Pennsylvania Business Corporate Law Key Changes

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You asked me to create an expanded memorandum regarding changes to the PA BCL, while paying special attention to topics about which participants might ask. I've followed the same format as my previous memorandum about the BCL changes.

I. Reporting Requirements

A. Prior Law

There was no prior reporting law for this information in the BCL. Section 146 is a new section.

B. Who Must File Reports?

1. According to Title 15 Section 146(a), entities required to file a report include domestic filing entities, domestic limited liability partnerships, domestic electing partnerships that are not a limited partnership, and registered foreign associations.[1]

2. Further research simplified this language by explaining that any entity registered with the Commonwealth and/or required to report other information must now report this information too.

3. Reports must be delivered to the Department of State (the "Department") and must be signed by the entity or association delivering the report.

4. To be more specific, here is a list of entities required to report:

   a. Domestic business corporations;

   b. Domestic nonprofit corporations;

   c. Domestic limited liability (general) partnerships;

   d. Domestic electing partnerships that are not limited partnerships;

   e. Domestic limited partnerships (including limited liability limited partnerships);

   f. Domestic limited liability companies;

   g. Domestic professional associations;

   h. Domestic business trusts; and

   i. All registered foreign associations

C. What Must Be Reported?

[1] https://www.legis.state.pa.us/cfdocs/legis/li/uconsCheck.cfm?yr=2022&sessInd=0&act=122

1. Summarized in Section 146(a)(1)-(6), entities must report the following information to the Department:

a. Entity Name;

b. Jurisdiction of Formation;

c. The Address of its Registered Office in the Commonwealth, if any (street and number included) – please note that if this information is different the address currently registered with the Commonwealth, the filing of this new address will be treated as an address change (146(e));

d. Name of one Governor (board member/director);

e. Names and Titles of the Principal Officers;

f. Address of its Principal Office, if any, wherever located (street and number included); and

g. Entity Number or similar identifier previously issued by the Department

2. The reported information must be current as of the date the report is delivered to the Department for filing. (Section 146(b)).[2]

D. By When Must Entities File Reports

1. Reports must be filed annually beginning with the calendar year *after* which an entity or association becomes subject to this Section. The Section will take full effect on January 3, 2024, however, according to the Department's website, the actual reporting requirement begins in the 2025 calendar year.[3]

2. Section 146(c) labeled specific annual deadlines for filing based on entity form:

a. Prior to July 1: domestic or foreign corporation, for profit and not-for-profit

b. Prior to October 1: domestic or foreign limited liability company

c. On or prior to December 31: any other form of domestic or foreign association

E. What if the report does not contain all the required information, or incorrect information?

1. Subsection 146(d) states if an annual report does not contain all the required information, the Department must reject the report; promptly notify in record

[2] Id.

[3] https://www.dos.pa.gov/BusinessCharities/Business/Resources/Pages/Annual-Reports.aspx

form the reporting entity or association of its rejection; and return the report for correction.

2. Section 113 of the BCL was additionally amended in 2022, to take effect in January of 2023, to add that a document in record form may be delivered by the Department to a person (or entity) via email or other electronic communication if a person supplied that method to the Department. This method of delivery is in addition to in person, mailed to the registered address, mailed to the principal office address, or to a different address provided by the person.

3. Also, Section 136(f) was added to the BCL providing that the Department may additionally reject any report for filing if it believes the document is being filed fraudulently or may be used to accomplish a fraudulent, criminal, or unlawful purpose.

4. If an annual report must be updated due to a change of information for an entity, the entity may deliver to the Department a new annual report with a statement that the report contains a change in the information previously included in the report for that year.

F. Reminders from the Department

1. Subsection 146(g) provides that the Department will annually deliver notice to each entity required to file an annual report at least two months prior to the annual report due date. However, the failure of the Department to deliver notice or an entity to receive notice does not constitute a waiver of the requirement to file an annual report. Entities must be aware of their deadline and filing requirements.

2. The Department uses the address and agent information that entities have registered with the State to mail these reminder notices to entities required to file. Entities should be sure that their registered address and registered agent information is correct so that they receive these mailed reminders.

G. Filing Fees

1. In conjunction with Section 146, Section 153 of the BCL was amended to reflect the fees that come with filing these annual reports.

2. Corporation, limited partnerships, or limited liability companies organized not-for-profit will not have any filing fees for these annual reports. (153(a)(18)(i)). All other entities required to report must pay $7.00.00 with each annual report.

H. What Happens if an Annual Report is not filed?

1. This topic relates not only to this form of annual reporting, but all annual reporting. However, I am including it here because it can be covered using the new annual reports as an example.

2. Subchapter H was added as an entirely new subchapter to Chapter 3, spanning sections 381-384. Its enactment was effective as of January 3, 2023, however there is a provision that provides for a certain transitional period.

3. First, under §381, if an entity does not deliver an annual report to the Department within six (6) months after its due date, the Department may commence a proceeding to administratively dissolve a domestic filing entity or cancel the statement of registration of a domestic limited liability partnership or the statement of election of an electing partnership that is not also a limited partnership.

4. Importantly, this section 381 applies to annual reports due on or after January 4, 2027. Therefore, as of right now and for the next couple of years, there will be no such penalty as this for missing an annual report. There is a transition period until January 4, 2027.

5. Section 382 lists the procedure by which the Department can affect this administrative dissolution or cancellation.

a. First, the Department must deliver notice to the entity of the Department's determination. This notice would be sent to the entity's registered office and the address of the entity's principal office.

b. Second, if within 60 days after the Department delivers notice, the entity does not file the required report, then the Department must administratively dissolve or cancel the entity.

c. Third, after dissolution/cancellation, the Department must deliver a copy of the statement of dissolution or cancellation to the entity at its registered office and its principal office.

d. Last, as a result of a dissolution, the entity can only carry on wind up activities. As a result of cancellation, a limited liability partnership or electing partnership continues its existence as a general partnership.

6. There is a reinstatement process for entities that were subject to 382 administrative dissolution or cancellation. The entity must deliver to the Department a signed application that states:

a. The name of the entity at the time 382 was effectuated;

b. The address, street and number included, of the entity's registered office;

c. The principal office of the entity at the time of the application for reinstatement; and

d. Either (1) that the grounds for action did not exist or (2) that the most recent annual report not filed is attached to the application with the fee for each annual report.

6. If the Department finds that the application meets the requirements for reinstatement, it would cancel the prior action by filing a statement of reinstatement and deliver a copy to the entity.

a. As a result of reinstatement, the reinstatement relates back to and takes effect as of the effective date of the administrative dissolution or cancellation. However, the activities of the entity during the interim will be valid as if the administrative dissolution never occurred.

b. If, on the other hand, the Department rejects an entity's application for reinstatement, the Department must deliver the entity notice in record form that explains the reasons why.

II. Corporate Governance Related Changes

A. Mergers - §321(f)

1. The Pennsylvania Legislature changed Section 321 of the BCL by amending and adding language relating to the approval of entity transactions by a business corporation. Section 321 discusses only the approval by a business corporation. Other sections in Subchapter B of Chapter 3 discuss approval by other types of entities.

2. Most importantly, Subsection 321(f) was added, and the previous subsection (f) was converted into subsection (g), which only mentions where Section 321 is cross-referenced. Subsection 321(f) provides for a new method of approval for two step transactions (merger or interest exchange).

3. This new method states that, unless the articles of incorporation (not the bylaws) of the registered corporation otherwise provides, approval by shareholders of a plan of merger or interest exchange is not required when the transaction complies with the following steps.

a. The plan of merger or interest exchange (1) permits or requires the transaction to be effected under Subsection 321(f) of the BCL and (2) provides that, if the transaction is to fall under Subsection 321(f), the transaction will be effected as soon as practicable.

b. Another party to the merger, the acquiring association in the interest exchange, or a parent of another party to the merger or acquiring association in the interest exchange, *makes an offer to purchase all of the outstanding shares in the corporation that would be entitled to vote on the plan of merger or exchange*.

4. One exception to this step is that the offer may exclude shares that are owned at the commencement of the offer by the corporation, the offeror, any parent of the offeror or any subsidiary of the offeror. Also, the offer may be subject to a specific minimum number of shares or percentage of share being tendered and any other conditions allowed under applicable law.

a. The offer must disclose that the plan of merger or interest exchange will be effected as soon as practicable and that the shares of the corporation that are not tendered will be treated as in subsection viii.

b. The board has not rescinded its recommendation at the time the offer closes.

c. The offeror purchases all shares properly tendered in response to the offer and not properly withdrawn.

d. At the close of the offer, the following shares are collectively entitled to cast at least the minimum number of votes on the transaction that would be required by this chapter and by the articles of incorporation for the approval of the transaction by the shareholders both in general and by any shares entitled to vote as a separate voting group:

(1) Shares purchased by the offeror in accordance with the offer

(2) Shares owned by the offeror or by any parent or wholly owned subsidiary

(3) Shares subject to an agreement that they are to be transferred, contributed or delivered to the offeror (parent or subsidiary included) in exchange for shares or interests in the offeror

(4) The offeror or a wholly owned subsidiary merges with or into the corporation, or effects an interest exchange in which it acquires shares of the corporation.

(5) Each outstanding share of each class or series of shares of the corporation that the offeror is offering to purchase, that is not purchased in accordance with the offer, is to be converted in the merger into (or into the right to receive), or is to be exchanged for (or for the right to receive), the same amount and types of securities, interests obligations, rights, cash, or other property to be paid or exchanged in accordance with the offer for each share of that class or series of shares tendered in response to the offer.

(6) However, these following shares of the corporation does not need to be converted for consideration:

(a) Shares owned by the corporation

(b) Shares described in (vi)(b)-(c)

(c) Shares to which the shareholder has perfected dissenters rights

e. As a summary, unless it is stated in the articles of incorporation (not the bylaws), a plan of merger or ownership interest exchange does not always require shareholder approval.

f. These two-step transactions are more facilitated. Now if a tender offer is made, upon its consummation the offeror would own shares having adequate voting power to satisfy any required shareholder approval, then shareholder approval is not required.

g. Instead, the board can adopt a resolution of a plan for merger without the shareholder approval. Essentially, the act of sufficient shareholders tendering shares in the tender offer suffices for the shareholder approval. This change went into effect on January 3, 2023.

B. Forum Selection for Internal Corporate Claims

1. Section 1513 of the BCL is a newly added section that took effect on January 3, 2023. It relates to forum selection provisions related to internal corporate claims.

2. As a general rule, it provides that bylaws for a corporation may state that "internal corporate claims must be brought exclusively in a specified court or courts of the Commonwealth and, if so specified, also in:

a. other identified courts sitting in this Commonwealth; or

b. identified courts sitting in other jurisdictions with which the business corporation has a reasonable relationship."

3. If there is a claim arising under the Securities Act of 1933, then the bylaws can provide that those claims may only be brought in a federal court.

4. If a bylaw is created under this forum selection provision, it would not automatically confer jurisdiction onto the specified court. Essentially, the specified court must still have subject matter jurisdiction and personal jurisdiction over the matter. If jurisdiction is not found in the specified court, then the internal corporate claim will be transferred to a Commonwealth court that does have jurisdiction.

5. Internal corporate claims are fiduciary duty actions, derivative actions and actions related to this Title 15, the articles of incorporation or bylaws, or any agreement regarding the governance of the corporation.

6. Importantly, this Section does not include an option for arbitration instead based on my understanding.

C. Renunciation of Business Opportunities

1. Section 524 is a newly added section to the BCL and there was no previous statutory law here.

a. It states that an entity, through its articles of incorporation or an action of the board of directors, may renounce any interest or expectancy in, or in being offered an opportunity to participate in, a specific business opportunity that was presented to the corporation or to one or more of its directors, officers, shareholders, or members.

b. This addition is interesting because typically, in line with their fiduciary duty of loyalty, directors, officers, shareholders, or members would always have to disclose to the board of directors any opportunities presented to them in their capacity for the entity. Otherwise, they would breach their fiduciary duties and be subject to liability.

c. Now, certain corporations, in their articles of incorporation or through an action of the board of directors, may waive the right to have business opportunities presented to them by directors, officers, shareholders, or members before those individuals may act for their own gain.

2. This provision went into effect on January 3, 2023.

D. Reduction of Personal Liability of Officers

1. Section 1735 of the BCL was added in an attempt to offset the greater liability certain officers or directors might be exposed to as a result of the new annual reporting.

a. As a reminder, the annual reports require that entities file the name of at least one governor and all the names and titles of the principal officers. This information, unlike FinCEN, will be available to the public. Due to this, certain persons might be exposed to more public scrutiny or liability from disgruntled parties.

b. The Pennsylvania legislature might have recognized this risk and attempted to combat it with the addition of 1735.

2. Section 1735 provides that the shareholders may adopt a bylaw that provides that an officer would not be held personally liable for monetary damages for any action taken unless (1) the officer breached or failed to perform the duties of an officer (as stated below in the standard of care section) or (2) the breach or failure to perform constitutes self-dealing, willful misconduct or recklessness.

a. The recklessness definition is another addition to the BCL, and it is "conduct that involves a conscious disregard of a substantial and unjustifiable risk.

b. The risk must be of such a nature and degree that, considering the nature and intent of the actor's conduct and the circumstances known to the actor, its conscious disregard involves a gross deviation from the standard of conduct that a reasonable person would observe in the actor's situation."

c. This limited liability is limited itself in that shareholders cannot erase liability for responsibility arising from a criminal statute or from the payment of taxes under Federal or State or local law.

III. Fiduciary Duty Related Changes

A. Standard of Care, Justifiable Reliance, and the Business Judgment Rule

1. Another area of amendment, or additions to currently existing law, occurs in Section 512 which relates to fiduciary duty standards of care, justifiable reliance, and the business judgment rule. The provision about the business judgment rule has been added, which means Pennsylvania has denoted that it will deviate from the common law business judgment rule.

2. Analyzing this section piece by piece, subsection (a) works with directors' standard of care in relation to the corporation and the performance of their duties.

a. Previously, the BCL only stated that a director must perform his duties in good faith, in a manner the director reasonably believes to be in the best interests of the corporation and with such care the skill and diligence, as that person of ordinary prudence would use under similar circumstances.

b. The Pennsylvania Legislature added a further burden on this standard by stating that the standard of care includes a reasonable inquiry into issues required by the statute of the Commonwealth to be considered in the circumstances and those interests and factors listed in 515(a) and 516(a).

c. The 515(a) factors include the effects of any action on any or all groups affected by such action, the short term and long-term interests of the corporation; and the resources, intent, and conduct of any person seeking to acquire control of the corporation.

d. The 516(a) factors include considering the effects of any action upon the employees, suppliers, customers, and communities in which offices or other establishments of the corporation are located.

3. The Pennsylvania Legislature also added subsection 512(d) which enumerates a specific standard for the business judgment rule.

a. Traditionally, the business judgment rule stands for the proposition that a Board of Directors should be allowed to make business decisions, some that may be controversial, without fear of prosecution by shareholders who might object.

b. The rule assumes that it is unreasonable to expect managers to make optimal decisions all the time, and under this the courts presume that directors are acting rationally and in good faith. The burden of proof was on the accuser to show otherwise.

4. Now, Pennsylvania has deviated from this common law doctrine and creates its own standard. Under 512(d), a director or officer who makes a business judgment in good faith fulfills his duties under this section if:

a. The subject of the business judgment does not involve self-dealing

b. The director or officer is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and

c. The director or officer *rationally* believes that the business judgment is in the best interest of the corporation.

5. The key difference here is the third factor, which inputs a rationality standard instead of a reasonableness standard. Rationality is an easier test to meet. The burden of proof is still on the accuser and they must show that there was a breach of duty of care and that (in a damage action) the breach was the legal cause of damage suffered by the corporation. These additions went into effect on January 3, 2023.

B. Interested Director/Officer Transaction

1. Section 1728 of the BCL clarified the standard for transactions involving interested directors. If the transaction is between a corporation and a wholly owned association, that fact that there is an interested officer or director does not alone render the entire transaction void and the two parties may proceed.

2. In subsection 1728(d), if the transaction is between a corporation and a non-wholly owned entity, the transaction will not be automatically void or voidable solely on the grounds of there being an interested director or officer if one of four events occur:

a. 1728(a)(1) the material facts of the relationship/interest are disclosed to board and authorized by affirmative vote of the disinterested directors;

b. 1728(a)(2) the material facts are disclosed to the shareholders and the shareholders approve the transaction in a good faith vote;

c. 1728(a)(3) the transaction is fair to the corporation when approved by the shareholders or directors; or

d. 1728(d)(i)-(ii) the directors or officers serving for both parties neither participate in negotiations in a substantial or personal manner for either entity, nor is their vote required at a meeting for either entity to approve the transaction.

3. This section was added and took effect in January of 2023.

IV. Internal Corporate Procedures

A. Bylaws and Powers in Emergency

1. Section 1509 is an area of existing law that was amended with added language reflecting further clarification and authorities in cases of emergency.

2. First, starting with the definition of an emergency, 1509(a) previously stated that an emergency was any emergency resulting from an attack on the United States, a nuclear disaster, or another catastrophe as a result of which a quorum of the board could not readily be ascertained.

a. While I can imagine this definition seemed to suffice for a while, the introduction of the COVID-19 pandemic changed the scope of emergencies.

b. As a result, the Pennsylvania Legislature scrubbed this definition and added 1509(i), which describes an emergency as a period during which a quorum of the board, or of persons on whom the powers and duties of the board have been conferred or imposed, cannot be assembled as a result of:

(1) an attack on the United States,

(2) a nuclear disaster,

(3) an epidemic or pandemic,

(4) a state of emergency under Federal or state law covering a geographic area in which the corporation has its principal office or a significant regional office or operation, or

(5) any other catastrophe. As you see, the scope of this definition is wider than what was previously included, and thus the scope of this entire section expands as well.

3. Besides the clarification on the definition of emergency, further additions to 1509 are relatively straightforward.

a. First, in 1509(f), a corporate action to further the ordinary business affairs of the corporation that is taken in accordance with emergency bylaws are valid and binding on the corporation.

b. Also, the required time for holding a shareholder meeting is tolled during emergencies, but the board of directors through a majority of who can be assembled may take action that it deems practical and necessary to address the circumstances of the emergency.

c. These actions include postponing the meeting to a later time or notifying shareholders of a meeting postponement or virtual meeting.

4. One other change here is that the board of directors, acting through a majority of those assembled during an emergency, may change the record date or payment date of a distribution that has been declared if the record date has not yet occurred.

5. However, the new payment date cannot be more than 60 days after the new record date and the corporation must give shareholders prompt notice.

B. Virtual Shareholder Meetings and Notice Requirements

1. With the growth of technology, more governance and internal corporate procedures have been conducted virtually.

2. Section 1708(c) of the BCL was added so that a shareholder meeting is no longer required to be held at a physical location unless the bylaws of the corporation require it.

3. However, the BCL states that if a shareholder meeting is virtual, shareholders must have a reasonable opportunity to participate in the meeting, read or hear proceedings simultaneously (to a substantial extent) with their occurrence, vote on matters submitted to the shareholders, and make motions and comment on the business of the meeting (subject to procedures and guidelines adopted by directors).

4. The BCL was also amended with further notice requirements.

a. To conduct shareholder meetings virtually, notice must be given personally, or delivered (instead of sent) through first class mail, express mail, or courier service, postage/charges prepaid, or by facsimile transmission, email, or other electronic means.

b. The key difference here is that merely sending notice is not enough, it must be personally given to the shareholder or delivered through one of the other methods.

5. However, if a corporation is registered with the SEC and has previously provided shareholders with a notice that the corporation utilizes an online website to post proxy materials, which is in line with SEC requirements, the corporation may post a notice of a virtual shareholder meeting on same website where proxy materials are located.

V. Ratification of Defective Entity Actions

This change deserves a section of its own because it is an entirely new law. The Pennsylvania legislature added the entire Subchapter B to Chapter 2 of the BCL to discuss the ratification of defective entity actions. This Subchapter B took effect as of January 3, 2023.

A. What are Defective Entity Actions?

1. A defective entity action is an overissue or any other entity action purportedly taken that is and, at the time the entity action was purportedly taken that

   a. is void or voidable;

   b. cannot be determined not to be void or voidable by the governors of the ratifying entity or previous entity; or

   c. does not operate fully in the manner intended at the time the entity action was purported to have become effective

3. A void act is an act that the entity or action takers lack the power or capacity to take. For example, this could be the issuance of shares in excess of the number authorized, or entry into a contract to perform an illegal act.

4. A voidable act is an act that was within the company's power or capacity to take but was not properly authorized or carried out.

B. How can a Defective Entity Action be Ratified? (§223)

1. Section 223 enumerates the ratification of certain defective entity actions based on the classification of each action.

2. First, general actions by governors can be ratified when the governors of the ratifying entity take an action stating:

   a. the defective entity action and if necessary the number and type of putative interests issued;

   b. the date of the defective entity action;

   c. the nature of the failure of authorization with respect to the defective entity action to be ratified; and

   d. that the governors approve the ratification of the defective entity action.

3. In contrast, the election of initial governors and any action related thereof require a different ratification process.

4. A majority of the persons who exercise the power of the governors can take an action stating the:

a. name of each person who first took action in the name of the entity as the initial governors;

b. the earlier of the date on which each person first took action or was purportedly elected; and

c. that the ratification of the election of each person as an initial governor is approved.

5. The quorum and voting requirements applicable to the approval by the interest holders are the quorum and voting requirements applicable to the entity action proposed to be ratified at the time of the interest holder approval.

6. If the ratification is one regarding the election of governors, either of the following must occur:

a. that the votes cast within the voting group favoring ratification exceed the votes cast opposing ratification of the election at a meeting at which a quorum is present; or

b. in the case of directors or a class of directors of a business corporation elected by cumulative voting, that the votes cast against ratification not be sufficient to elect one or more directors to the board or to the class.

7. When a ratified action would have required a filing with the Department, the entity must submit a statement of validation with the Department after the action was ratified.

C. What is an Action on Ratification?

1. The above section mentioned that the governors must take action. Section 224 provides for what actions qualify as a proper ratifying action. If the ratification involves the governors taking action, all that is needed is a proper quorum and required vote of the governors.

2. If the ratification involves shareholders (or interest holders), the entity has to give notice to each shareholder as of the record date for notice of the meeting, regardless of whether they are entitled to vote. If the ratification relates to an overissue, it must also give notice to the holders of both the valid and putative interests. Any notice must state the purpose of the meeting is one to consider ratification as well as a copy of the action taken.

3. The final major change noted in a few articles related to defective entity actions.

4. A defective entity action is an entity action that was purportedly effective but: (1) is void or voidable; (2) cannot be determined not to be void or voidable by the

governors of the ratifying entity or previous entity; or (3) otherwise does not operate fully in the manner intended.

5. Generally, ratification of defective acts under the changes to the BCL will require approval by the classes of parties that should have originally approved the action.

6. When a ratified action would have required a filing with the Pennsylvania Department of State, the entity must submit a statement of validation with the Department. Where the approval of an interest holder is required, the entity must give notice to the interest holders regardless of entitlement to vote. Further information on the ratification process is found in §224.