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# THE PROPOSED ALASKA CORPORATIONS CODE: AN OVERVIEW

<u>The Need for Revision</u>: The current Alaska Business Corporations Act (ABCA) was adopted in 1957. It was a copy of the then existing corporations code in the State of Oregon which was, in turn, a version of the Model Business Corporation Act. The Model Act, or MBCA, was drafted by the business law section of the American Bar Association and has been adopted, in whole or in part, by more than half of the states. It is thus evident that it is a "general" statute which has been drawn up without regard to the economic, physical, or social conditions which may require attention in any specific state. The Model Act went through major revisions in 1962 and 1969 and experienced lesser changes in 1973 and 1977. This activity is suggestive of the fact that business problems and the climate of their legal regulation are not static. While there have been occasional amendments to the Alaska code, there has been no attempt to react to the significant changes in the Model Act which have been recommended since that time.

In the nearly thirty years since the ABCA's enactment other jurisdictions have devoted substantial energy to rethinking and redrafting the content of their corporate laws. Delaware, New York, and California have evolved approaches which may prove more attractive to Alaskans than either the historical or current content of the Model Act. When these developments in the law were viewed along with the very significant changes within the population and economy of Alaska since 1957, the Code Revision Commission was of the view that the existing ABCA was deserving of thorough study.

The Goals of the Commission and Some Basic Value Judgments:

The goal of the Commission was to design a statute which would assist individuals in appreciating the obligations associated with business in the corporate form as well as the choices which should be confronted at the outset of corporate organization. In this respect the Model Act and current Alaska law were found quite deficient. Closely related topics are scattered throughout the statute with the consequence that individuals may never appreciate the "big picture." The rights of shareholders, the duties of officers and directors, the circumstances under which corporate assets may be distributed to shareholders, and the obligations to report to the state on aspects of corporate activity are set forth without consistency or order.

An initial value judgment concerns the degree to which the statute ought to be biased toward a strong board of directors or in the direction of maximum accountability to the shareholders. Delaware provides an example of a management oriented statute while California stands at the opposite extreme. Ultimately, the Commission decided to draft a statute which had no internal bias. Hence, it was decided that the new Alaska act should impose the fewest possible restrictions while clearly articulating the choices Alaskans could make with respect to their individual desires. Thus, under the proposed act it is possible to have a corporation designed with a strong board of directors who are relatively insulated from accountability to shareholders. However, it is equally possible to organize a corporation under the proposed Alaska Corporations Code (ACC) which would produce the opposite result.

To facilitate making these choices, the format of the new statute divides the code into thirteen articles. The scheme takes a corporation from organization through dissolution. With minor adjustments, this framework is borrowed from the New York Business Corporations Law which has been widely praised by members of the business community, accountants, lawyers, and government officials.

<u>Some of the More Important Substantive Changes</u>:

As will be elaborated in the article-by-article analysis which follows, the Commission draft works some important changes in Alaska law. Many of these changes are adapted from provisions of the 1977 California General Corporation Law, the New York Business Corporations Law, and the Delaware code. Others have been originated by the Commission in collaboration with its consultant, Daniel Wm. Fessler, Professor of Law, University of California, Davis.

The most striking major revision has been the elimination of the concepts of "earned surplus" and other concepts of "legal accounting" and their replacement with a far simpler test for determining when a corporation may make a distribution of cash or other property to its shareholders. The earned surplus test has proven an insufficient protection to business creditors and the holders of common stock. It has further proven unworkable when viewed by accountants, for it relied upon principles which either were never meaningful to that profession or which were long ago abandoned in favor of more useful tools. In this attempt to reform the language of the law and lawyers so that they can understand and be understood by the business community and accounting profession, the proposed Alaska law has been heavily influenced by the recent California act.

For the first time since statehood, Alaska will have a comprehensive statutory regulation of the shareholder's derivative suit. Under the law as it now stands, a rule of the Supreme Court, modeled upon the federal rule, is the only attempt to distinguish the meritorious shareholder action designed to remedy wrongs done to the corporation by its officers or directors from the "strike suit" brought with the hope that by vexing incumbent management the plaintiff will be "bought off" with an out of court settlement.

The use of the corporate form to victimize small unsecured creditors (including employees) will be far more difficult if the legislature enacts the Commissions's draft.

A uniform procedure for reporting to the state will be adopted, eliminating a source of significant past confusion. The articles dealing with formation are designed to be used much like a cookbook, with step by step stages focusing the attention of incorporators on the basic decisions which they will need to make.

The sum of all of these forms is a Commission draft which combines the best of corporate law as it has evolved in numerous jurisdictions. Notwithstanding these influences, the Commission has insisted that the physical and economic conditions of Alaska be kept in sharp focus, and that government intervention be kept at the minimum level necessary to protect citizens from those who would abuse the corporate form. With the law formulated to say what it means and mean what it says, it is the conviction of the Commission that the occasions for litigation have been significantly reduced.

GENERAL PROVISIONS.

A foundation for the ACC is created by the provisions of Articles 12 and 13. The ACC is made applicable to all business corporations formed under Alaska law since statehood, and to foreign corporations authorized to do or doing business in Alaska. Rules of construction, definitions, and ground rules for voting shares and preparing and processing documents are set forth; these are basic materials upon which the remainder of the ACC relies. Further provisions of Article 13 allow for waiver of notice requirements, reserve power to the Legislature to amend the ACC at will (Section 10.06.965), declare severability (Section 10.06.963), and make special provisions for Native Corporations.

The applications section (10.06.955) cautiously follows a trend of increased regulation of foreign corporations. The general contours of the regulation imposed by prior law have been continued in Article 10. Additionally, Section 10.06.015 (the defense of ultra vires), Section 10.06.020 (limitations on authority of corporate agents), Section 10.06.155 (non-residents with controlling interests), Section 10.06.233 (regarding shareholder inspection of bylaws), Section 10.06.433 (annual reports to shareholders), Section 10.06.435 (derivative suits), Section 10.06.450(d) (director's absolute right of inspection), and Section 10.06.488 (secondary liability of officers and directors) are applicable to foreign corporations in Alaska. The Commission draft does not follow New York and California, in attempting plenary regulation of foreign entities which are deemed to be "pseudo-foreign" corporations.

Extensive definitions are adopted to preclude ambiguity and to give precise meanings to terms used throughout the ACC.

ARTICLE 1: CORPORATE PURPOSE AND POWERS.

Existing law on the purposes and powers of corporations is continued with minor modifications in wording and coverage. Section 10.06.015 on the defense of ultra vires also represents a continuation of current law. The Commission's goal was to recast basic concepts in more precise language. Section 10.06.020 is a new provision which covers the power of corporate agents to bind the corporation and the capacity of the articles, bylaws, board resolutions or shareholder agreements to limit the authority of corporate agents in dealings with third parties.

ARTICLE 2: DOMESTIC CORPORATIONS.

The ACC provisions on corporate name, registered agent, registered office, and service of process are largely a continuation of existing law. A corporate name may be reserved prior to incorporation and must be registered annually by corporations desiring exclusive rights to the use of a name. A corporation must maintain a registered office and a registered agent in Alaska. Nonresidents with controlling interests in either domestic or foreign corporations also must designate an agent within Alaska for service of process. Change of registered office or agent and the resignation of a registered agent are governed by Sections 10.06.165 and .170.

Section 10.06.160 imposes a duty on the Commissioner of Commerce and Economic Development to make available a list of all domestic corporations and authorized foreign corporations, including their names and addresses. A requirement of weekly updates guarantees that this list will provide current and reliable information to interested citizens. Section 10.06.175 details the procedure for service of process. Changes in this section include placing the burden of substitute service on the serving party rather than the commissioner, and requiring the serving party to make reasonable inquiry to locate a corporate defendant.

ARTICLE 3: FORMATION OF CORPORATIONS.

Several important changes are proposed in rules guiding the formation of corporations. Only natural persons 19 or older may act as incorporators.

Section 10.06.218 fixes the issuance of the certificate of incorporation as the bright line event commencing corporate existence and extending limited liability to those doing business in the corporate form. This section will preclude vexing litigation respecting the status of enterprisers who have not obtained a certificate of incorporation but who have nonetheless attempted business in a corporate guise. Unless released by the terms of a written agreement, such enterprisers are personally liable to all third parties (Section 10.06.220). The common law doctrines of de jure compliance, de facto corporations, and corporations by estoppel are expressly abolished by Section 10.06.218.

Two provisions govern the contents of the articles of incorporation. Section 10.06.208 lists those matters which must be included in the original articles. Section 10.06.210 sets forth matters which may optionally be included. This section is vital in molding a corporation's legal character, for if the Section 10.06.210 issues are not decided by the articles they may not be implemented by the bylaws, board resolution, shareholder agreement, or otherwise. In combination, these sections compel those contemplating formation of a corporation to make basic decisions respecting its structure and the rights of shareholders. A further advantage is that a potential investor need look only to the articles to determine the basic structure of a corporate entity.

Naming directors in the original articles is no longer required. In recognition of the possibility that incorporators will be in control of the entity until the organization meeting, Section 10.06.225 specifies the powers of incorporators. These powers include adopting bylaws and electing directors but do not include transacting business or electing officers. An organizational meeting is required after the issuance of the certificate of incorporation, at which directors are to be elected (if none have been named in the articles), officers are to be appointed, and other business may be transacted.

Section 10.06.228 empowers both the board and the shareholders to adopt, amend, or repeal bylaws. The articles may remove this power from the board, but shareholders' power of amendment is mandatory under the ACC. Section 10.06.230 requires that the bylaws establish the number of directors if this has not been accomplished by the articles. A suggested list of matters which may be covered in the bylaws is also included in Section 10.06.230. Section 10.06.233 requires that bylaws be kept for shareholder inspection at the corporation's principal office.

ARTICLE 4: CORPORATE FINANCE.

The new provisions on corporate finance represent a significant departure from existing law. It is proposed that the former system limiting a corporation's right to pay dividends and repurchase or redeem shares be replaced by a "ratio of assets to surplus" test long recommended by accountants as simpler and more protective of creditor and preferred shareholder rights. The provisions governing financing of a corporate venture through sale of securities (Sections 10.06.305 - .355) are largely continued from current law.

Under the Model Act and the current ABCA, elaborate provisions limit the circumstances under which a corporation may distribute its assets to shareholders. The weakness of this system is that it employs concepts unfamiliar to accountants and the business community. It has also become so riddled with exceptions as to impose little pragmatic check on individuals determined to abuse corporate creditors or holders of senior shares. This "earned surplus" test, and its allied concepts of stated capital and par value, have been swept aside in the Comission's draft of the ACC. While the new code continues to prohibit a distribution or the payment of a dividend that would render the corporation unable to meet its obligations as they mature (a condition of equitable insolvency), the balance of Article 4 is built around a simple concept relating corporate assets to liabilities.

Under Section 10.06.358, a distribution of assets to shareholders is permissible if either of two tests are met.

If the distribution can be made out of "retained earnings" (previously undistributed profits), the code has no objection and the decision is left to the business judgment of directors. If retained earnings are insufficient to fund the distribution, it still may be made provided that in the wake of the payment, the assets of the corporation are at least equal to 1.25 times liabilities <u>and</u> its current assets are at least equal to current liabilities. Sections 10.06.363 and .368 give basic protection to liquidation and dividend preferences with tests similar in nature to those of Section 10.06.358. Sections 10.06.368 (for redemption of shares of a deceased shareholder) and .370 (for regulated investment companies) are limited exceptions to these restraints.

Section 10.06.373 forbids shares of one class to be distributed as dividends to the shareholders of another class without the consent of the holders of the distributed class. Section 10.06.375 permits further prohibitions on the distribution of assets to be placed in the articles, bylaws, indentures or other agreements. Section 10.06.380 requires identification of dividends other than those chargeable to retained earnings in order to set the stage for shareholder's liability for illicit distributions. Section 10.06.383 makes the limitations of Article 4 inapplicable in a winding up and dissolution proceeding.

Section 10.06.385 specifies the procedure for redemption of shares; Section 10.06.388 provides for cancellation of redeemed or repurchased shares. Section 10.06.390 continues the policy of former law in permitting the board to capitalize all or part of the corporation's retained earnings.

ARTICLE 5: SHAREHOLDERS.

While numerous changes in the rights of shareholders are contained in the Commission's draft, the overall statutory framework continues prior law. Section 10.06.405 permits any shareholder to obtain a summary judicial order calling an annual meeting if the directors fail to convene such a meeting within thirteen months. Recognizing the communications problems frequently encountered in Alaska, the minimum period for notice of shareholder meetings has been increased to twenty days. The twenty day period also applies to the requirement of Section 10.06.413 that the shareholder list be made available for inspection. Once a quorum of shareholders has been obtained, Section 10.06.415(b) precludes a disgruntled minority from frustrating the other shareholders by staging a "walk out."

Protection of voting rights is firmly established under the Commission's draft. Proxies are presumptively limited to eleven months and their creation and revocation is regulated by Section 10.06.418. Cumulative voting of shares in the election of directors is the norm unless eliminated by the articles. Under Section 10.06.423 shareholders are permitted to act informally without a meeting. Voting trusts can no longer be secret. Other shareholder agreements affecting voting rights are regulated by Section 10.06.425 and the common law. Preemptive rights are continued and regulated under Section 10.06.428.

Sections 10.06.430 and .433 greatly expand the circumstances under which shareholders can obtain information concerning the operation of the company by the directors and officers. To facilitate access to books and records, durational and numerical standing requirements have been eliminated so that any shareholder may inspect. To prevent this right from being used to harass management, a proper purpose for inspection is now required. Section 10.06.433 mandates that management provide shareholders an annual report. This important feature is supplemented by Section 10.06.433(c) which permits a sharholder to obtain recent financial reports upon demand.

Section 10.06.435 is the most comprehensive derivative suit statute in the United States. The present code contains no provision on this subject. In addition to protecting defendants from nuisance suits, Section 10.06.435 makes it impossible for a backdoor settlement to deprive the corporation of the fruits of a recovery. Recent holdings in some jurisdictions that independent directors should be permitted to obtain the dismissal of a shareholder's derivative suit (on the theory that its prosecution is not, in the director's business judgment, in the best interests of the entity) are rejected by Section 10.06.435.

SECTION 6: DIRECTORS AND OFFICERS.

The basic framework of a potentially strong board acting through officers and agents is maintained, but the duties, liabilities and privileges of management have been altered in numerous particulars.

Section 10.06.450 gathers into one place basic provisions on the structure of corporate management. Four major issues are settled: (1) the exercise and delegation of board functions; (2) the standard for the duty of care which must be observed by directors, and the right of directors to rely upon certain information, opinions, reports or statements from officers, experts, or committees of the board on which they do not serve; (3) the absolute right of inspection of every director as to all corporate books, records and documents of every kind;and, (4) the consequences of a director's failure to dissent as to any action taken at a meeting at which such director was present.

Section 10.06.453 continues to require a minimum of three directors except in corporations with only one or two shareholders. The number of positions on the board of directors of a corporation must be fixed in the articles or in a shareholder adopted bylaw. Special representation may be given to a class of shareholders by making that class competent to elect one or more representatives to the board. Directors serve one year terms unless the total number of the board is nine or more in which case the board may be "classified" with directors serving staggered three year terms.

Under the ACC the majority of shares may remove incumbent directors at any time for any reason. This provision reflects the Commission's belief that the directors should at all times be satisfactory to the majority share interest. Minority interests may bring judicial proceedings to remove any director upon proof that the defendant is abusing the standards established under Section 10.06.463. Unless they result from removal, vacacies on the board may be filled by either the shareholders or the directors remaining in office.

The desire to achieve managerial efficiency is balanced against the goal of insuring effective minority representation in the ACC's provisions on delegation of board authority and function. An important safeguard is the provision that delegation of functions does not relieve directors of their duty of care.

Section 10.06.475 recognizes that both distance and adverse travel conditions may sometimes hamper the ability of directors to meet formally. The ACC permits both the board and board committees to conduct meetings via communications equipment allowing simultaneous contact of all participants. If all of the members sign written consents, board action may be taken without any formal meeting.

Conflicts of interest are defined in two distinct and classical instances: where the contract or other transaction is between the corporation and one or more of its directors; and, where the contract or transaction is between two corporations sharing a common director or directors.

Section 10.06.483 regulates the number, kind, and tenure of corporate officers. This section clarifies the status of corporate officers and provides machinery whereby persons dealing with such officers may insure that they gain the undisputed liability of the corporate entity. For the first time a duty of care is articulated for corporate officers, to assist both shareholders and courts in evaluating their performance.

Section 10.06.488 is a notable feature of the proposed code. For the first time, a carefully defined class of traditionally abused creditors may proceed against corporate directors and officers if the corporation defaults on its obligations. This secondary liability is designed to make management responsible to creditors. It is important to note that this liabiity may be eliminated by written contract.

Section 10.06.490 continues with minor variation the existing law on the indemnification of directors, officers and employees on account of their role in the corporation.

**ARTICLE 7: AMENDMENTS AND CHANGES.**

Present law on amending the articles of incorporation is continued with few alterations. The process has been given flexibility by allowing either the board of the shareholde to initiate amendment. Unless a greater majority is required by the articles, an absolute majority of the shares may authorize an amendment instead of the 2/3 majority required by existing law. In addition to establishing "supermajority" requirements, the articles may provide that shares vote by "classes" in amending the articles.

Sections 10.06.522 and .526 adopt a recent Model Act innovation which permits amendment of the articles by judicial order in bankruptcy proceedings. This procedure eliminates potential federal tax liability.

ARTICLE 8: ORGANIC CHANGE.

Sections 10.06.530 and .542 define and set up uniform procedures for proposal, approval and implementation of three classical organic changes. In the event of either a merger or a consolidation, one or both of the participating conrporations formally ceases to exist. In the course of a share exchange, there is no formal supression of a constituent corporation but one of the entities becomes a wholly owned subsidiary of the other. In each instance, the scheme of the ACC is to place responsibility for framing a proposal with the boards of the participating corporations. Approval of the shareholders is then required and obtained under Sections 10.06.544 and .546.

Due to the inherently different interests involved, the merger of a subsidiary corporation into the parent is governed by a separate section.

The use of mergers, consolidations or share exchanges to "freeze out" minority share interests will violate a statutory presumption created by Section 10.06.542.

The sale, other than in the regular course of business, of all or subsantially all of the corporate assets is treated as another type of organic change by the ACC.

The organization and substance of the provisions on the rights of shareholders who dissent from an organic change and who wish to have the corporation buy out their interest have been adopted from the latest version of the Model Act.

ARTICLE 9: DISSOLUTION.

Dissolution is to a corporate entity what death is to a natural person. As with the provisions respecting articles bylaws, amendments, and organic change, the protection of shareholders and corporate creditors is addressed in the ACC sections governing dissolution.

Article 9 distinguishes between two types of dissolution. is the key, the dissolution is said to be "voluntary." If the life of the corporation is to be taken as a consequence of gross abuse of a minority or because of persistent and serious flaunting of the state's regulation, then corporate termination is "involuntary."

Voluntary dissolution has been removed from the ambit of the board; it now rests entirely with the shareholders. A two-thirds majority is still required to make an election to dissolve. A revocation of the election is permitted if made prior to the commencement of winding up proceedings. Section 10.06.618 continues the policy of current law which allows the corporation to petition for judicial supervision of the winding up; this option has been expanded by permitting shareholders and creditors to petition for such supervision as well.

In addition to being the ultimate sanction against the gross oppression or abuse of minority interests and as a release in the event of deadlock at the shareholder or director level, involuntary dissolution may be sought by the commissioner as a means of enforcing compliance with a variety of reporting and fee payment requirements, or to protect the state against gross abuse of corporate powers.

An innovation in the law regarding shareholders' suits for involuntary dissolution is Section 10.06.638's provision for a judicially supervised purchase of the plaintiffs' shares by shareholders desiring to preserve the corporation. Concern for the fate of a corporation which may be an otherwise viable employer and competitor in the marketplace is reflected in Section 10.06.640's machinery for appointment of a provisional director to resolve deadlock at the board level.

In the wake of any disslution the winding up process follows the presumption that a more advantageous disposition of the corporate assets can be accomplished by the existing management (officers and directors) than by the "liquidating receiver" assigned this task under current law. This presumption is subject to judicial alteration in appropriate cases. Receivers may be appointed even prior to winding up under Section 10.06.643 if the corporate assets are in danger of being wasted.

The powers of the court in a dissolution and the authority and duties of the board during winding up are specified in detail. A system for settling corporate obligations in one court proceeding provides for judicial economy. Further provisions govern recovery of improper distributions to shareholders and the continued existence of the dissolved corporation for purposes of proceedings and actions not terminated prior to issuance of the certificate of dissolution.

ARTICLE 10: FOREIGN CORPORATIONS.

The most important alteration in the treatment of corporations organized under the laws of another state which seek to do business in Alaska is the imposition of many of the same standards of fairness and disclosure which apply to domestic corporations. A foreign corporation doing business in Alaska must register with the commissioner; notify him of changes in its name, purposes, or articles; and formally withdraw upon terminating business in the state. Each foreign corporation must maintain in Alaska a registered agent for service of process and a registered office. Abuse of these requirements will result in revocation of the "certificate of authority" to transact business in Alaska.

ARTICLE 11: REPORTS, FEES, AND PENALTIES.

The provisions on reporting, fees, and relations with the commissioner in Article 11 reflect the legislature's comprehensive amendment of the ABCA in 1980.

TRANSITION PROVISIONS.

The adoption of major substantive changes in corporate law requires provisions to insure a non-disruptive transition. This is accomplished by establishing an effective date which draws the line between the applicability of prior law and that of the ACC. See, *Sec. 3.