

**2008 Business Law Legislation: Amendments to the Iowa Business Corporation Act  
and the Uniform Prudent Management of Institutional Funds Act**

**Willard L. Boyd III  
Nyemaster, Goode, West, Hansell & O'Brien, P.C.  
700 Walnut, Suite 1600  
Des Moines, IA  
515-283-3172  
wlb@nyemaster.com**

**I. Iowa Business Corporation Act**

A. Iowa Code section 490.870 (Business Opportunities).

1. The Iowa Business Corporation Act (“IBCA”), which is based on the American Bar Association’s Model Business Corporation Act (“MBCA”), was amended this year (HF 2165) to include a MBCA provision that sets forth a safe harbor under which directors are able to weigh possible involvement with prospective business opportunity that might constitute a “corporate opportunity.”
2. The amendment provides as follows:

490.870 BUSINESS OPPORTUNITIES

1. A director's taking advantage, directly or indirectly, of a business opportunity may not be the subject of equitable relief, or give rise to an award of damages or other sanctions against the director, in a proceeding by or in the right of the corporation on the ground that such opportunity should have first been offered to the corporation, if before becoming legally obligated respecting the opportunity the director brings it to the attention of the corporation and any of the following apply:

a. Action by qualified directors disclaiming the corporation's interest in the opportunity is taken in compliance with the procedures set forth in section 490.832, as if the decision being made concerned a director's conflicting interest transaction.

b. Shareholders' action disclaiming the corporation's interest in the opportunity is taken in compliance with the procedure set forth in section 490.832, as if the decision being made concerned a director's conflicting interest transaction; except that, rather than making the disclosure as required in section 490.832, in each case the director shall have made prior disclosure to those acting on

behalf of the corporation of all material facts concerning the business opportunity that are then known to the director.

2. In any proceeding seeking equitable relief or other remedy based upon an alleged improper taking advantage of a business opportunity by a director, the fact that the director did not employ the procedure described in subsection 1 before taking advantage of the opportunity shall not create an inference that the opportunity should have been first presented to the corporation or alter the burden of proof otherwise applicable to establish that the director breached a duty to the corporation in the circumstances.

3. The common law doctrine of “corporate opportunity” has long been recognized as a core part of the director’s duty of loyalty. The doctrine stands for the proposition that the corporation has a right prior to that of its director to act on certain business opportunities that come to the attention of the director. In such situations, a director who acts on the opportunity for the benefit of the director or another without having first presented the opportunity to the corporation can be held to have “usurped” or “intercepted” a right of the corporation. See MBCA, Comments to Section 8.70.
4. The amendment provides guidance to both directors and courts with regard to how business opportunity issues are to be handled. When properly employed, the provision will provide a safe-harbor mechanism enabling a director to pursue an opportunity for his or her own account or for the benefit of another free of possible challenge claiming conflict with the duty of loyalty on the ground that the opportunity should have first been offered to the corporation. Id. The safe harbor is based on the safe harbor provision for conflict of interest transactions and, in fact, references the conflict of interest procedures set forth in Iowa Code section 490.832.

B. Iowa Code section 490.640 (Distribution to Shareholders).

1. Iowa Code section 490.640 currently contains all but one of the subsections of the MBCA Section 6.40. In particular, the IBCA provision does not include subsection (g) of the MBCA.
2. Iowa Code section 490.640(3) provides that a corporation may not make a distribution to a shareholder if (a) the corporation would not be able to pay its debts as they become due in the usual course of business or (b) the corporation’s total assets would be less than the sum of its total liabilities plus the amount that would be needed if the corporation were to be dissolved at the time of the distribution, to satisfy preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

3. Iowa Code section 490.640 was amended to include the following provision:

7. Indebtedness of a corporation, including indebtedness issued as a distribution, is not considered a liability for purposes of determinations under subsection 1 if its terms provide that payment of principal and interest are made only if and to the extent that payment of a distribution to shareholders could then be made under this section. If the indebtedness is issued as a distribution, each payment of principal or interest is treated as a distribution, the effect of which is measured on the date the payment is actually made.

4. Under the amendment, indebtedness does not need to be taken into account as a liability in determining whether the tests of section 490.640(7) have been met if the terms of the indebtedness provide that payments of principal or interest can be made only if and to the extent that payment of a distribution could then be made under section 490.640. This has the effect of making the holder of the indebtedness junior to all other creditors but senior to the holders of all classes of shares, not only during the time the corporation is operating but also upon dissolution and liquidation. See MBCA, Comments to Section 6.40.

5. Although section 490.640(7) is applicable to all indebtedness meeting its tests, it is anticipated that it will be applicable most frequently to permit the reacquisition of shares of the corporation when the deferred purchase price exceeds the net worth of the corporation. This type of reacquisition will often be necessary in the case of businesses in the early stages of development or service businesses whose value derives principally from existing or prospective net income or cash flow rather than from net asset value. In such situations, it is anticipated that net worth will grow over time from operations so that when payments in respect of the indebtedness are to be made the two insolvency tests will be satisfied. In the meantime, the fact that the indebtedness is outstanding will not prevent distributions that could be made under section 490.640(7) if the indebtedness were not counted in making the determination. Id.

C. Iowa Code sections 490.1111 to 490.1114 – Conversion.

1. As part of the Revised Uniform Limited Liability Company Act (“RULLCA”) legislation (SF 2395), the IBCA was amended to include provisions addressing conversions involving Iowa business corporations and other types of business entities.

2. An amendment to IBCA was necessary because RULLCA allows for the conversion involving a LLC and an Iowa business corporation only if the IBCA allows for such conversion.

3. Process for conversion is similar to RULLCA provisions and provisions in the Uniform Limited Partnership Act, Iowa Code Chapter 488.
4. For an Iowa business corporation that is converting into another entity, the following is required:
  - a. A plan of conversion needs to be adopted by the corporation's board of directors.
  - b. The plan of conversion must be submitted to the shareholders for their approval along with a recommendation from the board of directors unless the board makes a determination that because of conflicts of interest or other special circumstances it should not make a recommendation.
  - c. All shareholders (including non-voting shareholders) need to be notified of the meeting at which the plan is to be submitted for approval.
  - d. The board may condition its submission of the plan of conversion on any basis.
  - e. Unless the articles of incorporation, bylaws or the board of directors require a greater vote or greater number of votes to be present, the approval of the plan of conversion shall require the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the plan exists, and, if any classes or series of shares is entitled to vote as a separate group on the plan, the approval of each such separate voting group at a meeting at which quorum of the voting group consisting of at least a majority of the votes entitled to be cast on the conversion by that voting group is present.
  - f. If any provision of the articles of incorporation, bylaws, or an agreement of the corporation to which any of the directors or shareholders of the corporation are parties, adopted or entered into before the effective date of this section, applies to a merger of the corporation and the document does not refer to a conversion of the corporation, the provision shall be deemed to apply to a conversion of the corporation until such provision is subsequently amended.
  - g. If as a result of the conversion, one or more shareholders becomes subject to owner liability for debts, obligations, or liabilities of any other person or entity approval of the plan of conversion shall require the execution by each such shareholder of a separate written consent to become so subject to such owner liability. Iowa Code section 490.1112.

5. Articles of conversion are required to be filed with the Secretary of State's office. Iowa Code section 490.1113.
6. A corporation or other entity that that has been converted is for all purposes the same corporation or other entity that existed before the conversion. All property, debts, liabilities, and other obligations, and rights, privileges, immunities, powers and purposes of the converting entity remain with the converted entity. Iowa Code section 490.1114.

## **II. Uniform Prudent Management of Institutional Funds Act**

### **A. Iowa Legislation and NCCUSL.**

1. The Uniform Prudent Management of Institutional Funds Act ("UPMIFA") (SF 2316) becomes effective July 1, 2008, and will be codified at Iowa Code Chapter 540A.
2. UPMIFA replaces the Uniform Management of Institutional Funds Act ("UMIFA"), Iowa Code Chapter 540A.
3. Both UPMIFA and UMIFA were developed by the National Conference of Commissioners on Uniform State Laws ("NCCUSL").
4. UMIFA was adopted in 1972 and has been enacted in 47 states.
5. UPMIFA, which was adopted by NCCUSL in 2006, and, to date, has been enacted by twenty-one states, including Nebraska and Minnesota, and introduced in an additional eleven other states.

### **B. Summary of UPMIFA.**

#### **1. Overview.**

- a. UPMIFA (like UMIFA) addresses the standards for the investment of institutional funds and the expenditures of such funds.
- b. According to the UPMIFA commentary, both uniform laws are supported by two general principles: (1) that assets of charitable organizations are to be invested prudently in diversified investments that seek growth as well as income, and (2) that appreciation of assets can prudently be spent for the purposes of any endowment fund held by a charitable institution. UPMIFA, as an update and successor to UMIFA, is considered a sounder and more unified basis for charitable fund management than UMIFA has provided.

2. Entities Affected By UPMIFA. UPMIFA applies to the following types of entities: nonprofit corporations, governmental entities that hold funds for exclusively charitable purposes, and trusts that have both charitable and noncharitable interests after the noncharitable interests have been terminated. Iowa Code section 540A.102(4).
3. Standards for Investments.
  - a. UPMIFA requires investment “in good faith and with the care an ordinary prudent person in a like position would exercise under similar circumstances.” Iowa Code section 540A.103(2). It requires prudence in incurring investment costs, authorizing “only costs that are appropriate and reasonable.” Id.
  - b. Factors to be considered in investing are expanded to include:
    - i. General economic conditions.
    - ii. Possible effect of inflation or deflation.
    - iii. Expected tax consequences.
    - iv. Role each investment plays with an overall portfolio.
    - v. Expected total of return from income and appreciation.
    - vi. Other resources of the institution.
    - vii. Needs of the institution and fund to make distributions and preserve capital.
    - viii. Asset’s special relationship or special value, if any, to the charitable purposes of the institution. Iowa Code section 540A.103(5)(a).
  - c. UPMIFA emphasizes that investment decisions must be made in relation to the overall resources of the institution and its charitable purposes. Iowa Code section 540A.103(5)(b).
4. Standards for Expenditures.
  - a. Whereas UMIFA requires that asset growth and income can be appropriated for program purposes, subject to the rule that an endowment fund could not be spent below its “historic dollar value,” UPMIFA provides more specific guidance on prudence and eliminates a floor on spending.

- b. UPMIFA states that an institution “may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines to be prudent for uses, benefits, purposes and duration for which the endowment fund is established.” Iowa Code section 540A.104(1).
- c. UPMIFA provides that in making a determination appropriate or accumulate, the institution shall act in good faith, with the care that an ordinary prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, all of the following factors:
  - i. Duration and preservation of the endowment fund.
  - ii. Purposes of the institution and the endowment fund.
  - iii. General economic conditions.
  - iv. Possible effect of inflation or deflation.
  - v. Expected total return from income and the appreciation.
  - vi. Other resources of the institution.
  - vii. Investment policy of the institution. Iowa Code section 540A.104(1).
- d. Terminology Used in Gift Instruments.
  - 1. UPMIFA provides: “Terms in a gift instrument designating a gift as an endowment, or a direction or authorization in the gift instrument to use only ‘income’, ‘interest’, ‘dividends’, or ‘rents, issues, or profits’ or ‘to preserve the principal intact’, or words of similar import to do all of the following:
    - a. Create an endowment fund of permanent duration unless other language in the gift instrument limits the duration or purpose of the fund.
    - b. Do not otherwise limit the authority to appropriate for expenditure or accumulate under subsection 1.” Iowa Code section 540A.104(3).
  - 2. The comments to UPMIFA state that the Section provides “rules of construction” to assist institutions in interpreting donor’s intent. The comments also provide as follows: the Section assumes that if a donor wants an institution to spend “only the income” from a fund, the donor

intends that the fund both support current expenditures and be preserved permanently. The donor is unlikely to be concerned about the designation of particular returns as “income” or “principal” under accounting principles. Rather, the donor is more likely to assume that the institution will use modern total-return investing techniques to generate enough funds to distribute while maintaining the long-term viability of the fund. The comments further provide that the Section is an intent effectuating provision that provides default rules to construe donor’s intent.

3. The comments note that the Section provides that a donor who wants to specify particular spending guidelines can do so. For example, the comments note that a donor might want to limit expenditures to trust accounting income and not want the institution to be able to expend appreciation. According to the comments, an instruction to pay only the “income” will not be specific enough, but an instruction to “pay only interest and dividend income earned by the fund and not to make other distributions of the kind authorized by Section 4 of UPMIFA” should be sufficient.
4. Iowa Code section 540A.104(4) was added based on a concern that donors may not understand that restricting expenditure authority to “income” does not really do that under UPMIFA (and probably does not do so under UMIFA). The language in subsection (4) is based on the premise that a gift instrument could contain some language making this point clear.

5. Delegation of Duties.

- a. UPMIFA allows delegation of management/investment functions provided certain requirements are met.
- b. Such delegation may take place in good faith and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances with regard to (1) selection of an agent; (2) establishing scope and terms of delegation; and (3) requiring periodic reviews and supervision of the agent. Iowa Code section 540A.105(1).
- c. In addition, UPMIFA provides that an agent has a duty of reasonable care in performing such delegated functions. Iowa Code section 540A.105(2).
- d. By accepting the delegation, the agent is subject to the jurisdiction of Iowa courts. In addition, an institution may delegate management and investment functions to its committees, officers, or employees as authorized by the laws of the state. Iowa Code section 540A.105(4).

6. Donor Intent.

- a. UPMIFA recognizes and protects donor intent more broadly than UMIFA, in part, by providing a more comprehensive treatment of the modification of restrictions on charitable funds.
- b. Among other things, UPMIFA provides that a court may release or modify a restriction where the restriction is, among other things, impracticable or wasteful, or the purpose is unlawful, impracticable, impossible to achieve or wasteful. For small funds with a value of less than \$50,000 and where more than twenty years has elapsed since their establishment, the institution may institute a release or modification without court approval. Iowa Code sections 540A.106(1) through (4).
- c. The Iowa version of UPMIFA also includes a donor standing provision.
  - i. Under such provision, a donor whose aggregate gifts to an endowment fund exceed \$100,000 may maintain an action in the district court of the county in which the institution's principal office is located to enforce restrictions respecting the purposes of the fund established by the donor in a gift instrument. Iowa Code section 540A.106(5)(a).
  - ii. The donor may designate in the gift instrument or other record signed by the donor and delivered to the institution one or more persons, by name or by description, whether or not born at the time of such designation, to enforce the restrictions during the lifetime of the donor if the donor is declared judicially incompetent. Iowa Code section 540A.106(5)(b). Similarly, the donor may designate one or more persons to enforce the restrictions for a period of fifty years after the death of the donor. Iowa Code section 540A.106(5)(c).
  - iii. If the donor prevails in any action in district court respecting the purposes of the fund in the gift instrument, the district court may order the institution to reimburse the donor's costs, including reasonable attorney fees, if the court finds that the institution acted in bad faith or with gross negligence. Id.
  - iv. The provisions of Iowa Code section 540A.106(5) may be altered by contrary provisions in the gift instrument. Iowa Code section 540A.106(5)(d).