶ CRS § 7-108-402 has been extensively rewritten, primarily to codify and clarify Colorado law with respect to the application of the business judgment rule, and will set forth the circumstances in which a director will be liable to the corporation and its shareholders for money damages:

- **Failure to meet the standard of conduct.** CRS § 7-108-402(1)(a) and (b) are directly related to the standard of conduct described in CRS § 7-108-401(a) and (c). In other words, a director may be liable if the person asserting liability establishes that the challenged act, omission, or decision was not in good faith or was one that the director did not rationally believe to be in the best interests of the corporation.
- **Gross negligence, unless the standard is raised or reduced by the articles of incorporation.** CRS § 7-108-402(1)(c) is designed to incorporate the standard of conduct set forth in CRS § 7-108-401(1)

(b) and assumes application of the business judgment rule. Thus, the director is liable only if the person asserting liability establishes that the director was at least grossly negligent.¹⁷

- **Ignoring red flags.** CRS § 7-108-402(1)(d) makes explicit an inquiry principle that is currently included in CRS § 7-108-401(c) only by implication. Essentially, CRS § 7-108-401(c) provides that a director is liable if the person asserting liability establishes that the director did not make, or cause to be made, appropriate inquiry when particular facts or circumstances of significant concern came to the director's attention that would have alerted a reasonably attentive director to the need for inquiry.¹⁸ Delaware courts have long recognized a duty of inquiry.¹⁹ Such a duty has never before been expressly recognized or rejected by Colorado courts.
- **Failure to provide oversight.** This concept was taken from the 2008 RMBCA. CRS § 7-108-402(1)(e) creates liability when there is a "sustained or systematic failure of a director to exercise oversight" of the business and affairs of the corporation.²⁰ Therefore, a director is liable for money damages if the person asserting liability establishes that the challenged act, omission, or decision consisted of, or resulted from, a sustained or systematic failure by the director to exercise oversight of the business and affairs of the corporation. Delaware courts have recognized a duty of oversight or a duty to monitor with consequent liability for the failure to do so.²¹ Colorado courts have never had the occasion to determine whether this duty should be recognized in Colorado law.
- **Breach of duty of loyalty, direct or indirect receipt of improper benefit, and violation of standards applicable to making distributions.** CRS § 7-108-402(1)(f) and (g) are exactly the same as the exceptions in CRS § 7-108-402 before SB 19-086. A director remains liable if he or she breaches the duty of loyalty, including by directly or indirectly receiving an improper personal benefit, or if his

or her actions violate CRS § 7-108-405 (formerly § 403) with respect to making distributions.

- **Causation and damages.** Lastly, CRS § 7-108-402(2) provides that a person seeking to hold a director liable must also establish causation and damages. These requirements exist under current Colorado law.²² The party seeking to hold the director liable must establish that the corporation or its shareholders suffered money damages and that these damages were caused by the director's challenged conduct. If a money payment is sought, or if the cause of action is based on equity, such as recovery of profit or disgorgement, the claimant must establish that the money payment or equitable remedy "is appropriate in the circumstances."²³

Director or Officer Liability for Employee Torts

New CRS § 7-108-403 codifies the protections for directors and officers from liability for employee actions (formerly included in CRS § 7-108-402(2)). The language and intent did not change.

Limitation on Injunctions

SB 19-086 makes an important clarification in CRS § 7-108-404(2) with respect to whether a transaction should be enjoined if one or more, but not all, of the directors acted in a manner that did not meet the standard of care set forth in CRS § 7-108-401 and thus "violated one or more of the standards of liability set forth in section 7-108-402(1)" (referred to as a "precluded director").

When effective, CRS § 7-108-404 will prohibit a court from enjoining, setting aside, or declaring void or voidable certain actions by the corporation because one or more precluded directors participated in voting on the action. The CBCA provides that the transaction should stand if a sufficient number of untainted directors (i.e., directors who are not precluded directors) approved it. Notwithstanding the presence or participation of one or more precluded directors in approving the transaction, the subject action may not be enjoined if it has been authorized, approved, or ratified by either

- the affirmative vote of the number of directors present at the meeting that would be sufficient to take action at the meeting under the CBCA or the corporation's bylaws;²⁴ or
- if the action is taken without a meeting by written consent and signed by all of the directors,²⁵ a majority of the directors were not precluded directors.²⁶

Limitation on the Personal Liability of Directors for Monetary Damages

CRS § 7-108-402(1) currently provides that the personal liability of a director for monetary damages may be eliminated or limited (subject to certain non-waivable exceptions) only if that limitation or elimination was provided for in the corporation's articles of incorporation. SB 19-086 moves this exculpation provision to CRS § 7-102-102(2)(d) and modifies it to be consistent with other provisions addressing potential director liability.

Upon its effectiveness, CRS § 7-102-102(2)(d) will provide that the articles may include a provision eliminating or limiting the liability of a corporation director or its shareholders for money damages in any action except for

- the amount of a financial benefit a director receives to which the director is not entitled,
- intentional infliction of harm on the corporation or the shareholders,
- violation of the provisions relating to distributions, or
- intentional violation of criminal law.

Accordingly, including a broad exculpation provision in a corporation's articles can still protect a director from application of the CRS § 7-108-402 liability standards. That is, a Colorado corporation can elect to essentially eliminate the risk of personal liability for a director arising from a breach of the duty of care. In advising clients setting up a Colorado corporation, practitioners therefore still need to consider whether an exculpation provision in a corporation's articles is in the best interests of his or her client.

To the extent that the articles of incorporation for a Colorado corporation client mirror the exculpation language previously found in CRS § 7-108-402(1), practitioners may want to

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recommend to clients that they amend their articles of incorporation to mirror new CRS § 7-102-102(2)(d) and provide maximum protection for directors. All Colorado lawyers should update their forms for articles of incorporation to be consistent with the new CRS § 7-102-102(2)(d) provisions.

Forum Selection

Forum selection clauses are common in many contracts. The U.S. Supreme Court has recognized the presumptive validity and enforceability of forum selection clauses since 1972.²⁷ But until recently, few corporations included forum selection clauses in their corporate charters or bylaws, even though articles of incorporation and bylaws had long been held to be contracts between corporations and their stockholders. That changed with the proliferation of multi-forum litigation by stockholders challenging merger transactions and other significant corporate transactions in recent years. Boards of directors

of public companies faced with the high cost and uncertainty of multi-forum litigation began to adopt forum selection clauses as a means to reduce costly, duplicative, and often specious, lawsuits.

The validity of these clauses was subject to extensive litigation in Delaware and elsewhere.²⁸ In 2015 the Delaware State Legislature conclusively resolved the question of validity in Delaware, and approved amendments to the Delaware General Corporation Law that authorized forum selection clauses in the charters or bylaws of Delaware corporations specifying Delaware as an exclusive forum for litigating internal corporate claims. The 2016 MBCA adopted a similar provision in § 2.08, which was not included in previous MBCA versions.²⁹

SB 19-086 adds CRS § 7-102-108 to the CBCA, which permits the articles of incorporation or bylaws of a Colorado corporation to specify the forum or forums for the litigation of internal corporate claims. Thus, a corporation may specify a court or courts within the State of Colorado or “in any other jurisdiction with which the corporation has a reasonable relationship,”³⁰ provided that the specified jurisdiction has personal and subject matter jurisdiction to hear the case.³¹

When effective, the statute will not apply to all claims that may be brought against a corporation. The statute limits internal corporate claims to claims based on a violation of a duty under Colorado law by a current or former director, officer, or shareholder in such capacity; derivative actions or proceedings brought on behalf of the corporation; claims arising pursuant to the CBCA, the corporation's certificate of incorporation, or bylaws; or claims governed by the internal affairs doctrine.³²

Lastly, it is noteworthy that the statute provides that neither the articles of incorporation nor the bylaws may prohibit bringing an internal corporate claim in Colorado courts or require the claims to be determined by arbitration.³³

Conflicting Interest Transactions

SB 19-086 makes a number of changes to the provisions addressing transactions between a director and the corporation contained in CRS §§ 7-108-501 et seq.

Scope of “conflicting interest transaction.” The first notable change relates to the scope of a “conflicting interest transaction.” Currently, the CBCA defines a conflicting interest transaction as a loan to a director by the corporation,³⁴ a guaranty by the corporation of an obligation of a director,³⁵ or a contract or transaction between the corporation and a director.³⁶ When effective, CRS § 7-108-501(1) (a) will include a qualifier to each of these categories requiring that the transaction “is known to, and material to, the director.” This qualifier is in part intended to address inadvertent conflicting interest transactions. For example, a director may unwittingly approve a contract between the corporation and a large public company of which the director owns de minimis shares. Similarly, the inclusion of the materiality qualifier is intended to avoid shareholders asserting claims against a director over immaterial conflicts, such as when a director makes a personal phone call from the corporation’s conference room before a board meeting.

This qualification “known to and material to the director” limits the scope of potential conflicting interest transactions for which there is potential liability, but certainly leaves room for interpretation. For example, determining what is “material” to a director may be difficult. The concept of “materiality” to a corporation is the subject of many statutes and cases, but the concept of materiality to an individual director is novel; it could be quantitative (e.g., a dollar threshold), or subjective (e.g., a director’s emotional attachment to a particular asset or transaction).³⁷ Corporations and directors will need to carefully and thoughtfully consider these difficult issues.

In addition, the definition of conflicting interest transaction now includes “the director’s taking a corporate opportunity.”³⁸ SB 19-086 does not define a “corporate opportunity,” although the language in CRS § 7-102-102(2)(e) now states that the articles of incorporation may include a provision “limiting or eliminating a duty of a director or any other person to offer the corporation the right to have or participate in any, or one or more classes or categories of, business opportunities . . .”

Colorado courts have on several occasions found that certain transactions constituted corporate opportunities.³⁹ Delaware courts have defined a business opportunity as one that

- the corporation is financially able to exploit;
- is within the corporation’s line of business;
- the corporation has an interest or expectancy in; and
- if taken for the director’s own benefit, places the corporate fiduciary in a position inconsistent with the director’s duties to the corporation.⁴⁰

The significance of including a business opportunity as a conflicting interest transaction is that under CRS § 7-108-501(3), a corporation may approve a director’s pursuit of a corporate opportunity without such action being subject to an injunction or giving rise to damages from a shareholder, where the articles of incorporation

fail to address the question as permitted in CRS § 7-102-102(2)(e) (discussed below).

Conflicting interest transaction safe harbors. Historically, the CBCA has provided three safe harbors to approve a conflicted director transaction such that the transaction will not be void or voidable, cannot be enjoined, and will not give rise to an award of damages by a shareholder. These are:

- approval by the disinterested directors, even if less than a quorum, where the directors know the material facts;
- approval by the shareholders in good faith following disclosure of the material facts; or
- where the transaction is “fair” to the corporation.⁴¹

SB 19-086 makes two modifications to the safe harbor of having the conflicted director transaction approved by a vote of the sharehold-

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ers. First, under the current CBCA, the provision requires that the conflicting interest transaction be approved by the shareholders “in good faith.” The “in good faith” inclusion may have meant that the votes of the conflicted shareholders not be included, but it was subject to different interpretations by practitioners. And it could be argued that had a vote only by disinterested shareholders been intended, the shareholder language would have mimicked the previous subsection requiring approval by “disinterested directors.” Thus, the amended provision requires approval of a conflicted director transaction by the “disinterested shareholders” and deletes the “in good faith” requirement as not necessary where only disinterested shareholder votes are counted.

Second, SB 19-086 further clarifies the safe harbor by requiring that the disinterested shareholders’ vote be one in which the votes cast in favor of or authorizing the conflicted director transaction exceed the votes cast in opposition, regardless of the total number of votes cast. This change is important to allow a majority of the disinterested shares to approve a transaction even where the statute may require a majority of the outstanding shares to do so.

Lastly, SB 19-086 strikes CRS § 7-108-501(4), which currently imposes limitations on the corporation making a loan to a director. The CBA Committee determined that the limitations were too restrictive, unnecessary in light of federal statutory requirements under the Sarbanes-Oxley Act of 2002,⁴² and otherwise adequately addressed in the CBCA.

Dissenter’s Rights are Appraisal Rights

SB 19-086 follows the lead of the 2008 RMBCA, which eliminates the term “dissenter’s rights” and substitutes the term “appraisal rights.” These rights occur when a shareholder of a Colorado corporation disagrees with a significant corporate transaction and demands that the corporation buy the shareholder’s shares rather than convert the shares into the consideration contemplated by the transaction agreement.

The CBA Committee believed that the change to appraisal rights from dissenter’s rights more accurately describes the situation and is consistent with modern corporation law.⁴³ The

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CBA Committee also believes that this is not a substantive change, even though the wording changed significantly to adapt to the concept of “appraisal rights” rather than “dissenters’ rights” and some procedural modifications were made.

Dissolution

The bill modifies certain provisions for corporate dissolution under the CBCA, adding as a ground for judicial dissolution that the “corporation has

abandoned its business and has failed within a reasonable time to liquidate and distribute its assets and dissolve.”⁴⁴

SB 19-086 also adds CRS § 7-114-301(5), which provides that judicial dissolution is inappropriate if the corporation is an entity that has a class or series of shares that is either a “covered security,”⁴⁵ is traded in an organized market with a non-affiliate⁴⁶ market value of at least \$20 million, or is issued by an open-end management investment company registered with the federal Securities and Exchange Commission under the federal Investment Company Act of 1940.⁴⁷

Following a petition for judicial dissolution, CRS § 7-114-302(4) provides that the corporation must send notice to all shareholders. The notice must state (among other things) that the shareholders are entitled to avoid dissolution by purchasing the petitioner’s shares. CRS § 7-114-305 sets forth the procedure by which the corporation or its shareholders may elect to purchase the petitioning shareholders’ shares and thereby avoid judicial dissolution. The process is designed to be prompt,⁴⁸ and if the parties are not able to define the fair value of the shares, the court will do so.⁴⁹

CCAA Revisions

While SB 19-086 contains a number of CCAA amendments, only two are significant. The other amendments to the junction box statute for the most part make clarifying changes.

Conversions, Mergers, and Exchanges

Currently, Part 2 of the CCAA addresses conversions and mergers. When amended CRS § 7-90-203.1 is effective, it will address exchanges of owners’ interests in a manner similar to mergers, including the requirement in CRS § 7-90-203.3(2) to adopt a “plan of exchange” for exchanges of owners’ interests replicating the “plan of merger” in CRS § 7-90-203.3(1). The voting provisions for mergers in CRS § 7-90-203.4 are amended to include plans of exchange. These provisions were adapted from the “plan of share exchange” and implementation procedures previously found in CRS §§ 7-111-102 et seq.

Like the share exchange provisions, many of the corporate merger and conversion provisions

are removed from Article 111 of the CBCA and moved to the CCAA, Part 2. This provides greater coordination among and consistency for these provisions among all Colorado entities. It is important to note, however, that the provisions for a corporate “short-form merger” (the merger of a parent and its 90% owned subsidiary) remain in the CBCA at CRS § 7-111-104.

Similarly, the provisions requiring shareholder approval of a merger, conversion, or share exchange remain in the CBCA at CRS § 7-111-103, although many of the cross-references are changed to reflect the applicable CCAA provisions.

Merger and Conversions and Attorney-Client Privilege

One little known but extremely important CCAA provision that remains unchanged is found in CRS § 7-90-204(1)(a), which provides in part:

Every merging entity merges into the surviving entity and the separate existence of every merging entity ceases. All of the rights, privileges, *including specifically the attorney-client privilege*,⁵⁰ and powers of each of the merging entities, all real, personal, and mixed property, and all obligations due to each of the merging entities, as well as all other things and causes of action of each of the merging entities, shall vest as a matter of law in the surviving entity and shall thereafter be the rights, privileges, powers, and property of, and obligations due to, the surviving entity. Title to any property vested in any of the merging entities shall not revert or be in any way impaired by reason of the merger; except that all rights of creditors in and all liens upon any property of any of the merging entities shall be preserved unimpaired in the same property, however held. All obligations of the merging entities shall attach as a matter of law to the surviving entity and may be fully enforced against the surviving entity. *A merger does not constitute a conveyance, transfer, or assignment.* Nothing in this section affects the validity of contract provisions or of reversions or other forms of title limitations that attach conditions or consequences specifically to mergers. (Emphasis added.)

The language about the attorney-client privilege should be considered by all attorneys who advise corporations and other entities merging into another entity. Where an attorney represents the merging entity, the attorney-client privilege continues to attach to the merged entity, even though the owners, officers, and directors may be completely different. This issue can and should most often be addressed in the merger agreement. If this is not addressed appropriately in the merger agreement, the merging entity’s privileged communications regarding the negotiations of the merger agreement will transfer to the merged entity, and the attorney for the merging entity may find himself or herself disqualified from representing the former owners, officers, directors, or managers of the merging entity if a disagreement on the merger subsequently develops.⁵¹

The second emphasized sentence is equally important. Where a merger occurs, unless specifically required by an agreement such as a lease, no transfer occurs, and the consent of contractual parties to the merging entity does not have to be sought to continue the contractual obligations. While CRS § 7-90-204(1)(a) only affects mergers, the CCAA has similar language for conversions in CRS § 7-90-202(4); following a conversion, “[t]he resulting entity is the same entity as the converting entity.”

Other Statutes Affected

SB 19-086 also amends CRS §§ 7-40-104(2)(b) (relating to ditch and reservoir companies), 7-55-107.5 (cooperatives-general), 11-41-134 (relating to savings and loan associations), and 11-103-602 (Colorado Banking Code) to update cross references to the revised CBCA.

Similar conforming amendments were made to CRS §§ 7-56-603 and -605 (relating to the Colorado Cooperative Act) and 7-101-506 (the Colorado Public Benefit Corporation Act).

Potential Revisions

The CBA Committee intends to continue updating and improving the CBCA and CCAA. To that end, it intends to consider the following changes along with other changes requested by CBA Committee members and Colorado lawyers.

Ratification of Defective Acts

The initial draft of SB 19-086 contained a new section addressing the ratification of defective corporate actions, which provided a safe-harbor procedure for corporations to ratify corporate action that could be challenged as void or voidable. The provisions were modeled after the ratification provisions found in §§ 1.45 through 1.52 of the 2016 MBCA. However, the statute contemplated a new form, “Articles of Validation,” that would be filed with the Colorado Secretary of State. As a result of the Secretary of State’s review, a \$200,000 fiscal note was attached to SB 19-086, which would have made its passage unlikely, so the CBA Committee worked with the sponsors and reluctantly struck the ratification section.

The CBA Committee will consider whether to again seek a provision to ratify defective corporate acts, but instead of requiring an “articles of validation” form, it will simply suggest use of the existing form for Articles of Amendment to Articles of Incorporation to provide notice that defective corporate acts have been ratified. Hopefully this approach will address the Secretary of State’s concerns.

Blockchain Record-Keeping

Following the lead of several other states, including Delaware and Arizona, the CBA Committee intends to consider whether to bring blockchain record-keeping into Colorado entity law. Among other things, the use of blockchain record-keeping would allow Colorado entities to use up-to-date technology for shareholder lists and other record-keeping obligations.

Virtual Shareholder Meetings

Technological developments, including blockchain, have made the Colorado rule that shareholder meetings must be held in a specific place⁵² less important. In November 2018, the ABA Business Law Section’s Corporate Laws Committee proposed changes to the 2016 MBCA to permit “remote only” shareholders’ meetings held without a “place” established. As stated by the ABA Corporate Laws Committee:

Technological developments have made remote participation in meetings more feasible in various settings, including meetings of

shareholders of corporations. Corporations, particularly those with a large number of shareholders, are increasingly turning to new methods of communication that make meetings accessible to more shareholders and reduce travel and other costs.⁵³


The Corporate Laws Committee further stated that it “takes no view on whether conducting meetings solely by remote participation is appropriate for a particular corporation,” but the law should provide each corporation the flexibility to do so if desired.⁵⁴ The CBA Committee will consider whether that flexibility should be offered to Colorado corporations.

Electronic “Writing”

In the Colorado entity statutes, “writing” is currently defined⁵⁵ by reference to the Uniform Electronic Transactions Act, CRS § 24-71.3-102(7). The CBA Committee will attempt to answer the question whether that definition is adequate in the current and future environment or whether another definition or concept should be considered.

Future CBA Committee Work

The authors of this article and other CBA Committee members who developed SB 19-086 over a 10-year period will announce future meetings in an upcoming Business Law Section newsletter.⁵⁶ The purpose of the meetings will be to establish a new committee to consider proposed amendments for the 2021 Colorado General Assembly. Though far more limited liability companies than corporations are formed each year in Colorado,⁵⁷ corporations remain a very important business entity in Colorado,⁵⁸ and the CBCA should remain an attractive business entity statute.

In the meantime, practitioners should email the authors of this article their specific ideas for proposed changes (including proposed language), as well as any errors or lack of clarity in the as-amended CBCA and CCAA. These suggestions will be brought to the CBA Committee for consideration. 



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NOTES

1. Lidstone and Schupbach, “How the Colorado General Assembly Works,” 45 *Colo. Law.* 33 (Dec. 2016).
2. See Clarke, “The New Colorado Corporation Act,” 35 *DICTA* 317 (Nov.–Dec. 1958); Clarke and Maer, Jr., “1959 Amendments to the Colorado Corporation Code,” 36 *DICTA* 489 (Nov.–Dec. 1959). Significant revisions to the Colorado Corporation Code, which were based largely on the 1969 Model Business Corporation Act, were adopted in 1977. See Maer and Giacomini, “The 1977 Revisions to the Colorado Corporation Code,” 7 *Colo. Law.* 910 (June 1978). Other *Colorado Lawyer* articles discussing subsequent major revisions to Colorado corporate laws are Sisson, ed., “Revisions to the Colorado Corporation Code Effective January 1, 1982,” 10 *Colo. Law.* 2272 (Sept. 1981); and Thompson and Weiler, “1984 Revisions to the Colorado Corporation Code: Effective March 1984,” 13 *Colo. Law.* 993 (June 1984).
3. HB 93-1154, effective July 1, 1994. The primary sponsors of the legislation were Representative Paul D. Schauer and Senator Richard F. Mutzebaugh. See Clodfelter et al., “An Overview of the New Colorado Business Corporation Act,” 22 *Colo. Law.* 2337 (Nov. 1993).
4. CRS § 7-108-401(1)(b). The 2016 MBCA § 8.30(b) uses the phrase “with the care that a person in a like position would reasonably believe appropriate under similar circumstances.”
5. The Colorado Supreme Court described the business judgment rule as the “business judgment doctrine which ‘bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in furtherance of a lawful and legitimate furtherance of corporate purposes.’” *Hirsch v. Jones Intercable, Inc.*, 984 P.2d 629 (Colo. 1999).
6. See *Kim v. Grover C. Coors Trust*, 179 P.3d 86 (Colo.App. 2007); *Polk v. Hergert Land & Cattle Co.*, 5 P.3d 402 (Colo.App. 2000); *Wolf v. Rose Hill Cemetery Ass’n*, 914 P.2d 468 (Colo.App. 1995); *Rifkin v. Steele Platt*, 824 P.2d 32 (Colo. App. 1991).
7. One court failed to appreciate this subtlety under the predecessor Colorado Corporation Code and erroneously concluded that directors were to be held to an ordinary negligence standard of care. *Resolution Trust Corp. v. Heiserman*, 839 F.Supp. 1457 (D.Colo. 1993) (“The clear, plain, and unambiguous language of § 7-5-101(2) supports my conclusion that the Colorado General Assembly intended to hold bank directors to an ordinary negligence standard of care.”).
8. *Anstine v. Alexander (Anstine I)*, 128 P.3d 249 (Colo.App. 2005), *rev’d on other grounds* 152 P.3d 497 (Colo. 2007).
9. *Id.* at 252.
10. Delaware courts specifically rejected the “zone of insolvency” creating a duty to a corporation’s creditors in *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007).
11. *Alexander v. Anstine (Anstine II)*, 152 P.3d 497, 498 (Colo. 2007).
12. *Id.* Thus, the attorney was dismissed from the case because the directors/officers had no primary liability.
13. The *Anstine II* Court stated:
It has been said that directors and officers of an insolvent corporation are “trustees” for the corporation’s creditors. . . . The trustee role with regard to creditors does not encompass the full set of fiduciary duties owed by directors and officers to shareholders of a solvent corporation. Rather, it is a limited duty that requires officers and directors to avoid favoring their own interests over creditors’ claims. (“Under the common law, a director of an insolvent corporation is deemed to be a trustee for it and its creditors and, as such, owes a duty to the corporation and its creditors not to divert corporate property for his or her own benefit.”)
. . . .
We have never recognized a duty to creditors broader than this and have not defined the duty owed to creditors as fiduciary in the usual sense. . . . In the context of a breach of fiduciary duty claim against a corporate officer, creditor claims are limited to cases where officers or directors have favored their interests over creditors’ claims.
Id. at 502 (citations omitted).

14. See CRS § 7-108-401(4), which currently states that a director or officer would not be liable to the corporation or its shareholders if “the director or officer performed the duties of the position in compliance with this section.” The former title of CRS § 7-108-402, “Limitation of certain liabilities of directors and officers,” had similar language.

15. Note that while CRS § 7-108-401 addresses the standard of conduct for directors and “officers with discretionary authority,” CRS § 7-108-402 only addresses standards of liability for directors.

16. See, e.g., current CRS § 7-108-402 and Colo. Jury Instr. Civ. § 26:1.

17. As discussed above, a corporation’s articles of incorporation may, under CRS § 7-102-102(2)(d), lower that standard of liability to intentional misconduct or knowing violation of law, or raise the standard of liability to ordinary negligence.

18. If red flags of this nature exist, whether a director could convince a fact finder that he or she reasonably believed his or her actions were in the best interests of the corporation is another matter. Nevertheless, this addition to CRS § 7-108-402 makes the point clearly.

This concept was adapted from the 2008 RMBCA § 8.31(a)(2)(iv), which is identical to the 2016 MBCA § 8.31(a)(2)(iv): “(iv) a sustained failure of the director to devote attention to ongoing oversight of the business and affairs of the corporation, or a failure to devote timely attention, by making (or causing to be made) appropriate inquiry, when particular facts and circumstances of significant concern materialize that would alert a reasonably attentive director to the need therefore.” The CBA Committee changed “materialize” to “come to the attention of the director” because it believes that “materialize” suggests a mysterious and illusive appearance, while “come to the attention of” is a clearer requirement.

19. See *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125 (Del. 1963) (stating “[i]f a [director] . . . has ignored either willfully or through inattention obvious danger signs of employee wrongdoing, the law will cast the burden of liability upon him.”); *Beam v. Stewart*, 833 A.2d 963 (Del. Ch. 2003) (interpreting *Graham* to mean that “a duty to monitor may arise when the board has reason to suspect wrongdoing.”).

20. *In re Caremark Int’l, Inc. Derivative Litigation*, 698 A.2d 959, 971 (Del. Ch. 1996).

21. See *Stone v. Ritter*, 911 A. 2d 362, 370 (Del. 2006) (holding that director oversight liability arises where directors utterly fail to implement any reporting or information system or controls, or having implemented such a system or controls, consciously fail to monitor or oversee its operations, thus disabling themselves from being informed of risk or problems *requiring their attention*). See also *Caremark*, 698 A.2d 959.

22. See Colo. Jury Instr. Civ. §§ 9:18 to 9:21, 26:1, and 26:5.

23. CRS § 7-108-402(2)(c).

24. In determining whether the number of votes is sufficient, the vote of the precluded

director may not be counted for purposes of authorizing the action but may be counted for the purpose of determining a quorum.

25. CRS § 7-108-202 permits the directors to act by unanimous written consent.

26. CRS § 7-108-404(1)(b) raises the standard from a majority, if set forth in the corporation’s bylaws.

27. *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972).

28. *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013); *Galaviz v. Berg*, 763 F.Supp.2d 1170 (N.D.Ca. 2011).

29. Corporate Laws Committee, ABA Business Law Section, “Changes in the Model Business Corporation Act—Proposed Section 2.08,” 71 *Bus. Law.* 543 (ABA Spring 2016).

30. CRS § 7-102-108(1).

31. CRS § 7-102-108(2).

32. CRS § 7-102-108(4).

33. CRS § 7-102-108(3).

34. CRS § 7-108-501(1)(a)(I).

35. CRS § 7-108-501(1)(a)(II).

36. CRS § 7-108-501(1)(a)(III).

37. The 2016 MBCA uses the phrase “a material financial interest,” which is clearer.

38. CRS § 7-108-501(1)(a)(IV).

39. See *Carper v. Frost Oil Co.*, 211 P. 370 (Colo. 1922); *Colo. Utah Coal Co. v. Harris*, 49 P.2d 429 (Colo. 1935); *Collie v. Becknell*, 762 P.2d 727 (Colo.App. 1988); *Three G Corp. v. Daddis*, 714 P.2d 1333 (Colo.App. 1986); *Bator v. Mines Dev., Inc.*, 513 P.2d 220 (Colo.App. 1973).

40. *Guth v. Loft, Inc.*, 5 A.2d 503 (Del. Ch. 1939).

41. Although not statutorily required, lawyers generally suggest to their client corporations that any conflicting interest transaction should be fair to the corporation and, after full disclosure of the facts, either ratified by the disinterested directors or the shareholders. After all, if the transaction is not “fair” to the corporation, how can the directors meet their standard of care, and why would shareholders vote to approve the transaction?

42. Section 402 of the Sarbanes-Oxley Act (codified at 15 USC § 78m(k)) prohibits any public company from providing credit in any form to its executive officers and directors.

43. See, e.g., 2016 MBCA ch. 13; 8 Del. C. § 262.

44. CRS § 7-114-301(2)(e), effective July 1, 2020.

45. As defined in 15 USC §§ 77r(b)(1)(A) and 77r(b)(1)(B) (sections 18(b)(1)(A) or (B) of the federal Securities Act of 1933).

46. This would include all trading shares, not including those held by the corporation’s subsidiaries, senior executives, directors, and persons known to hold more than 10% of the outstanding shares.

47. 15 USC §§ 80a-1 et seq.

48. The election to purchase the petitioning shareholders’ shares must be made within 90 days after the petition for dissolution is filed. CRS § 7-114-305(2)(a). The parties have 60 days after the election to reach an agreement as to the fair value of the shares. CRS § 7-114-305(3).

49. CRS § 7-114-305(4).

50. This language about the attorney-client privilege was specifically added by the General Assembly in HB 15-1071.

51. To see this problem in practice, see *Shareholder Representative Servs. LLC v. RSI Holdco, LLC*, C.A. No. 2018-0517-KSJM (Del. Ch. May 22, 2019). There the merger agreement contained a provision seeking to (1) preserve privilege over pre-merger communications, (2) assign control over such privileged communications to the designated representative of sellers, (3) have the parties take the necessary steps to safeguard the privileges, and (4) prevent the buyer and its affiliates from using privileged communication in post-closing litigation against the sellers. Despite the contractual language, the buyer sought to use the pre-merger attorney-client communications against the sellers. The Chancery Court enforced the contractual restrictions.

52. CRS § 7-107-101(2) requires that annual meetings of shareholders be held “at a place stated in or fixed in accordance with the bylaws . . . [or by] resolution of the board of directors.” For special meetings, see CRS § 7-107-102(3). CRS § 7-107-105(1) requires that the notice of the meeting set forth the “place of each annual and special shareholders’ meeting.”

53. “Changes in the Model Business Corporation Act—Proposed Amendments to Chapters 7 and 10 Permitting Shareholders’ Meetings Solely by Remote Participation,” by the Corporate Laws Committee, ABA Business Law Section, 74 *Bus. Law.* 151 (ABA Winter 2018-2019).

54. *Id.*

55. CRS § 7-90-102(66).

56. This meeting will take place at the CBA offices; the specific date will be announced in either the Nov./Dec. 2019 or Jan./Feb. 2020 newsletter.

57. According to the Colorado Secretary of State’s records, the numbers of LLCs recently organized are: 75,317 in 2014; 73,322 in 2015; 82,084 in 2016; 88,248 in 2017; and 95,606 in 2018. The number of corporations recently incorporated are: 10,626 in 2014; 10,615 in 2015 (not including 175 public benefit corporations (PBCs)); 10,786 in 2016 (not including 239 PBCs); 11,103 in 2017 (not including 270 PBCs); and 11,179 in 2018 (not including 299 PBCs). Email to Herrick Lidstone from Alberta Bennett, office of the Colorado Secretary of State, Jan. 3, 2019.

58. As of March 31, 2019, there were 123,305 Colorado corporations in good standing. By comparison, there were 455,814 Colorado LLCs in good standing. The Colorado Secretary of State’s Quarterly Business & Economic Indicators report for Q1 2019 at 3, <https://www.sos.state.co.us/pubs/business/quarterlyReports/2019/2019-Q1-SOSIndicatorsReport.pdf>.