

Attachment A  
Indemnification and Insurance of Directors and Officers of Nonprofit Corporations  
(A.R.S. §§ 10-3850 through 10-3858) (as of 12/8/05)

A.R.S. § 10-3850 (Definitions)

In this article, unless the context otherwise requires:

1. "Corporation" includes any domestic or foreign predecessor entity of a corporation in a merger or other transaction in which the predecessor's existence ceased upon consummation of the transaction.
2. "Director" means an individual who is or was a director of a corporation or an individual who, while a director of a corporation, is or was serving at the corporation's request as a director, officer, partner, trustee, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other entity. A director is considered to be serving an employee benefit plan at the corporation's request if the director's duties to the corporation also impose duties on or otherwise involve services by the director to the plan or to participants in or beneficiaries of the plan. Director includes the estate or personal representative of a director and includes ex officio members of the board.
3. "Expenses" include attorney fees and other costs and expenses reasonably related to a proceeding.
4. "Liability" means the obligation to pay a judgment, settlement, penalty or fine, including an excise tax assessed with respect to an employee benefit plan, or reasonable expenses actually incurred with respect to a proceeding and includes obligations and expenses that have not yet been paid by the indemnified persons but that have been or may be incurred.
5. "Officer" means an individual who is or was an officer of a corporation or an individual who, while an officer of a corporation, is or was serving at the corporation's request as a director, officer, partner, trustee, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other entity. An officer is considered to be serving an employee benefit plan at the corporation's request if the officer's duties to the corporation also impose duties on or otherwise involve services by the officer to the plan or to participants in or beneficiaries of the plan. Officer includes the estate or personal representative of an officer.
6. "Official capacity" means if used with respect to a director, the office of director in a corporation and, if used with respect to an officer as contemplated in section 10-3856, the office in a corporation held by the officer. Official capacity does not include service for any other foreign or domestic corporation or any partnership, joint venture, trust, employee benefit plan, or other entity.

7. "Outside director" means a director who, when serving as a director, is not or was not a compensated officer, employee or member holding more than ten per cent of the voting power of the corporation or any affiliate of the corporation or an officer, employee or holder of more than ten per cent of the voting power of such a member or any affiliate of that member.

8. "Party" includes an individual who was, is or is threatened to be made a named defendant or respondent in a proceeding.

9. "Proceeding" means any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative and whether formal or informal.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3851 (Authority to indemnify)

A. Except as provided in subsection D of this section, a corporation may indemnify an individual made a party to a proceeding because either:

1. The individual is or was a director against liability incurred in the proceeding if all of the following conditions exist:

(a) The individual's conduct was in good faith.

(b) The individual reasonably believed:

(i) In the case of conduct in an official capacity with the corporation, that the conduct was in its best interests.

(ii) In all other cases, that the conduct was at least not opposed to its best interests.

(c) In the case of any criminal proceedings, the individual had no reasonable cause to believe the conduct was unlawful.

2. The director engaged in conduct for which broader indemnification has been made permissible or obligatory under a provision of the articles of incorporation pursuant to section 10-3202, subsection B, paragraph 2.

B. A director's conduct with respect to an employee benefit plan for a purpose the director reasonably believed to be in the interests of the participants in and beneficiaries of the plan is conduct that satisfies the requirement of subsection A, paragraph 1, subdivision (a) of this section.

C. The termination of a proceeding by judgment, order, settlement or conviction or on a plea of

no contest or its equivalent is not of itself determinative that the director did not meet the standard of conduct described in this section.

D. A corporation may not indemnify a director under this section either:

1. In connection with a proceeding by or in the right of the corporation in which the director was adjudged liable to the corporation.

2. In connection with any other proceeding charging improper personal benefit to the director, whether or not involving action in the director's official capacity, in which the director was adjudged liable on the basis that personal benefit was improperly received by the director.

E. Indemnification permitted under this section in connection with a proceeding by or in the right of the corporation is limited to reasonable expenses incurred in connection with the proceeding.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3852 (Mandatory indemnification)

A. Unless limited by its articles of incorporation, a corporation shall indemnify a director who was the prevailing party, on the merits or otherwise, in the defense of any proceeding to which the director was a party because the director is or was a director of the corporation against reasonable expenses incurred by the director in connection with the proceeding.

B. Unless limited by its articles of incorporation, section 10-851, subsection D or subsection C of this section, a corporation shall indemnify an outside director against liability. Unless limited by its articles of incorporation or subsection C of this section, a corporation shall pay an outside director's expenses in advance of a final disposition of a proceeding, if the director furnishes the corporation with a written affirmation of the director's good faith belief that the director has met the standard of conduct described in section 10-851, subsection A and the director furnishes the corporation with a written undertaking executed personally, or on the director's behalf, to repay the advance if it is ultimately determined that the director did not meet the standard of conduct. The undertaking required by this subsection is an unlimited general obligation of the director but need not be secured and shall be accepted without reference to the director's financial ability to make repayment.

C. A corporation shall not provide the indemnification or advancement of expenses described in subsection B of this section if a court of competent jurisdiction has determined before payment that the outside director failed to meet the standards described in section 10-851, subsection A, and a court of competent jurisdiction does not otherwise authorize payment under section 10-854. A corporation shall not delay payment of indemnification or expenses under subsection B of this section for more than sixty days after a request is made unless ordered to do so by a court of competent jurisdiction.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3853 (Advance for expenses)

A. A corporation may pay for or reimburse the reasonable expenses incurred by a director who is a party to a proceeding in advance of final disposition of the proceeding if both of the following conditions exist:

1. The director furnishes to the corporation a written affirmation of the director's good faith belief that the director has met the standard of conduct described in section 10-3851 or that the proceeding involves conduct for which liability has been eliminated under a provision of the articles of incorporation pursuant to section 10-3202, subsection B, paragraph 1.

2. The director furnishes the corporation with a written undertaking, executed personally or on the director's behalf, to repay the advance if the director is not entitled to mandatory indemnification under section 10-3852 and it is ultimately determined that the director did not meet the standard of conduct.

B. The undertaking required by subsection A, paragraph 2 of this section is an unlimited general obligation of the director but need not be secured and may be accepted without reference to financial ability to make repayment.

C. Authorizations of payments under this section shall be made in a manner consistent with section 10-3830 or 10-3842.

D. This section does not apply to advancement of expenses to or for the benefit of an outside director. Advances to outside directors shall be made pursuant to section 10-3852.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3854 (Court ordered indemnification)

Unless a corporation's articles of incorporation provide otherwise, a director of the corporation who is a party to a proceeding may apply for indemnification or an advance for expenses to the court conducting the proceeding or to another court of competent jurisdiction. On receipt of an application, the court after giving any notice the court considers necessary may order indemnification advances for expenses if it determines either:

1. The director is entitled to mandatory indemnification under section 10-3852, in which case the court shall also order the corporation to pay the director's reasonable expenses incurred to obtain court ordered indemnification.

2. The director is fairly and reasonably entitled to indemnification in view of all the relevant circumstances, whether or not the director met the standard of conduct set forth in section 10-3851 or was adjudged liable as described in section 10-3851, subsection D, but if the director was adjudged liable under section 10-3851, subsection D, indemnification is limited to reasonable expenses incurred.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3855 (Determination and authorization of indemnification)

A. A corporation may not indemnify a director under section 10-3851 unless authorized in the specific case after a determination has been made that indemnification of the director is permissible in the circumstances because the director has met the standard of conduct set forth in section 10-3851.

B. The determination shall be made either:

1. By the board of directors by a majority vote of the directors not at the time parties to the proceeding.

2. By special legal counsel:

(a) Selected by majority vote of the disinterested directors.

(b) If there are no disinterested directors, selected by majority vote of the board of directors.

3. By the members, but directors who are at the time parties to the proceeding may not vote on the determination.

C. Neither special legal counsel nor any member has any liability whatsoever for a determination made pursuant to this section. In voting pursuant to subsection B of this section, directors shall discharge their duty in accordance with section 10-3830.

D. Authorization of indemnification and evaluation as to reasonableness of expenses shall be made in the same manner as the determination that indemnification is permissible, except that if the determination is made by special legal counsel, authorization of indemnification and evaluation as to reasonableness of expenses shall be made by those entitled under subsection B, paragraph 2 of this section to select counsel.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3856 (Indemnification of officer)

A. A corporation may indemnify and advance expenses under this article to an officer of the corporation who is a party to a proceeding because the individual is or was an officer of the corporation as follows:

1. To the same extent as a director.
2. If the individual is an officer but not a director, to the further extent as may be provided by the articles of incorporation, the bylaws, a resolution of the board of directors, or contract except for:
  - (a) Liability in connection with a proceeding by or in the right of the corporation other than for reasonable expenses incurred in connection with the proceeding.
  - (b) Liability arising out of conduct that constitutes:
    - (i) Receipt by the officer of a financial benefit to which the officer is not entitled.
    - (ii) An intentional infliction of harm on the corporation or the members.
    - (iii) An intentional violation of criminal law.

B. Subsection A, paragraph 2 of this section applies to an officer who is also director if the basis on which the officer is made a party to the proceeding is an act or omission solely as an officer.

C. An officer of a corporation who is not a director is entitled to mandatory indemnification under section 10-3852, subsection A and may apply to a court under section 10-3854 for indemnification or an advance for expenses, in each case to the same extent to which a director is entitled to indemnification or advance for expenses under those sections.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3857 (Insurance)

A corporation may purchase and maintain insurance on behalf of an individual who is or was a director or officer of the corporation or who, while a director or officer of the corporation, is or was serving at the request of the corporation as a director, officer, partner, trustee, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other entity, against liability asserted against or incurred by the individual in that capacity or arising from the individual's status as a director or officer, whether or not the corporation would have power to indemnify or advance expenses to the person against the same liability under this article.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3858 (Application of article)

A. A provision treating a corporation's indemnification of or advance for expenses to directors that is contained in its articles of incorporation, bylaws, a resolution of its members or board of directors or a contract or otherwise is valid only if and to the extent the provision is consistent with this article. If the articles of incorporation limit indemnification or advances for expenses, indemnification and advances for expenses are valid only to the extent consistent with the articles of incorporation.

B. This article does not limit a corporation's power to pay or reimburse expenses incurred by a director in connection with the director's appearance as a witness in a proceeding at a time when the director has not been made a named defendant or respondent to the proceeding.

C. This article does not limit a corporation's power to indemnify, advance expenses or maintain insurance on behalf of an employee or agent.

HISTORY: Last year in which legislation affected this section: 1997

Attachment B  
Conflicting Interest Transactions  
(A.R.S. §§ 10-3860 through 10-3864) (as of 12/8/05)

A.R.S. § 10-3860 (Definitions)

In this article, unless the context otherwise requires:

1. "Conflicting interest" with respect to a corporation means the interest a director of the corporation has respecting a transaction effected or proposed to be effected by the corporation, by a subsidiary of the corporation or by any other entity in which the corporation has a controlling interest if either:

(a) Whether or not the transaction is brought before the board of directors of the corporation for action, the director knows at the time of commitment that the director or a related person either:

(i) Is a party to the transaction.

(ii) Has a beneficial financial interest in or is so closely linked to the transaction and of such financial significance to the director or a related person that the interest would reasonably be expected to exert an influence on the director's judgment if he were called on to vote on the transaction.

(b) The transaction is brought or is of such character and significance to the corporation that it would in the normal course be brought before the board of directors of the corporation for action, and the director knows at the time of commitment that any of the following persons is either a party to the transaction or has a beneficial financial interest in or is so closely linked to the transaction and of such financial significance to the person that the interest would reasonably be expected to exert an influence on the director's judgment if the director were called on to vote on the transaction:

(i) An entity, other than the corporation, of which the director is a director, general partner, agent or employee.

(ii) A person that controls one or more of the entities specified in item (i) of this subdivision or an entity that is controlled by or is under common control with one or more of the entities specified in item (i) of this subdivision.

(iii) An individual who is a general partner, principal or employer of the director.

2. "Director's conflicting interest transaction" with respect to a corporation means a transaction effected or proposed to be effected by the corporation, by a subsidiary of the corporation or by



any other entity in which the corporation has a controlling interest respecting which a director of the corporation has a conflicting interest.

3. "Related person" of a director means either:

(a) The spouse, or a parent or sibling of the spouse, of the director, a child, grandchild, sibling, parent or spouse of a child, grandchild, sibling or parent, of the director, an individual having the same home as the director or a trust or estate of which an individual specified in this subdivision is a substantial beneficiary.

(b) A trust, estate, incompetent, conservatee or minor of which the director is a fiduciary.

4. "Required disclosure" means disclosure by the director who has a conflicting interest of both:

(a) The existence and nature of the conflicting interest.

(b) All facts known to the director respecting the subject matter of the transaction that an ordinarily prudent person would reasonably believe to be material to a judgment about whether or not to proceed with the transaction.

5. "Time of commitment" respecting a transaction means the time when the transaction is consummated or, if made pursuant to contract, the time when the corporation, or its subsidiary or the entity in which it has a controlling interest, becomes contractually obligated so that its unilateral withdrawal from the transaction would entail significant loss, liability or other damage.

HISTORY: Last year in which legislation affected this section: 1997

#### A.R.S. § 10-3861 (Judicial action)

A. A transaction that is effected or proposed to be effected by a corporation, or by a subsidiary of the corporation or any other entity in which the corporation has a controlling interest, and that is not a director's conflicting interest transaction shall not be enjoined, be set aside or give rise to an award of damages or other sanctions in a proceeding by a member or by or in the right of the corporation, because a director of the corporation, or any person with whom or with which the director has a personal, economic or other association, has an interest in the transaction.

B. A director's conflicting interest transaction shall not be enjoined, be set aside or give rise to an award of damages or other sanctions in a proceeding by a member by or in the right of the corporation, because the director, or any person with whom or with which the director has a personal, economic or other association, has an interest in the transaction, if either:

1. Directors' action respecting the transaction was taken at any time in compliance with section 10-3862.

2. Members' action respecting the transaction was taken at any time in compliance with section 10-3863.

3. The transaction, judged according to the circumstances at the time of commitment, is established to have been fair to the corporation.

C. Any person seeking to have a director's conflicting interest transaction enjoined, set aside or give rise to an award of damages or other sanctions shall first prove by clear and convincing evidence that subsection B of this section is not applicable.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3862 (Directors' action; definition)

A. Directors' action respecting a transaction is effective for purposes of section 10-3861, subsection B, paragraph 1 if the transaction received the affirmative vote of a majority, but at least two, of those qualified directors on the board of directors or on a duly empowered committee of the board who voted on the transaction after either required disclosure to them, to the extent the information was not known by them, or compliance with subsection B of this section. Action by a committee is effective under this section only if both:

1. All of its members are qualified directors.
2. Members are either all of the qualified directors on the board or are appointed by the affirmative vote of a majority of the qualified directors or the board.

B. If a director has a conflicting interest regarding a transaction but neither the director nor a related person of the director specified in section 10-3860, paragraph 3, subdivision (a) is a party to the transaction and if the director has a duty under law or professional canon or a duty of confidentiality to another person, respecting information relating to the transaction such that the director may not make the disclosure described in section 10-3860, paragraph 4, subdivision (b), disclosure is sufficient for purposes of subsection A of this section if the director both:

1. Discloses to the directors voting on the transaction the existence and nature of the conflicting interest and informs them of the character and limitations imposed by that duty before their vote on the transaction.
2. Plays no part, directly or indirectly, in their deliberations or vote.

C. A majority, but at least two, of all of the qualified directors on the board of directors or on the committee is a quorum for purposes of action that complies with this section. Directors' action that otherwise complies with this section is not affected by the presence or vote of a director

who is not a qualified director.

D. For purposes of this section, "qualified director" means, with respect to a director's conflicting transaction, any director who does not have either:

1. A conflicting interest respecting the transaction.
2. A familial, financial, professional or employment relationship with a second director who does have a conflicting interest respecting the transaction, which relationship would, in the circumstances, reasonably be expected to exert an influence on the first director's judgment when voting on the transaction.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3863 (Members' action; definition)

A. Members' action respecting a transaction is effective for purposes of section 10-3861, subsection B, paragraph 2 if a majority of the votes entitled to be cast by the holders of all qualified membership interests was cast in favor of the transaction after all of the following:

1. Notice to members describing the director's conflicting interest transaction.
2. Provision of the information referred to in subsection C of this section.
3. Required disclosure to the members who voted on the transaction, to the extent the information was not known by them.

B. A majority of the votes entitled to be cast by the holders of all qualified membership interests is a quorum for the purposes of action that complies with this section. Subject to subsections C and D of this section, members' action that otherwise complies with this section is not affected by the presence of members or the voting of membership interests that are not qualified membership interests.

C. For purposes of compliance with subsection A of this section, a director who has a conflicting interest respecting the transaction shall inform, before the members' vote, the secretary, or other officer or agent of the corporation authorized to tabulate votes, of the number and the identity of persons holding or controlling the vote of all membership interests that the director knows are beneficially owned, or the voting of which is controlled, by the director or by a related person of the director, or both.

D. If a member's vote does not comply with subsection A of this section solely because of a failure of a director to comply with subsection C of this section and if the director establishes that his failure did not determine and was not intended by him to influence the outcome of the

vote, the court, with or without further proceedings respecting section 10-3861, subsection B, paragraph 3, may take such action, respecting the transaction and the director and give such effect, if any, to the members' vote, as it considers appropriate in the circumstances.

E. For purposes of this section, "qualified membership interests" means any membership interests entitled to vote with respect to the director's conflicting interest transaction except membership interests that, to the knowledge, before the vote, of the secretary or other officer or agent of the corporation authorized to tabulate votes, are beneficially owned, or the voting of which is controlled, by a director who has a conflicting interest respecting the transaction or by a related person of the director, or both.

HISTORY: Last year in which legislation affected this section: 1997

A.R.S. § 10-3864 (Conflict of interest policy; exceptions)

**[NOTE: This section will not apply to El Encanto Estates HOA as long as it meets the requirements of the exceptions in B.1 or B.2 of this section.]**

A. The board of directors of a corporation shall adopt a policy regarding transactions between the corporation and interested persons, including the sale, lease or exchange of property to or from interested persons and the corporation, the lending or borrowing of monies to or from interested persons by the corporation or the payment of compensation by the corporation for services provided by interested persons. For the purposes of this subsection, "interested person" means an officer or director of a corporation or any other corporation, firm, association or entity in which an officer or director of a corporation is a member, officer or director or has a financial interest.

B. The requirements of this section do not apply to any of the following:

1. A corporation that had assets at the end of its last fiscal year with a book value of less than ten million dollars, net of accumulated depreciation, or had gross receipts or revenues of less than two million dollars in its last fiscal year.

2. A corporation that offers goods or services only to members who are entitled to vote for its board of directors.

3. A corporation organized for religious purposes that does not have, as a substantial portion of its business, the offering of goods or services on a regular basis to the public for remuneration.

4. A corporation organized by or on behalf of the United States, this state, a political subdivision of this state or an agency or instrumentality of such a governmental entity.

5. A hospital, medical, dental or optometric service corporation licensed pursuant to title 20, chapter 4, article 3.

C. For the purposes of subsection B, paragraph 3:

1. Goods and services include medical, hospital, dental or counseling or social services offered on a regular basis to the public for remuneration.

2. A corporation organized for religious purposes includes a corporation or foreign corporation that controls or is controlled directly or indirectly by a corporation or foreign corporation organized for religious purposes.

D. The exemption provided by subsection B, paragraph 4 does not apply to a corporation that provides services to or operates assets of the governmental entity pursuant to a lease or contract.

HISTORY: Last year in which legislation affected this section: 1997