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argument suggests that change is inevitable and that the state's only choice is to regulate the pace and quality of that change.

Arguments against statutory accommodation of the closely held entity. The burden of dialogue with proponents of statutory "reform" includes response to the propositions just reviewed, plus the assertion of certain counter-thrusts.

The argument that citizens should be indulged in freedom of choice as among business vehicles is easily met. There is no entitlement to status if the choice requires concessions and sacrifice from non-participating citizens. When this is the consequence, the request is not made as of "right", but is a matter of grace to be settled upon an assessment of advantage and disadvantage to the society. If closely held entities cannot play the role of "corporations", they are not entitled to the status.

In the sense that it is an accurate prediction, there is merit in the claim that certain business activity may not transpire unless incorporation is permitted. It is untrue that incorporation is indispensable to the attainment of non-debt capital. General and limited partnerships afford this advantage. Yet they do not afford the same measure of risk avoidance.[5/] If the risk inherent in the

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[5/] In the social contract offered by the limited partnership an enterpriser may insulate assets beyond those invested in the business, provided such an investor retreats to an essentially passive role in the conduct of the firm and there has been compliance with the formal steps for creation of the firm, including the participation of one or more "general partners" who assume full entrepreneural risks. See §§1 and 7 of the ULPA.

venture is so great that none of the participants is willing to accept the full liability consequences, it should not automatically be concluded that the road to that result should be paved by a concession of limited liability. An alternative deserving of careful consideration is that such activity ought not be encouraged at all.

Another response is that the concept of "limited liability" enjoyed by enterprisers operating as a closely held corporation may be an illusion of security. Here we must distinguish between tort and contract claimants.

If the plaintiff is a tort victim and the assets of the corporate entity prove insufficient to remedy the wrong, there is strong possibility that a court will "pierce the corporate veil" and expose to recovery the personal assets of some (the active participants), if not all, of the investors. California leads a list of jurisdictions in adopting the late Professor Ballentine's theory of adequate capitalization as a price tag for limited liability in a tort setting. It does not appear that Alaska has taken a position on this question, but it is predicted that it would reach a result in substantial harmony with the views of Ballentine.

Respecting the contract claimant, there is probably greater security that the corporate barrier will hold as an effective shield when an aggrieved creditor exhausts the assets of the corporation before obtaining satisfaction. This difference turns on the fact that, unlike the tort

victim, the contract claimant can be charged with having taken the calculated risk at the formation of the bargain to accept the liability of the corporate entity as opposed to asking for the further guarantees of the individual enterprisers. The "you made your bed now lie in it" rationale runs as a theme through those cases which refuse to disregard limited liability at the behest of contract plaintiffs.

Yet even in the realm of contract litigation there is an assumption that the corporation will have been capitalized and operated in such a manner as to give the entity a "fighting chance" to remain responsible to creditors. Thus if the enterprisers are guilty of using the corporation in high risk areas of their activities while exploiting the low risk aspects of what is, in retrospect, a single business in a non-corporate vehicle, this "heads we win, tails creditors lose" attitude will prove the undoing of the party claiming limited liability. By the same token, if the enterprise is begun with insufficient assets placed at risk in the form of investment while the balance of necessary funds is characterized as "loans" by the shareholders, a court is likely to order "reclassification" of these spurious creditor claims so as to subordinate them to those of outside creditors.

The point is distressing: if plaintiff is well represented by counsel there is no certain protection for investors in a closely held corporate entity. But there is a social cost. While the assets of enterprisers are

presumably at stake in the case of a partnership or sole proprietorship, they must be the object of litigation in the instance that the identical business has been organized as a corporation. The unpalatable consequence is the emergence of two classes of "victims": those who can afford and obtain the services of competent counsel (who may eventually overturn the claim of limited liability); and, those who must live without recompense because somebody took out corporate papers.

The planning plea of Professor Bradley contains some of the best and worst aspects of the pro-concession arguments. To his credit, Professor Bradley recognizes that attainment of corporate entity status is a "privilege." Yet he holds the view that the classical structure of corporate organization is a "straight-jacket" imposing "senseless legal obstacles" to the business planner. But, if there is wisdom in the view that a "corporation" has been created to serve a utilitarian purpose to society, its prescribed structure is no more deserving of pejorative characterization than would girders in a bridge or the beams in a ceiling. Again, if the classical profile is rationalized from the nature of the corporate mission, the mandatory prescription is not "senseless." The lack of sense arises from the aspirations of Professor Brdaley's "participants" to adopt a form of association ill suited to their purposes. An analogy may press the point. Should five individuals desire to use an automobile to "drive" to Hawaii, the ensuing disappointment

of their "plans" and potential loss of life and property cannot be laid at the doorstep of the design limitations of the vehicle. The frustration and loss is traceable to the senseless selection of the mode of transportation. To select an automobile over a boat for purposes of water transportation because of a fixed preference for styling or an asserted familiarity with a steering wheel must be frankly discouraged.

A similar tone must be adopted in rejecting the pleas of those who have followed the ill-founded advice (or proceeded without the benefit of counsel) to incorporate and now find the "straight-jacket" uncomfortable. Before we react with the concession of limited liability or "entity" status to pseudomorphs, society has a right to examine the likely direction of the participants. If they are found to be hell bent for an arrangement classically regulated within the context of a partnership or limited partnership, then is it not both "sensible" and pragmatic to redirect their attention to business vehicles suited for these needs?[6/]

6/ The cries of the bailout advocates go beyond deploring the rigidity of the classical corporation structure to reveal problems peculiar to the "close" nature of the close corporation. Implicit in the following statement by Professor Bradley is broad recognition of trouble arising within the closely knit group of "participants". It is clear that problems inherent in the fallen nature of human-kind have not been cured by the wand of incorporation.

> In addressing the problem of unfairness and oppression in the close corporation, legislation will have to first define the close corporation in a manner which does not make that status merely optional. In addition, care must be taken to make sure that the substantive provisions

Also deserving of attention are the "costs" implicit in some of the "rescue legislation." When the impass of disagreement produces paralysis through the operation of shareholder agreements rejecting centralized management

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> do not affirmatively assist the majority in effecting an unfair situation for minority shareholders. Finally, the statute should formulate a set of minimum rights which each participant is entitled to, however, only presumptively and subject to the agreement of the parties. An equal voice in management and an equal share of profits would deserve the highest priority for inclusion in a catalogue of minimum rights, as would the right to information about the business. Other rights may be similarly deduced from the innate features of the close corporation relationship. The objective is to protect individual participants against exclusion from management, employment, salaries, dividends or other forms of corporate freeze-out, unless it is clear that what is happening is according to a compact unanimously arrived at. Legislation should nourish the principle that the close corporation is a cooperative undertaking for the mutual benefit of all of the parties involved.

Bradley, A Comparative Assessment of the California Close Corporation Provisions and Proposal for Protecting Individual Participants, 9 Loyola L.Rev. 865, 867 (1976).

It is respectfully submitted that what Professor Bradley is calling for is re-invention of the Uniform Partnership Act. The questions of an equal voice in the management and an equal share of profits, which Professor Bradley urges receive the highest priority, are assured by §§18(e) and 24 of the UPA (subject to agreement among the partners, every partner has equal rights in the management and conduct of the partnership business, and these are "property rights"); and §26 (defining a partner's interest in the partnership as his share of the profits and surplus). The fiduciary quality of the relationship inter se is the hallmark of the partnership at all stages of its life: formation, operation, and dissolution. See §21(1) of the UPA.

Of an importance rivaling the apt text of these provisions is the spirit of the partnership, which is well understood within the marketplace. In the event of violation, there is ample judicial precedent for application of the tested formulas of the UPA.

in favor of unanimity requirements, some commentators, some courts, and some legislatures have reacted by making such a corporation a ward of the state. No examination of entries in a citator for the milestone case of Galler v. Galler, 32 Ill.2d 16, 203 N.E.2d 577 (1965), can fail to excite depression at the continual attention demanded of the inferior Illinois judiciary in attempting to undo the schemes, plots, and ploys of two branches of a family bent upon war. If this case were multiplied even a hundred times, the burden upon all others awaiting a day in court would become obvious. In some jurisdictions special courts are proposed or have been created to act as receivers of glass jawed "plans" which ceased to be functional at the first breath of disagreement. Were such businesses partnerships, "dissolution" would have resolved the impass while ferreting out the villains. The businesses would likely have continued, but the enterprisers who had threatened their lives would be forced to lift their siege. Rather than return such business associations to the realm of the partnerships, proponents of concession urge the creation of state supported wards where non-functional close corporations may languish for an indefinite period. It is not unfair to greet these proposals with the question: "why"?

The argument respecting access to federal tax concessions is far more difficult to refute. As a consequence of historical accident, and notwithstanding strident efforts of the Internal Revenue Service to overcome it, qualification

for taxation at the significantly less onerous rates hinges upon the willingness of a state to grant a corporate charter. While Congress could change this result tomorrow, it shows no inclination to do so. As a result, even individuals may incorporate and, having obtained a charter, see their income from enterprise activity taxed at rates which do not exceed 46%. A non-incorporated taxpayer earning the same income could be subjected to taxation which runs as high as 70% (on every dollar in net income over $108,300). Certain tax reform, such as the maximum 50% tax bracket for income produced by the rendition of "personal service", has gone some distance in removing this irrational result. Notwithstanding, if a closely held enterprise operates as a partnership or limited partnership, the net business income is taxed to the owners in proportion to their interests in the firm, even though it is not distributed but retained for eventual expansion of the business. By contrast, the same business income which is not distributed by a corporation is taxed to the corporate entity at the lesser rates and there is no tax liability to the individual enterprisers. If any portion of this "after tax" corporate income is taken by the investors as a return on their capital (dividends), it is taxed a second time at the rates applicable to their personal income. Both legal and accounting practices thrive on these non-self-evident truths.

Corporate tax concessions obviously facilitate capital formation. Should the privilege be abused and the business earnings simply accumulated, using the corporate entity as

a tax minimizing piggy bank, there are unpleasant consequences. Yet no other business vehicle is afforded the chance for such accumulation.

Finally, the argument that the choice is between ordered change orchestrated by legislation or chaos produced by litigation contains elements of sound warning.[7] Yet one need not surrender to the cries of this Cassandra. While the approach has not been tested, a legislature could provide in the corporations code that it had expressly considered the question of discrete treatment for closely held associations and found the social costs opposed to such a result. Such a declaration could not destroy the power of the courts to create common law, but common sense as well as comity suggest that a court so warned would not rush to embrace a consciously avoided result.

Passing from a refutation of the arguments in favor of statutory concession, one must consider the further premises of the negative position.

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[7] Acceding to the demands for discrete statutory treatment does not create immunity from what may be viewed as common law meddling. A common feature of many of the legislative responses has been the attempt to define the close corporation in terms of a maximum number of shareholders. If the entity is organized with shareholders not exceeding this maximum, there is permission to claim the concessions implicit in the scheme. Such an arbitrary numerical limitation renders inevitable the case in which a court is plied with the argument that this particular entity has but "one more" shareholder and yet is deserving of a fate far closer to that of the *de jure* close corporation than the alternative statutory scheme which will be characterized as functionally appropriate to General Motors.

The most crucial argument directly assaults the essence of the modification scheme. From the earliest efforts in New York to the more radical legislation in Arizona, closely held corporation provisions increasingly transgress the fundamental assumptions upon which the concept of a "corporation" is founded and experienced. The board is either stripped of all meaningful power or eliminated in favor of non-centralized management; voting rights are locked into agreements which destroy the concept of majority rule; free transferability of interest is denied by restrictions upon sale or inheritance of stock; and, continuity of life is threatened by permitting disagreement (or even lack of unanimity) to become the source of paralysis and then using this pretext for dissolution of the entity.[8/] The road to this result is open and well traveled. Questions remain as to the utility of the journey.

A negative answer is suggested by a brief recollection of the role of the corporation. The accumulation of investment capital placed in the hands of centralized management

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8/ As has been repeatedly stressed by commentators who have no declared hostility to the concept, accommodation of the closely held corporation is no guarantee that enterprisers gathered under that umbrella will live in amity. See note 6, supra. Indeed, enticing investors into an entity with a presumed continuity of life sets the stage for "gang up" and other exploitative combinations exerted against a minority. Unlike rightful dissolution for breach of a partnership agreement, the victim of this harm dealing or income starving combination requires the extraordinary intervention of litigation to obtain relief which is neither certain nor clear. Thus while the thrust of the anti-concession arguments has been disservice to the public implicit in fostering "close corporations", there may be significant danger to individual enterprisers as well.

is thought to produce wealth and thus a public good. Yet to "incorporate a partnership" and hamstring its function by dent of shareholder agreements or provisions of the articles is to undermine the premise upon which the expectation of public advantage is grounded. True, limited liability is claimed, but the view has already been asserted that this was a concession to, and not the object of, a working corporation. Tax advantages are garnered in an essentially irrational interplay of state and federal law. Yet if the creation of corporate rates is traced to a desire to foster accumulation of capital for efficient deployment by centralized management, then this policy, like the essence of the corporate concept, is mocked by the close corporation.

The case for the opposition comes down to this: the modification of the corporate entity in the attempted accommodation of the "close client" involves the compromise, if not the surrender, of fundamental goals and vital assumptions. It is a transaction fraught with cost and without discernible benefit to the public. For the state to countenance such a result would be strange. To facilitate that end seems senseless.

B. General Survey of Close Corporation Legislation

1. Preliminary

This section collects and classifies existing close corporation legislation. The fifteen statutes analyzed here represent the efforts of fifteen state legislatures to go beyond the mere elimination of the traditional requirement

of three directors or the statutory sanction of high vote or quorum requirements. Organization is by substantive coverage; topics such as definitional factors, management structure, share transfer restrictions and special dispute resolution procedures will each warrant separate treatment. In addition, a list of the states surveyed, along with a classification of types of statutes in existence, appears as Appendix A.

As in all law, history plays an important part in the development of close corporation legislation. New York was the first to grant special recognition to the close corporation. In 1946 it enacted a provision allowing close corporation shareholder agreements to override or "sterilize" the power of the board of directors. The New York statute has since served as a model for the statutes of New Jersey, Michigan, North Carolina, South Carolina, Maine, and Florida.

Delaware leads the historically later trend to give the close corporation more extensive treatment. Delaware's statute extends to areas of dispute resolution and share transferability. Both Pennsylvania and Kansas have practically adopted this statute as their own. Texas, however, adopted Delaware's model but greatly expanded it.

The remaining states--Illinois, Maryland, California and Arizona--all have attempted to break new ground with their close corporation statutes. All four borrow and incorporate features of both the New York and the Delaware models. The result in each case, however, is unique.

Overall, however, individual states' treatment of the close corporation breaks down into three rough groups. In

the first group are states which have enacted separate close corporation legislation as a package of new rights and liabilities for the close corporation. In the second group are states which have merely amended their general corporation law with scattered provisions specifically exempting close corporations from various provisions. The last group of states is, in essence, a subset of the second; these states only amend one section of their general corporation law. While Appendix A contains a detailed breakdown of these provisions, certain facts warrant special consideration at this stage. Of the fifteen states involved, seven have separate articles for treatment of the close corporation. The remaining eight states are evenly split between multiple scattered provisions and single exemptions.

Within this group of states, Florida is noteworthy because of its complete about-face treatment of the close corporation. In 1963, Florida was one of the first states to enact a separate close corporation statute. Twelve years later, it repealed this eight section statute. In its place, Florida carved an exception to its shareholder agreement section. Thus, an early leader in the separate treatment of close corporations has completely disowned its early progressive stance. No overt reason appears for this change, although one commentator suggested, before the change, that the prior law was administratively difficult to apply. Dickson, The Florida Close Corporation Act: An Experiment That Failed, 21 Univ. Miami L.Rev. 842 (1967).

The remainder of this section separately considers, in

detail, the substance of each of these states' close corporation legislation. Initially, the question of how to select those corporations that will receive special treatment is addressed. Next, the topics common to most close corporation statutes are addressed in the following order: management structure, share transfer restrictions, and special dispute resolution procedures.

2. General Survey: Definitional Factors

Irrespective of the scope of statutory attention close corporations are to receive, the problem remains of how to rationally segregate those entities warranting special attention from the larger class of public corporations. The type of special treatment the close corporation receives, along with the social policies behind such different treatment, govern the factors to be used to define a close corporation. While it may very well be that one knows a Close corporation when one sees one, it is a completely different matter to select criteria that will affect only those entities deserving of special treatment. The remainder of this sub-section will describe the defining factors currently in use. The concluding section will attempt to identify the policies behind each factor.

a. Definitions containing a numerical test

Delaware was the leader in providing a close corporation definition using the number of shareholders as a defining factor. Del. Code Ann., Tit. 8, §342 defines a close corporation as a corporation with the following three features:

1. No more than 30 shareholders, and
2. Restricted transferability of shares, and
3. No offering of stock constituting a "public offering" under the federal Securities Act of 1933.

Delaware also requires the certificate of incorporation to state that the corporation is a close corporation. Id. §343(a). Several states have patterned their statutes on the Delaware model. They include: Pennsylvania (1968), Kansas (1972) and Texas (1973, revised 1975). Texas tinkered with the details by increasing the permissible number of shareholders to 35 and by referring to public offerings under either Texas or federal law. Texas Bus. Corp. Act, Art. 2.30-1(A).

California and Maine both define a close corporation on a strictly numerical basis. Maine is more liberal, setting the ceiling at 20. California, on the other hand, sets 10 shareholders as its maximum.

Arizona enacted a separate close corporation article in 1976. It also defines a close corporation with respect to the number of shareholders; however, it also adds a temporal element. Ariz. Rev. Stat. §10-203(3) provides only that "[t]he number of original investors shall not exceed ten." This presumably leaves open the potential for a subsequent increase in the number of beneficial owners of the firm.

b. Definitions focusing on the marketability of shares

Six states define a close corporation in terms of the marketability of its stock. New York was the first to enact such a provision in 1946. New York BCL §620(c) provides an

exemption from certain general corporation provisions for firms whose shares are not "listed on a national securities exchange or regularly quoted in an over the counter market." New Jersey, Michigan, and South Carolina have all adopted similar language. Florida, under both its old and its new law, and North Carolina have adopted a variant of New York's language. Both of these states provide certain exemptions for corporations whose securities are "not generally traded on a national securities exchange." This definition has the approval of F. Hodge O'Neal, F. O'Neal, Close Corporations §1.02, at 4 (1971).

c. Definitions based on some form of shareholder election

In Maryland, shareholders may unanimously agree to be treated as a close corporation. No other restrictions exist. Illinois, on the other hand, also requires unanimous shareholder approval, but adds that the corporation must place in its articles of incorporation at least one of five statutory methods of restricting share transfer. These include requirements mandating that any shareholder secure corporation approval before selling any stock, requirements that any shareholder must first offer the stock to the corporation at a prearranged price, requirements that no shareholder sell the stock so as to vitiate the Subchapter S election, specific person or class restrictions based on reasonable criteria, or any other lawful requirements. Ill. §1203.

d. Judicial definitions

The most famous judicial attempt at defining a close

corporation occurred in Galler v. Galler, 203 N.E.2d 577 (1965). Faced with a shareholder agreement not valid under Illinois' version of the Model Act, the Illinois Supreme Court defined a close corporation as one in which:

> the stock is held in a few hands, or in a few families, and wherein it is not at all, or only rarely, dealt in by buying or selling. 203 N.E.2d at 583.

It then held that the corporation at the bar met this definition, and that it did not have to strictly comply with the statute governing agreements among shareholders.

The court, in defining close corporations, utilized a combination of both numerical limits and share transfer restrictions. Both requirements, however, were given an open texture; no firm upper limit was set on the permissible number of shareholders and no strict limitation on marketability was delineated.

While Galler has met with judicial approval, Darwin v. Belmont Indust., 199 N.W.2d 542, 544 (Mich.Ct.App.1972), some courts have seen fit to add to it. In Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 511 (1975), the Supreme Judicial Court of Massachusetts quoted Galler, but intentionally went beyond it. It required an entity to have the following before attaining the status of a close corporation: (1) a small number of shareholders, (2) no ready market for the corporate stock, and (3) substantial stockholder participation in the management of the corporation.

These judicial definitions merely synthesize the current

discordant statutory strains of thought. Massachusetts' addition of the substantial identity between shareholders and management is not new. Most close corporation statutes are written with this fact in mind. The differing factors used by various courts and legislatures point out the need to isolate the principle behind the selection of one defining factor over the other. That is the function of the next section.

e. Policies behind the choice of different factors

The basic problems faced by the close corporation are clear. Close corporations have a limited market for their shares. This hinders the easy change of investment vehicle. Also, the high uniformity between shareholders and management creates problems distinct to the close corporation. Finally, the ineffectiveness of traditional remedies for corporate strife is a prime concern. Definitions can be framed which alleviate any one of these problems. The difficulty, however, occurs when one attempts to mold a definition to cure all of these ills. This memo will not attempt this task. Instead, it will analyze the concerns and the factors best serving them. From this discussion, a reasoned choice can then be made.

i. Concern: Avoidance of the "locked-in" syndrome

The locked-in syndrome occurs when a minority shareholder cannot liquidate his interest in a corporation. Its cause is the existence of a limited market for the corporation's shares.

Many definitions have used this quality of limited marketability as a segregating factor in order to relax traditional corporate strictures which might work to oppress minority shareholders. Typically, as in New York, this definition is used to exempt close corporations from traditional sanctions against shareholder agreements which attempt to limit the power of the board of directors. In this way, minority shareholders will have more of a say in the future of their investment. Thus, the line of definition is drawn along the lines of the perceived evil; smaller corporations receive a break if their investment is not liquid.

ii. Pragmatic Realization: Substantial identity between the board and the owners

Many of the reasons for the ineffectiveness of traditional corporate practices in close corporations is the inapplicability of the traditional pyramidal model of corporate organization. The close identity between ownership and management is more prevalent as the total number of shareholders decreases. Thus, many states have used the number of shareholders as a defining criteria. This practice is grounded in the belief that by setting a low ceiling, the corporations in which there is an identity between ownership and management will receive the close corporation status the statute warrants.

It is important to note the friction between these ideas. On the one hand there is a concern for the immobil[illegible] investor; by overriding the traditional ban on director sterilization agreements, it is thought that the lack of

liquidity can be made palatable. On the other hand, there is the deeper concern that the traditional corporate model will just not provide the answer for the myriad problems facing the closely held entity. This distinction is best illustrated by the gray zone; those corporations having some 50 to 100 shareholders but are not listed on any exchange nor is there a ready market for the corporation's stock. In these situations, it may very well be the case that the corporate pyramid may govern justly; it is also the case that each investor has a non-liquid investment. Thus, it can be seen that any attempted compromise between these two goals may be weighted in favor of the more favored class (i.e., immobile investors or small businesses) by tinkering with either the numerical limits or the definitions of marketability.

iii. Objective Classification: Increased certainty for planners

The use of numerical limits also fosters increased assurance of close corporation treatment. To receive close corporation status, all the corporation needs to do is stay within the prescribed number. Thus, planners may arrange the corporation's affairs with some certainty.

This certainty, however, is ephemeral. The numerical approach, as well as the marketability approach, can create situations where close corporation status may be lost for reasons external to the entity. The share may devolve to multiple heirs, thus placing the number of shareholders over

the permissible maximum, or the stock may be sold in amounts jeopardizing status under a marketability standard.

Maryland, Illinois and Arizona attempt to obviate this problem. All require shareholder approval to attain close corporation status. Maryland is the most permissive. Unanimous election is its only requirement. Illinois and Arizona, however, impose further restrictions. Illinois requires the imposition of some kind of share restriction provision. Arizona requires only that the initial number of investors be less than ten. Both of these schemes obviate the type of external bust-up noted above by making close corporation status, once granted, immune to anything except shareholder action.

v. External Considerations: Subchapter S election

Under IRC §1371, a corporation may elect to be taxed similarly to a partnership. Thus, a serious consideration for close corporation planners is the ability to meet section 1371's requirements. Chief among these is the ceiling on the maximum number of shareholders. The statute allows only fifteen. Illinois recognizes this and allows corporations to elect to make share transferability contingent on meeting Subchapter S's requirements.

f. Concluding Thoughts on Definitional Factors

The questions of how to select those corporations deserving of special treatment is, in many respects, the most baffling of all. While definitions using numbers or share restrictions or marketability have found factors common to the popular conception of the close corporation, each presents problems

for the corporate advisor. Thus, a slection between competing policies is required. In this respect, the starting point for the close corporation is the last step for the legislator; by molding the definition to serve express social policies, the ultimate purpose of a close corporation statute can be achieved.

3. Management Structure

One idea that pervades close corporation writing is that concessions must be made in close corporation statutes to the reality of the day-to-day existence of a small corporation. The management of a small corporation is said not to fit the pyramidal model of classic corporations law. Thus, to avoid judicial expansion of general corporation statutes, exceptions are made for the small corporation. These exceptions generally are found in provisions authorizing the nullification, or sterilization, of the traditional corporate management body, the board of directors. This sub-section thus explores how various states treat shareholder agreements which structure a close corporation in a way at variance with traditional models.

a. Shareholder's Agreements

New York's BCL §620(b) validates, in limited circumstances, provisions of the certificate of incorporation which either delegate or usurp the powers of the board of directors to the shareholders. Three conditions, however, must be met before the certificate's provision will be given effect. First, all outstanding shares must have authorized the provision. BCL §620(b)(1). Second, any subsequent transferees of the stock of such corporation must either know of, or consent to, the terms of such provision. BCL §620(b)(2). Finally, the

corporation cannot be listed on either a national stock exchange or on the over-the-counter market. BCL §620(c).

Thus, New York allows corporations whose stock is not publicly traded to deviate from the traditional form of corporate management. Strict conditions, however, are placed on this license. In addition to the above, the BCL requires all stock subject to such a certificate provision to contain a legend to that effect. BCL §620(g).

It should be noted that New York only validates such agreements when they are contained in the certificate of incorporation; no side agreements are recognized nor are by-law provisions to the same effect. In Beresovski v. Warzawski, 28 N.Y.2d 419, 217 N.E.2d 520, 322 N.Y.S.2d 673 (1971), however, the New York Court of Appeals specifically enforced a unanimous shareholder agreement to amend the certificate of incorporation of a close corporation. This decision could be used to validate by-laws or side agreements not mentioning certificate amendment on a pro tanto amendment theory or on some theory that specific performance would be the only way to achieve the parties' intent.

Florida §607.107, enacted in 1975, basically incorporates most of New York law. Florida differs, however, in that it specifically recognizes any unanimous shareholder agreement, regardless of whether it is contained in the articles of incorporation. Florida also adds that any transferee of shares of such a corporation takes subject to the agreement if he or she has notice of the agreement. Notice is con-

clusively presumed if the share certificate has a legend indicating the existence of the agreement. Fla. §607.107(3). Finally, Florida explicitly states that, to the extent that shareholders take over director's duties, they assume the risk of director liability. Fla. §607.107(4).

Maine §701 is similar to Florida's statute. It states that management may be by shareholders, and, if this option is taken, the shareholders shall be treated as directors for purposes of delineating duties, responsibilities, and liabilities. Maine, however, follows the lead of New York and requires such agreement to appear in the articles of incorporation.

Michigan §21.200(463) and New Jersey §14A:5-21 are, in substance, identical to New York's statute. Both require the agreement to be in the articles and both condition the provision's validity on unanimous agreement, notice to all transferees, and limited marketability of the corporation's shares. Both require all stock certificates to carry an appropriate legend. New Jersey explicitly states what both New York and Michigan imply; namely, that the board of directors may be completely eliminated. NJ §14A:5-21(2). Finally, both states impose director responsibility on shareholder managers.

North Carolina §55-73(b) begins with New York's basic premise: unanimous shareholder agreements concerning shareholder management should be given effect. It, however, expressly validates such agreements if they are contained in

by-laws or side agreements. Furthermore, North Carolina expressly states that agreements to manage the corporation "as if it were a partnership" are not invalid for that reason. This fact has been specifically recognized by North Carolina courts. See, e.g., Blount v. Taft, 29 N.C.App. 626, 255 S.E.2d 583 (1976).

South Carolina §33-11-220 is the final statute adopting the New York model. It recognizes the validity of unanimous by-laws or side agreements usurping the board of director's power, but only if the agreement is set forth, or referred to, in the articles of incorporation. S.C. §33-11-220(b)(b). Thus, the agreement's terms need not be divulged in the articles; only the agreement's existence. South Carolina also adopts the marketability restriction of New York, as well as the legend requirement. Finally, South Carolina places a 10-year limit on the existence of any such agreement and allows renewal only in the last year of the agreement's existence. S.C. §33-11-220(b)(3).

Delaware has set the trend for three states. Delaware §350 provides that agreements among any number of shareholders are not invalid because they interfere with or restrict the discretion or powers of the board of directors. Furthermore, §354 provides that such agreements may validly attempt to regulate the affairs of the corporation as if it were a partnership. Thus, Delaware eliminates the requirement of unanimity for shareholder agreements. Delaware does provide, however, for pure management by the shareholders in §351.

Section 351 allows the corporation to dispense with shareholder meetings to elect directors, and makes all stockholders directors. To take advantage of this section, there must be unanimous agreement of all shareholders, and the provision must be in the certificate of incorporation. Also, the existence of such a provision must be included in a legend on all stock certificates. The provisions of Kansas §§17-7210, 17-7211 and 17-7214 and Pennsylvania §§1381, 1382 and 1385 are similar. Kansas adds that all actions of corporations electing to be managed by the shareholders shall be taken by a vote of the shares, unless otherwise provided for in the articles of incorporation. Kansas §17-7211.

Maryland §4-401 is one of the broadest statutes regulating shareholder agreements. It states that "[u]nder a unanimous stockholders' agreement, the stockholders of a close corporation may regulate any aspect of the affairs of the corporation or the relations of the stockholders . . ." It then goes on to list some permissible provisions. Section 4-401(d) provides that an equity court will specifically enforce the agreement's provisions. This represents the fullest extent of the codification of the maxim volenti non fit injuria and has been copied by at least two other states, Illinois (§1211) and Texas (Art. 2.30-2). All three states specifically sanction the operation of the corporation in partnership form.

Maryland also makes it explicitly clear that a close corporation may elect to have no board of directors by approving a charter amendment to that effect. Md. §4-301.

In addition to a broad blessing for shareholder agreements, Illinois adopts Delaware's provision on management by shareholders (Ill. §1212). Texas, on the other hand, adopts Maryland's more open approach (Tex. Art. 2.30-2(B)(1)) by leaving the decision to the shareholder's agreement.

California §300(b) states that a unanimous shareholder agreement, as defined in §186, shall not be invalid because it restricts the board of directors, or attempts to regulate the corporation as a partnership. Thus, California fits the mold of such states as New York and Delaware. California differs, however, from most states in that it specifically lists items that may not be altered by shareholder agreement. Section 300(c), for example, does not allow shareholder modification of statutory mandates on dividend restrictions, involuntary dissolution procedures, records and reporting requirements and inspection rights. Finally, California allows close corporations to have agreements among less than all the shareholders, but only to the extent allowed for all corporations. §300(a).

b. Arizona--The Creation of a New Business Form

Arizona has a different approach to the management of close corporations. All Arizona close corporations must name one or more managers in their articles of incorporation. Ariz. §10-203(2). These managers are responsible for the day-to-day operation of the corporation. Ariz. §10-205. The manager's actual authority may not be restricted except by the articles and, even if so restricted, is not effective

against a third party dealing in good faith with the corporation. Ariz. §10-205. Further, the manager serves at the pleasure of a majority of the investors. Thus, in Arizona investors in close corporations must delineate the corporation's management structure in the articles of incorporation. In addition, provisions for dispute resolution and share transfer restrictions must also appear in the articles. Ariz. §10-204.

c. A Short Summary--Close Corporation Management

Several issues run throughout the close corporation legislation affecting management structure. If a structure different from the classic corporate model is to be tolerated, the question of what formalities must be observed arises. New York pioneered this area by requiring a unanimous agreement to be contained in the articles of incorporation. Other states have sanctioned side agreements, and still others, notably Delaware, have allowed less than all the shareholders to alter the basic structure to some extent.

A further concern is the protection of potential purchasers of stock subject to such an agreement. To this end, states have required legends on the stock certificates indicating the existence of a shareholder agreement. In addition, many states provide that a transferee who takes with such notice is bound by the terms of the agreement as if he or she was an original party. Thus, the state seeks to protect both sides to a subsequent share transfer.

Finally, it should be noted that most statutes are phrased in the negative. Constructions such as "shall not be invalid

as between the parties" are very common. This drafting technique allows for flexibility and leaves open the possibility that the agreement may be held invalid for reasons other than director sterilization. Furthermore, the use of the phrase "as between the parties" also leaves open the possibility that third parties, such as creditors, may attack the agreement for creating a situation to their detriment. In any event, there is much diversity present, and a great wealth of experience to be drawn upon to frame a shareholder agreement section.

4. Control Over Non-Participants

Many states, in apparent recognition of the highly personal nature of the close corporation, allow shareholders to establish restrictions on the alienability of shares which are more extensive than are generally allowed. Indeed, many states include the existence of share restrictions in their definition of a close corporation.

Illinois §1203 is the most graphic example. Its sole criterion for close corporation status is the existence, in the articles of incorporation, of at least one of the following five types of share restrictions: a corporate right of first refusal, corporate consent to the proposed transfer, specific person or class restrictions (so long as they are not "manifestly unreasonable"), transfers that destroy a Subchapter S election, or any other lawful restriction. Illinois thus allows the corporation to employ myriad devices to control its membership, many of which are unavailable to public corporation shareholders.

Delaware §342(a)(2), as well as Pa. §1372A(2) and Kansas §17-7202(a)(2), also requires close corporations to have at least one type of share restriction. The scope of permissible restraints is limited, however, to those restraints available to all corporations.

Maryland §4-503 invalidates any attempted share transfer unless each shareholder consents in writing within 90 days of the actual transfer, or the transfer is to the corporation or a trust under provisions of a unanimous shareholder agreement. In addition, this final type of transfer must be for the benefit of stockholders or their immediate families.

Arizona §10-209A requires that, as a condition precedent to a valid share transfer, the corporations commission must receive notice of the transfer on a standardized form.

Finally, California §418 allows a close corporation to retain its status by invalidating all inter vivos transfers of stock which impermissibly enlarge the number of shareholders beyond ten. A precondition of this invalidation, however, is that all stock certificates carry a legend indicating the permissible shareholder maximum.

5. Dispute Resolution

Due to the intensely interpersonal nature of the close corporation, many states have attempted to provide for special remedies for deadlock and dissension that such closeness tends to foster. In general, these include greater access to involuntary dissolution and the availability of provisional and custodial directors.

Many states grant a close corporation shareholder the right to petition for dissolution. However, in states such as California and Illinois, the right to petition is conditioned on the existence of corporate deadlock or the failure of any agreed remedies, such as arbitration. In addition to the normal grounds for involuntary dissolution, both California §1800(b) and New Jersey §14A:12-7(1)(c) give corporations with few shareholders additional grounds to ask for dissolution. California provides that if a corporation has fewer than 35 shareholders, dissolution may be granted if it is "necessary for the protection of rights or interests of the complaining shareholder . . ." New Jersey allows dissolution, or the appointment of a provisional or custodial director, upon a showing of mismanagement, abuse of authority, fraudulent behavior, or oppressive or unfair conduct by the corporation's directors if the corporation has 25 or fewer shareholders.

Other states, such as Maryland §4-603, provide for a "buy out" of the disgruntled shareholder in lieu of dissolution. Finally, some states allow the articles to give specific individuals the ability to dissolve the corporation at will. Ill. §1213.

Many states provide for the appointment of provisional directors. Cal. §308; Del. §353; Kansas §17-7213; N.J. 14A:12-7(3); Pa. §1384; Tex. Art. 2.30-4. A provisional director is a temporary addition to the corporation's existing board. He or she serves to break a corporate deadlock. As soon as the problem is resolved, the tenure of the provisional

director ends. A custodial director, on the other hand, has much broader powers. Generally, a custodian may assume duties of a corporate officer and manage the day-to-day corporate business. He or she may disregard the board and run the corporation on independent judgment. The custodian answers only to the court. Five states have adopted this drastic remedy: Ariz. §10.214A (called a conservator--scope of powers set by court); Del. §352; Kansas §17-7212; N.J. 14A12-7(4); and Pa. §1383.

Delaware, Kansas, and Pennsylvania utilize the custodian remedy upon deadlock and when the corporation is managed by the shareholders or when the petitioning shareholder has a right to dissolve the corporation under the articles. New Jersey's custodian is available to any corporation, subject to court order. It is basically an equitable receiver. Arizona's conservator is court-appointed when it is found that deadlock threatens to impair the conduct of the business.

6. Changes in Basic Structure

All states that treat the close corporation separately make provision for the merger or transformation into a public corporation. The main issue here is the type of approval necessary to convert the corporation's status.

Most states require a two-thirds vote of the shareholders, unless the articles provide for a higher requirement. Del. §346; Cal. §§158(c) (conversion), 1111 (merger); Ill. §1207; Kansas §17-7206; Pa. §1376. Arizona §10-211 and Maryland §4-203 require, however, unanimous shareholder approval to change status.

C. Legislative Agenda for Statutory Concessions to the Close Corporation

Should the Commission decide that specific concessions to closely held entities are desirable, then several legislative choices need to be made. Initially, the Commission must decide upon the method for defining a "close corporation." The Commission must next determine the application of agency law to the close corporation. As yet, no jurisdiction has addressed this problem. Such silence is an invitation to litigation. Finally, the Commission must decide the substantive breadth of any proposed statute.

1. The definitional criteria: As indicated in the survey of close corporations statutes in other jurisdictions, there is a major split respecting the criteria to be used in defining the close corporation. Many states, including California and Delaware, have opted for a numerical ceiling as the defining factor. The numbers range from a low of ten shareholders in California to a high of thirty-five permitted under the recent Texas Act. A second group of states focus upon the marketability of the corporation's stock as a defining factor. Close corporation status is available to those entities whose shares are not listed on a "national exchange" (New York, New Jersey, and South Carolina) or whose shares are "not generally traded on public markets" (North Carolina). Adoption of this approach would open the concessions to virtually every corporation organized under the laws of Alaska. As a third option, the Commission could follow the example of Maryland and simply leave the election

of close corporate status to the incorporators with no definitional requirements.

Recommendations of the drafter: There is a sense in which the motivation for statutory concessions impinges upon the selection of definitional criteria. If the major social issue is the "locked in" syndrome deplored by Professor Bradley, the absence of public trading in the shares becomes a rational criteria. Before the Commission should take this step, it may wish to consider that the pragmatic consequence is the likely availability of these statutory concessions to every business in Alaska. The social costs detailed in the anti-concessions arguments would be high indeed.

The drafter suggests that the Commission opt for a numerical limitation as the definitional factor. Further, the drafter recommends that the number be set at 15. The attraction of this figure is coordination with the Sub-chapter S election which, ironically, permits the close corporation to be taxed as if it were a prtnership. In the view of the drafter, such a limitation has the further advantage of minimizing the social costs involved in the proliferation of these fragile entities. It also permits increased certainty for the counseling lawyer.

2. The impact upon the law of agency: It has come as a surprise to the drafter that none of the existing statutory concessions to closely held entities has dealt with the inevitable complications which will be encountered with the law of agency. A brief summary of the classical law will illustrate the potential problem.

If a business is conducted as a sole proprietorship, the proprietor may choose to deal with third parties through the use of agents. The creation of this principal/agent relationship is consensual and conscious. A third party dealing with an individual who purports to be an agent for a disclosed principal has a duty to determine the bona fides of this claim as well as the extent of the agent's authority. If the agent has exceeded the authority defined (expressly or by implication) by his principal, the principal escapes liability on the unauthorized transaction. However, if the principal is guilty of acts or omissions which would cause a third party to reasonably be deceived into believing in the authority of the agent, such a betrayed principal is liable to the innocent third party on a theory of apparent authority.

What happens if the third party deals with a business conducted by more than one individual in a partnership form? The Uniform Partnership Act decrees that every partner is an agent of the firm. Further, the act of every partner apparently carrying on business of the partnership in the usual way binds the firm even though it is done without the authority of the other partners. The only exception is for a third party who has actual knowledge of the partner's lack of authority. It will at once be seen that the risks of internal disagreement inherent in this association of enterprisers is, by operation of the partnership act, turned against the firm. It is deemed unreasonable to place third parties at peril that a particular partner is, in fact, acting without the concurrence of a majority of the firm.

What if the business is a corporation? Here the problem is crucial, for a corporation, unlike a general or limited partnership, is a distinct legal entity. Who may bind such a "principal"? In order to answer this question, the law relied upon the pyramid corporate structure. The Board of Directors is regarded as the principal in that it is to make the determinations upon which transactions are authorized. Yet corporate officers are deemed to be agents, for they have the routine contact with third parties. In general, the president of the corporation is deemed a plenary agent with certain powers of agency inherent in the occupation of that office. Notwithstanding, a third party on notice that she is dealing with a corporate officer stands at peril of determining the bona fides of that relationship and the sufficiency of the officer's real authority from the board to cover the contemplated transaction.

Comes now the "close corporation" with the touted functional identity between shareholders, directors and officers. How is the law of agency to divide the risk of the "faithless or imposter agent" as between the enterprisers and third parties?

Recommendations of the drafter: The oft asserted desire of proponents of the concession theory to "incorporate partnerships" suggests to the drafter that the provisions of the Uniform Partnership Act provide a useful key to the application of agency law. Further, the drafter would like to suggest that many problems can be prevented in the market-

place if the statute commands that in all transactions a close corporation be forced to identify its status by the use of ". . . A Close Corporation" or "C.C." as part of its name. To alert third parties as to the nature of the beast is to set the stage for inquiry and care which the law demands. If the close corporation is thus identified, the problem of unauthorized transactions should be minimized while concepts akin to the UPA §§3, 9, 12, 13 and 14 are recommended to apportion the unavoidable balance of the risk to the enterprisers who are gaining the privilege of close incorporation.

3. <u>Substantive Breadth of Close Corporate Legislation</u>: The nature and extent of the concessions given to close corporations determines the impact of the statute; in short, a close corporation statute may be judged by the exemptions it creates. Historically, states have made concessions in three areas: management structure, share transfer restrictions, and dispute resolution.

a. <u>Management structure</u>: Every state which has acted in this area to date has made concessions to the alleged need for relaxation of the pyramid model of corporate organization. The rationale is the asserted human identity of the persons otherwise forced to play the role of shareholders, directors, and officers. The typical exemptions are two: the statutes are amended to permit sterilization or elimination of the board (so that there is direct shareholder management) or the members of the board are subjected to control by shareholder agreements.

Whether the board is eliminated or subjected to control by shareholders, the heart of the "new order" is the role of the agreement. Several important legislative choices immediately arise. Must the agreement be the product of unanimous consent or may a majority faction of the shareholders act in this extraordinary manner? How "formal" ought the agreement be? Here the choices range from New York's requirement that the agreement be the product of unanimous consent and enshrined in the articles of incorporation. Other jurisdictions deviate from the New York approach by failing to require that the unanimous agreement be placed in the articles. They would honor the terms of a less formally expressed agreement. Delaware stands at the opposite extreme requiring neither unanimity nor formal expression in the articles. Thus, unless the shareholders of a Delaware close corporation elect to eliminate the board and run the company directly, they may control election to the board and the apportionment of offices by an agreement among a bare majority of the shareholders.

In favor of the Delaware approach is the minimized risk of paralysis which is the constant threat to any requirement of unanimous consent. The danger of the Delaware approach is setting the stage for a "gang up" on a locked-in majority.

Recommendation of the drafter: On balance, the drafter favors the New York requirement that the shareholder agreement be placed in the articles of incorporation. It is felt that this formalism will have both a strong cautionary impact upon

the parties as well as an evidentiary convenience should a court ever be called upon to intervene. As a price tag for this concession from the pyramid model, the drafter favors the language found in many statutes to the effect that the fiduciary duties of care and loyalty which the act imposed upon officers and directors devolve upon shareholders to the extent that, by terms of agreement or conduct, they have usurped these roles.

b. Stock transfer restrictions: By their nature, close corporations tend to be highly personal associations. Because of this, many participants desire to have firm control over the transfer of ownership rights. Most close corporate legislation contains concessions to this desire. Indeed, Delaware and Illinois require such restrictions as a pre-condition for close corporate status.

Recommendation of the drafter: Transfer restrictions such as those found in the California Corporations Code appear both reasonable in nature and functional in operation. Should the Commission take this path, these provisions are recommended.

c. Special dispute resolution procedures: A social cost of concessions to the close corporation is the high probability that such creatures will wind up in a "legal emergency room." Due to the highly personal nature of the close association and the frequent use of shareholder agreements requiring unanimous consent, the potential for corporate deadlock is transformed into a probability. The vexing fact is that small matters or even petty personal differences may

cause deadlock in what is otherwise a profitable concern. Increasingly, concession states are experimenting with remedial devices. New Jersey and California take a pessimistic view, reacting to the probable deadlock by relaxing the grounds under which a disgruntled faction may seek involuntary dissolution Both jurisdictions join Delaware and Texas in providing for appointment of a "provisional director" to resolve a single issue dispute. If the rift is deeper or more pervasive, New Jersey, Pennsylvania and Delaware provide for a custodial director; a modern day equivalent of an equitable receiver who, instead of liquidating the business, attempts to preserve it despite the battling owners.

The legislative decisions presented by this panoply of remedies involve cost/effectiveness balancing. Each successive remedy has the potential to increase litigation and to enmesh the time and attention of a court with the evolving problems of a going concern. Every other litigant on the docket of a trial court must suffer delay and inconvenience as the inevitable price for this exertion. Balanced against these costs are the interests of society in preservation of going concerns which function as employers, competitors and sources of goods and services in the marketplace.

Recommendation of the drafter: New Jersey has given its courts of general jurisdiction the full range of remedial devices to deal with the problem of deadlock for all corporations. Its only special concession is in giving small corporations more expansive grounds for dissolution. The

inherent disadvantages in such a step include increased litigation and increased potential for judicial interference in business matters. An alternative would involve extensive use of private arbitration. Arizona and Maryland have created great incentives to use this remedy. As a price tag for close corporate status, the act could require that the enterprisers agree to mandatory arbitration of any disputes arising under their agreement.

Appendix A

I. States with Separate Close Corporation Articles or Other Groupings

State	Statutory Provisions	Year of Enactment
1. Arizona	§§10-201 to 10-218	1976
2. Delaware	Tit. 8, §§ 341-56	1953
3. Florida	Repealed 1975	1963
4. Illinois*	Chap. 32, §§ 1201-16	1977
5. Kansas	§§ 17-7201 to 17-7216	1972
6. Maryland*	§§ 4-101 to 4-603	1967, revised 1975
7. Pennsylvania	Tit. 15, §§ 1371-86	1968
8. Texas*	BCL Art. 2.30-1 to 2.30-5	1973, revised 1975

II. States with Scattered Provisions Relating to Close Corporations (references are to provisions defining the close corporation)

State	Statutory Provision	Year of Enactment
1. California	Cal. Corp. Code § 158	1975
2. Maine	Tit. 13-A, § 102(5)	1973
3. Michigan	MSA § 21.200(101), (103)	1972
4. New Jersey*	Tit. 14A:5-21(3)(b)	1972

III. States Which Define the Close Corporation for One Specific Purpose

State	Statutory Provision	Year of Enactment
1. Florida	§ 607.107	1973 (shareholder agreements)
2. New York	BCL § 620(c)	1946 (shareholder management)
3. North Carolina*	§ 55-73	1955 (shareholder agreements)
4. South Carolina	§ 33-11-220	1962 (shareholder agreements)

IV. States Which Use the Number of Shareholders as a Defining Factor

State	Number Used	Other restrictions
1. Arizona	Initially, 10	Articles provision
2. California	10	Articles provision
3. Delaware	30	Articles provision No public offering of stock
4. Kansas	30	Articles provision No public offering of stock
5. Maine	20	
6. Pennsylvania	30	Articles provision No public offering of stock
7. Texas	35	Articles provision No public offering of stock Unanimous shareholder election

*Denotes Model Act State

Appendix A (cont.)

V. States Which Use the Marketability of the Corporation's Stock as a Defining Factor

State	General Language	Other Restrictions
1. Florida (both old and new)	"not generally traded on public markets"	
2. New Jersey	"not listed on nat'l sec. exch."	
3. New York	"not listed on nat'l sec. exch."	
4. North Carolina	"not generally traded on pub. mkts"	unanimous s/h election
5. South Carolina	"not listed on nat'l sec. exch."	unanimous s/h election

VI. States Which Use Shareholder Election as a Defining Factor

State	Other Restrictions
1. Maryland	None
2. Illinois	Must use one of five statutory means of transfer restriction
3. Arizona	Cannot have more than 10 initial stockholders
4. Texas	No more than 35 shareholders; no public offering of stock
5. North Carolina	Stock cannot be listed on nat'l sec. exch.
6. South Carolina	Stock cannot be listed on nat'l sec. exch.

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WILLIAM E. MOSELEY
MARC D. BOND
J. MICHAEL MOXNESS
J. D. CELLARS
GREGORY J. MOTYKA
JAMES B. FRIDERICI

March 30, 1984

Senator Joseph P. Josephson
Alaska Senate
Capitol, Room 508/510
Juneau, Alaska 99811

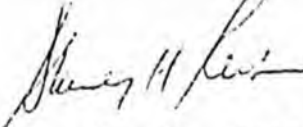
Re: SB 246
An Act Revising the
Corporate Code

Dear Senator Josephson:

Enclosed is a copy of the report dated March 30, 1984 made by the Task Force of the Business Law Section of the Alaska Bar Association to the Judiciary plus Labor and Commerce Committees of the Alaska House as agreed to during the course of the public hearing in Anchorage by such Committees on February 24, 1984.

This is the report described in my March 12, 1984 letter to you and your responsive March 16, 1984 communication.

Very truly yours,



Stanley H. Reitman

SHR:jf

cc: Alaska Code Revision Commission
John W. Abbott, Chairman
L. S. Kurtz, Jr., Esq.
Judge Thomas B. Stewart
Alaska Bar Association
Paul D. Kelly, Esq.

EXHIBIT D

RECEIVED MAR 30 1984

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March 30, 1984

Honorable Charlie Bussell
House Labor and Commerce Committee
Pouch V
Juneau, Alaska 99811

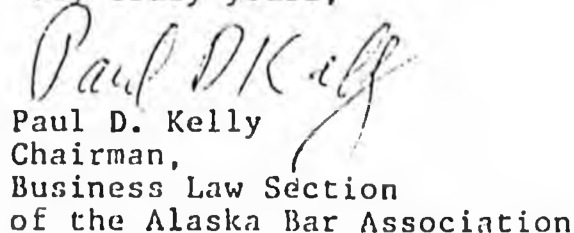
Re: Report of the Task Force of the Business Law Section of the Alaska Bar Association regarding HB 343 and SB 246, Corporate Code Revision.

Dear Representative Bussell:

Enclosed please find the report of the Task Group of the Business Law Section of the Alaska Bar Association. The report is the result of significant efforts by members of the task group who took time out of their busy practices to serve without compensation in providing their expertise on a subject of great importance to the Alaska business community. Each member on the task group has significant experience as a business law practioner.

Admittedly, the accompanying report is a brief review of a lengthy piece of legislation. The drafters have attempted to highlight certain areas of concern and hope that this report will aid the legislature. Listed below are the members who participated in the task group and their addresses and phone numbers. Please feel free to contact the group if we can be of any further assistance.

Very truly yours,



Paul D. Kelly
Chairman,
Business Law Section
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PDK/pj
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March 30, 1984

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House Labor and Commerce Committee
Pouch V
Juneau, Alaska 99811

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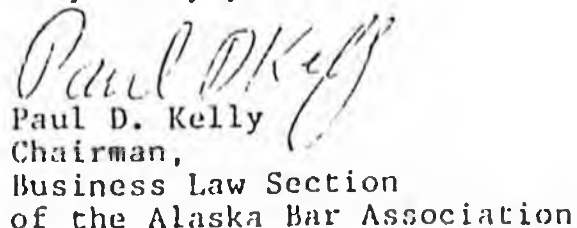

Paul D. Kelly
Chairman,
Business Law Section
of the Alaska Bar Association

PDK/pj
enclosure

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ALASKA BAR ASSOCIATION

P.O. BOX 279, ANCHORAGE, ALASKA 99510, (907) 272-7469

BUSINESS LAW SECTION

March 30, 1984

Honorable Charlie Bussell
House Labor and Commerce Committee
Pouch V
Juneau, Alaska 99811

Re: Report of the Task Force of the Business Law Section of the Alaska Bar Association regarding HB 343 and SB 246, Corporate Code Revision.

Dear Sir:

Enclosed is a review by the Task Force of the Business Law Section of the Alaska Bar Association of Senate Bill 246 and House Bill 343, the Corporate Code Revision.

The Review represents a time-limited study of the bills and was performed for the limited purpose of bringing to your attention some of the possible legal and economic consequences to the business community and the Alaska public that could arise if the bill were adopted in its present form. We urge you, then to consider this only as such and not an exhaustive section by section analysis of proposed amendments or a scholarly attempt at opposition or rebuttal to the work product of the Code Revision Commission.

In our deliberations, we met, both in subcommittees and as a whole Task Force with John Abbott, Chairman of the Code Revision Commission. At some of those meetings, Jerry Kurtz, another member of the Commission, was also present. At these meetings there was candid exchanges of views on the bills. In addition, we were advised that Professor Dan Fessler was available to meet with us, although at a date too late to assist us with this report given the time constraints put on our work by your Committees.

Individual sections of the bills are commented upon in the attached review, but considering the bills as a whole, we would make the following observations:

ALASKA BAR ASSOCIATION

P.O. BOX 279, ANCHORAGE, ALASKA 99510, (907) 272-7469

BUSINESS LAW SECTION

March 30, 1984

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House Labor and Commerce Committee
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Enclosed is a review by the Task Force of the Business Law Section of the Alaska Bar Association of Senate Bill 246 and House Bill 343, the Corporate Code Revision.

The Review represents a time-limited study of the bills and was performed for the limited purpose of bringing to your attention some of the possible legal and economic consequences to the business community and the Alaska public that could arise if the bill were adopted in its present form. We urge you, then to consider this only as such and not an exhaustive section by section analysis of proposed amendments or a scholarly attempt at opposition or rebuttal to the work product of the Code Revision Commission.

In our deliberations, we met, both in subcommittees and as a whole Task Force with John Abbott, Chairman of the Code Revision Commission. At some of those meetings, Jerry Kurtz, another member of the Commission, was also present. At these meetings there was candid exchanges of views on the bills. In addition, we were advised that Professor Dan Fessler was available to meet with us, although at a date too late to assist us with this report given the time constraints put on our work by your Committees.

Individual sections of the bills are commented upon in the attached review, but considering the bills as a whole, we would make the following observations:

1. Any major revision of a comprehensive body of law, such as the Corporate Code should include as one of its objectives, making the practice of law and business operations under the Code easier and more explicit.

We believe the proposed bill goes a long way to make the law more explicit than our current Code in many aspects, but not necessarily easier under which to practice or conduct business. For an Alaskan practioner, far more work needs to be done in carefully drafting Articles, By-laws and other documents than is currently the case. While it may be the intent to encourage the preventive practice of law and reduce remedial litigation, in the vast majority of cases, we think it will merely raise the cost of going into business in the corporate form.

For the out-of-state practioner, the problem is compounded, because as more states adopt the revised Model Act, Alaska's unique departures will require special time and study to assure compliance.

2. The Bills contain very material departures from current law in substantive rights and liabilities among corporate management, shareholders, creditors, secondary acquirers of shares and third parties doing business with Alaskan and even foreign corporations in Alaska.

We have two concerns about these departures. First, some substantive changes, such as the proposed limitations on distributions and the proposed direct liability of Officers and Directors to creditors are significant barriers to stimulation of commercial activity in the state and ought not to be adopted as this state's public policy. Second, we believe that passing a law this session with a July 1, 1984, effective date that contains such significant changes will prove to be an unwarranted shock on the practicing bar, the affected business community and the public.

3. Many provisions of the current Alaska Corporations Code merit attention and any thorough revision of the Code should analyze these special provisions to test their current value. Many of these provisions, such as registration of controlling out-of-state shareholders and disclosure of alien ownership, are ripe for elimination.

We found numerous occasions in the bills and the accompanying comments where these provisions were restated in the revision without explanations to their continuing value.

4. In March, 1983, a final exposure draft of the revised Model Business Corporation Act drafted after much careful study, under the auspices of the American Bar Association was released. The revised Model Act is the product of top legal and business professionals from across the nation.

We recognize that Professor Fessler has drawn liberally, in his proposals to the Code Revision Commission version, from the Model Business Corporation Act before its 1983 revision. Submitted herewith for your reference is a copy of the March 1983 Model Act draft. The final version is due to be published in the summer of 1984, with minor changes.

Some members of the Task Force have reviewed the revised Model Act and the accompanying commentary had the benefit of nationwide consideration by practioners and academicians and, to the extent adopted in other states, will enhance interstate corporate commerce. In our opinion if a comprehensive revision is deemed necessary, the revised Model Act is the appropriate vehicle for Alaska to utilize.

Furthermore, we urge consideration of the Model Act because its adoption in many states will provide a body of decisional law upon which Alaskans may draw for guidance in interpreting the Act, something a very unique Act would not have available. In addition, an extensive legal commentary accompanies the Model Act aiding the reader in a clear understanding of the provisions. Finally, as is the case with the old Model Act, the draftmen of the revised Model Act will provide model bylaws and official corporate forms to assist the public. This should significantly reduce legal costs.

We hope that this rather hurried review is useful to your committees in your own deliberations on the bills.

It is our view that there are numerous questions about specific provisions in the that the Committees should require more study.

Since the HB 343 carries such important consequences and there has been no showing of urgency to change the law, nothing is lost by deferring action on a new comprehensive code for Alaska until next session. By so doing, the legislature could accomplish the following:

a. give the Legislature, Code Revision Commission, and the public a meaningful opportunity to fully consider the revised Model Act;

b. give all sectors of the business community an opportunity to consider and propose specific amendments;

c. explain to the non-lawyer business community the Legislature's interest in revising the Code and seek an expression of support or concern from affected economic sectors.

The Task Force is willing to continue working with your Committees and with the Code Revision Commission towards a bill that is the best possible statute for Alaskans.

Yours cordially,

Richard Block
Task Group Chairman

RB/pj
enclosures

ARTICLES 1. CORPORATE PURPOSES AND POWERS
By: Richard Block, David Bendell and Mark Copeland

A.S. 10.06.005. Purposes. This section assumes that banks and insurance companies have within their respective regulatory statutes comprehensive provisions dealing with incorporation. As to banks, there may be some justification for that assumption, but correlative changes to the banking law would have to be adopted to assure no conflict or gap. As to stock insurance companies, there is a statutory provision for special differences between the general corporation code and the incorporation provisions affecting insurance companies, but A.S. 21.69 does not provide a comprehensive scheme for all corporate matters, certainly not as comprehensive as the proposed code. Either the Code should be made applicable to insurance companies or the Insurance Code modified to make it a more comprehensive statutory scheme for regulating corporate affairs.

A.S. 10.06.010. General Powers. The Code would not prohibit loans to officers and directors which is a change from current Alaska law. e detect as a main theme in the Code, a tendency to require financial legitimization of the corporation, i.e. a tendency to require preservation of its financial substance for the protection of creditors and stockholders. This permission to make loans to officers and directors tends to defeat that objective.

Elsewhere in the code is specific authority for the corporation to indemnify officers and directors. If the "cookbook" approach is intended, would it not be appropriate to list authority to indemnify as one of the corporation's enumerated powers?

A.S. 10.06.015. Ultra Vires. This is a worthy protection for Alaskans in dealing with foreign corporations. Though we are not familiar with any assertions of "Ultra Vires" by foreign corporations in Alaska to annul a contract made here, the public policy approach of this section is welcome.

ARTICLE 2. NAME AND SERVICE OF PROCESS

By: Richard Block, Daivd Bendell and Mark Copeland

A.S. 10.06.105. Corporate Name. Prohibition of use of the words "city", "borough" or "village" would outlaw a number of currently valid trade names in Alaska such as "Village Inn" and "City Electric". The determination of deceptive similarity should be left to the Director of the Corporation Division as it is now, without numerous statutory restrictions.

A.S. 10.06.105(c). Prohibition of the word "Limited" by other than a corporation would preclude its use in Alaska by a limited partnership.

A.S. 10.06.135-145. Procedure for Registration of Corporate Name. These sections establish a procedure for reservation of name and registration of name which is more complex and more demanding than current procedures.

A.S. 10.06.155. Registration of Agent by Nonresident Agent. This section is indeed a recodification of a 1983 amendment to existing Alaska law, but is believed to be an unnecessary burden on corporations with out-of-state investors. If the basic concept of corporate existence is a valid one, there should be no valid reason for preserving a means of reaching its controlling shareholders.

A.S. 10.06.175. Service of Process on Corporation. This imposes a larger burden on plaintiffs to seek out a more direct link to the corporation for affecting service of process than the Director of Division of Corporations. Generally this is regarded as a beneficial change.

ARTICLE 3. FORMATION OF CORPORATIONS

By: Richard Block, David Bendell and Mark Copeland

A.S. 10.06.208. Articles of Incorporation. This, like section 155, carries forward the parochial requirement for disclosing the involvement of outsiders in Alaskan corporations. Since no law prohibits foreign or alien participation, why should there be special requirements for disclosing their involvement?

A.S. 10.06.208(6). There is inherent in this provision the requirement for a specific detailing of the relative rights and privileges of various classes and series of shares of stock. We question the necessity of such specificity if, by reason of section 315, the Board may be given the authority to determine the rights and privileges of particular series by its own resolution.

A.S. 10.06.210. Articles of Incorporation: Optional Provisions.

210(1)(C). This provision requires that for a restriction on qualifications of shareholders is to be effective, the restrictions must be set out in the Articles. This could prove to be a burden for a corporation which wishes to qualify an offering under one of the exemptions under the Federal Securities Act. It would appear that continued modification of the Articles could be required to tailor the shareholder qualifications to the needs of differing offerings.

210(1)(H). Certain forms of bank and other institutional borrowing require that voting rights be conferred in the event of default. It is hard to know until the borrowing arrangements are made what the terms of such an agreement will be, yet the Articles must permit this authority. It could prove fatal to a borrowing transaction if the deal were held up pending approval of an amendment to the Articles of Incorporation.

As a general observation, it would appear that the general thrust of these sections is to use the Articles as much as a prospectus and disclosure statement as an organic document to bring the corporation into existence. This may, we suspect, be asking the corporation to unduly tie its hands, since changes to the Articles are made only after some time and difficulty, particularly if there are many shareholders.

A.S. 10.06.223. Organization Meeting. For most private corporations, it seems unnecessary to require 20 days notice before the organization meeting. We suspect that either the first meeting will be a "paper" meeting only, in which the case the requirement will be essentially ignored or the careful lawyer will have to insist on a basically needless delay in the incorporation process.

A.S. 10.06.230. By-laws: Number of Directors. There is offered no reason for putting statutory parameters on the number of directors that may be placed upon the Board. As long as the number does not exceed the limits if any placed in the Articles, the Board should not be further restricted in bringing needed or desired talent to its midst.

ARTICLE 4. CORPORATE FINANCE.
By: Richard Block, David Bendell and Mark Copeland

A.S. 10.06.320/323. Filing of Statement. These sections create a new way to amend the Articles-determine the specifics of a new stock offering and file a description of the new issue with Division of Corporations. Assuming that the offering does not require filing for a securities permit, these sections would be tantamount to making a securities filing anyway, with unclear responsibilities on the Director of the Corporations Division in dealing with the filing when it is made.

A.S. 10.06.325. Redemption of Shares. This provision unnecessarily prohibits what is believed to be a valid form of corporate financing, a security with a put. So long as all parties are cognizant of the terms there is no reason to prohibit such a financing option.

A.S. 10.06.333. Forfeiture of Shares. We here reiterate our concern for requiring the by-laws to contain things that can and ought to be merely a matter of contract. Remedies for failure to pay for subscribed shares are necessarily contained in what ever document the subscriber signs, making restatement in the by-laws redundant. Furthermore, the statute becomes unduly specific in the rights of a defaulting subscriber, including giving him a vested right in the realized appreciation in the value of shares for which he has failed to pay.

A.S. 10.06.348. Certificates Representing Shares. It is our concern whether the preservation of the certificate concept, even with the authority for facsimile signature, really will facilitate going to a book entry registration of share ownership capability.

A.S. 10.06.355. Issuance of Fractional Shares or Script. The proposed statute precludes the simplest method of dealing with fractional interests, the payment of cash. It is realignment of public policy to provide protection of the interests of infinitesimal minority shareholders by increasing the administrative burden on the corporation.

A.S. 10.06.358-363. The Financials. These sections introduce one of the most significant of substantive changes to the corporate law of this state. To achieve the intended result of prevention of asset dissipation for the protection of creditors, the Commission does away with the concept of "par value", establishes new criteria and more stringent criteria which must be met before dividends may be declared and imposes upon the corporate officers and directors standards for determining the propriety of dividends that can only be met, in our opinion, by obtaining a certified public audit of the books to determine if the criteria have been satisfied.

It is not within the province of this review to discuss the propriety of the public policy provisions, although the Task Force does not believe that the financial problems of debtors have been occasioned by abuses that would be stopped by these provisions. It is, however, our desire to bring to the attention of the Committees, what we perceive as the significant impacts of these provisions.

The oil of the free enterprise system is capital and the trick for a state that has as one of its manifestos, the attraction of capital, is to create an environment that permits the freest use of that capital consistent with equity and fairness for all involved with the enterprise. Recognizing that this last statement in a sense begs the issue, nonetheless, for the last many decades, at least, it has not seemed unfair to creditors to permit business enterprise the latitude to structure their capital to maximize their leveraged use of the resource, moving money from one enterprise to another.

The legislature should consider carefully what impact there will be on the attraction of capital to an enterprise that must by law reduce their leverage opportunity.

A.S. 10.06.368. Exception for Purchase or Redemption of Shares of Deceased Shareholder. This provision is of course important, but we cannot understand why the authority is limited to proceeds of insurance beyond the premiums paid. In other words, if over time $25,000 were paid in premiums for $500,000 life insurance to fund a buy-out provision, the corporation could only pay $475,000.

A.S. 10.06.378 Liability of Shareholders Receiving Prohibited Distribution. This provision raises some interesting prospective problems.

It should be noted that there are some on the Task Force that wonder why knowledge of the improprieties of the distribution is requisite to the cause of action. They argue that if the distribution is wrongful, akin to theft from the creditors, it should be returned, even though they may not have actually had knowledge of its illicit nature.

It is suspected by the Task Force that this section could be the foundation for a whole new source of complicated and expensive litigation.

ARTICLE 5. SHAREHOLDERS

By: Brian J. Brundin

A.S. 10.06.405 MEETINGS OF SHAREHOLDERS.

This section proposes three changes to the current Alaska Business Corporation Act. The first is that a shareholder may petition for a court order that an annual shareholder meeting be held if one has not been held within any 13-month period. The second is removal of the provision that failure to hold the annual meeting at the designated time does not work a forfeiture or dissolution of the corporation. The third adds the Chairman of the Board to the virtually unlimited number of persons who may be authorized to call a shareholders' meeting.

COMMENT: The first change, allowing any shareholder to obtain a court order to hold an annual meeting, presents more questions than it answers. Who will pay the court costs? May there be legitimate reasons for not holding a meeting within any 13 months? The major business usually conducted at the annual meeting of shareholders who can influence the electing of directors, namely who holds one-tenth or more of the shares entitled to vote, already have the statutory right to call a meeting. Under this proposal, the holder of one share could sue for an order that a meeting be held and probably charge the court costs to the corporation - even if he had no real ability to affect the business to be done at the meeting and even if there was a good reason why there had not been a meeting within the past 13 months. This change is unnecessary and gives the ability for an insignificant minority "trouble-maker" shareholder to either grab publicity or otherwise stir the pot to the detriment of other shareholders and the corporation. The holding of the meeting of a large corporation, and particularly one publicly held where proxie statements must be mailed, can be a very expensive undertaking.

Does the second proposed change mean to suggest that failure to hold the annual meeting at the designated time may work a forfeiture or dissolution of the corporation? That consequences could be disastrous.

As to the third proposed change, present law allows the president, the board, ten percent shareholders "or the other officers or persons provided in the articles of incorporation or the bylaws" to call a shareholders' meeting. If ommission of the Chairman of the Board is a problem, corporations may now resolve that problem by simply including his name in the Articles or Bylaws. A change of statute is not required. Apparently the Revised Model Act does not confer this right on the Chairman of the Board, since absent other authority given to the Chairman, he simply chairs the Board of Directors, and it is the Board of Directors who takes Board action, not the Chairman.

A.S. 10.06.408 CLOSING OF TRANSFER BOOKS AND FIXING RECORD DATE.

It appears three changes here are also proposed. The first is that instead of closing the stock transfer books for a period not exceeding 50 days, and for at least 10 days before a meeting, 60 days and 20 days are substituted. Secondly, a new way to fix record date is provided. If the Directors do not act, the date on which the notice of meeting is mailed or the date on which the resolution of the Board declaring the dividend is adopted is the record date. Thirdly, the determination of shareholders applies to an adjournment of the meeting of shareholders - under earlier law it would apply if the 50 days had expired.

COMMENT: As to the first change, this and the subsequent sections appear to make it impossible to hold a meeting of shareholders in less than 20 days without waiver of all shareholders; an extension of time which, in this day of modern communication, would seem to unnecessarily hamper the corporation in the holding of a meeting in less time if necessary. The Model Act retains 10 days. No reason is given why 20 days is suggested.

The second change seems unnecessary. In a very small corporation, the people who are shareholders remains relatively fixed, and no "new" way to determine who they are is required. In a large corporation, the present law is adequate and directors are capable of utilizing one of the two ways now provided.

The third change would seem to allow a possible "freezing out" of new shareholders by the adjournment of a meeting for longer than the 50-day period that the stock transfer books may now be closed.

A.S. 10.06.410 NOTICE OF SHAREHOLDERS' MEETINGS.

Besides some rewording, it appears the change in this section is to set a minimum time of 20 days rather than 10 days from the date notice is given until the meeting held. See comment above.

A.S. 10.06.413 VOTING LIST; LIABILITY.

Despite the long discussion of this section in the official comment, it appears there is no change to the prior law except again the 10 days to 20 days.

COMMENT: Shareholders now have an absolute right to view the shareholder list prior to a meeting, and so far as I know, the "proper purpose" doctrine is not applied in this instance, for it is manifestly a proper purpose for a shareholder to exercise his statutory right to view a voters' list prior to a meeting. See earlier comment regarding increase in time from 10 to 20 days.

A.S. 10.06.415 QUORUM OF SHAREHOLDERS.

The change proposed here allows a quorum once constituted to continue notwithstanding the withdrawal of enough shareholders to leave less than quorum and is intended to prevent a meeting from continuing by a "walk-out" of a minority.

COMMENT: While this change is not now in our statutes, it may be provided for by common law or by Roberts Rules of Order. While it seems to be a useful change, in my almost 18 years of practice, this question has never presented a problem to a client.

A.S. 10.06.418 PROXIES.

This proposed change expands the four-line section of current law to more than two pages in an attempt to regulate the giving of proxies under several enumerated situations. It undoes a 1972 amendment which prohibited proxies lasting more than eleven months.

COMMENT: While it is arguably useful to allow long-term proxies for security agreements, pledges, employment contracts, trusts and the like, the two new pages of proposed regulations will undoubtedly create many new opportunites for court battles. On balance I think it is cheaper and better to maintain the present law that only short-term proxies are allowed. The important right to vote should be difficult to take away from a shareholder. Requiring a shareholder who wishes to give a proxy to do so annually makes him think about his corporate investment at least annually and allows a reconsideration of whether a proxy given should be renewed.

A.S. 10.06.420 VOTING OF SHARES.

The major proposed change of this section is to lean back again toward cumulative voting, only more strongly than ever before. Alaska's law has bounced back and forth on this question, and presently allows cumulative voting unless the Bylaws provide otherwise. The suggested change presumes it unless the Articles say otherwise, and once cumulative voting is allowed, for no change to it if not approved by a shareholder who, under cumulative voting, could elect a director. Part (f) lists "administrator, executor" instead of personal representative as described in A.S. 13.06.050(30).

COMMENT: The issue of presuming or not presuming cumulative voting has long been debated and, as stated earlier, Alaska law has changed on this subject over the years. I am not aware of any Alaskan business proposal to change it back again.

Since the present statute has been unamended since 1964, adoption of this new provision would require many corporations to undergo the expenses of amending their Articles or Bylaws for a matter than does not appear to be a burning issue.

A.S. 10.06.423 ACTIONS TAKEN WITHOUT MEETING: MEETING CONSENT; REVOCATION OF CONSENT.

This appears only to rewrite and not change current law regarding unanimous consent. The official comment is confusing; it seems to say there is a change. Added to present law is a provision allowing revocation of such consent.

COMMENT: The rewriting does not seem to be required, nor is the addition of a provision alllowing revocation of consent. In my experience, consent is most always requested to confirm actions earlier taken.

A.S. 10.06.425 VOTING TRUSTS AND AGREEMENTS AMONG SHAREHOLDERS.

This provision again amplifies current law. Whether or not it changes the law is debatable. Current law requires a copy of the trust agreement to be deposited with the corporation for inspection. The new proposals spells out the names and addresses of all the holders of trust certificates also must be deposited, which may already be required. Additionally a new section is added from California law which does not invalidate pooling arrangements so long as they comply with the more complex proxy rules proposed by Section 413.

COMMENT: Voting trust and pooling interest have not been burning issues in Alaska. The proposal is to regulate them to a greater degree. The proposal is at variance with the Model Act and is apparently a synthesis of former Alaska law, the Model Act and California law.

Like other provisions proposed, where a question has not been an issue in Alaska and is unlikely therefore to have court interpretations, I think it is not useful to adopt proposals that synthesize the law of several jurisdictions. From a practitioner and businessman's view point it would be better to adopt the Model Act so that if questions do arise, decisions from other jurisdictions regarding the Model Act, and its commentaries, will provide guidance.

A.S. 10.06.428 SHAREHOLDERS' PRE-EMPTIVE RIGHTS.

This is again a one-page substitution for 12 lines of two current sections. Current law leaves the matter to the Articles of Incorportion and, if not covered by the Articles, provides for sales to officers or employees upon a two-thirds

vote of shareholders. The proposal continues the right to limit or deny (but apparently not to expand) pre-emptive rights and spells out several rules that will exist with respect to different kinds of shares if such rules are not changed by the Articles. The official comments suggest the Legislature intends to occupy the field with respect to circumstances under which pre-emptive rights are to be recognized and, apparently beyond the words of the proposed statute, for the Legislature to adopt the holding and reasoning of the Kazowitz case, which limits the ability of a corporation to issue additional stock, thus financially troubling shareholders who wish to exercise pre-emptive rights, unless a valid business purpose can be established for the issuance of the stock.

COMMENT: The proposal is stated to be "predicated" upon the Model Act, but apparently is not the same. For reasons suggested above, I think it is preferable, if any change needs to be made, the Model Act language be used.

A.S. 10.06.430 BOOKS AND RECORDS.

This proposal enlarges considerably the requirement for keeping of books and records and allowing inspection of them by shareholders. Under present law, a person who has been a shareholder of record for at least six months or who holds at least five percent of the outstanding shares may inspect and copy such reocrds. The proposal allows all shareholders to do so. Under current law refusal to give the information can result in payment of a penalty of ten percent of the value of the shares owned by the shareholder in addition to other damages. The new proposal is that the penalty be ten percent or $5,000.00, whichever is greater, in addition to other damages. Under current and proposed law a court may order inspection irrespective of the amount of shares owned or the time they have been owned. Official comments declare that the Legislature intends to adopt numerous cases cited.

COMMENT: This change would make it easier for a person to buy one share of the stock of a corporation and "stir up the pot". The citation of cases and the official comment which the writer requests that the Legislature adopt again suggests the proposal is not verbatim from the Model Act, which carries its own interpretive law, and accordingly the proposal may be "skewed" toward the bias of the drafter.

A.S. 10.06.433 ANNUAL REPORT TO SHAREHOLDERS: CONTENTS; FINANCIAL STATEMENT ON REQUEST.

This proposal, new to Alaska and taken from the California law according to the official comment, describes an elaborate three-page regulation requiring annual reporting by corporations to shareholders. Corporations with under 100 share-

holders will have to amend their Articles of Incorporation to avoid its complex rules. Corporations with 100 or more shareholders will have to make elaborate reporting such as is done by a publicly-owned corporation under provisions of the Securities & Exchange Act. Additionally the corporation must prepare quarterly financial statements, keep them on file, and mail them to any shareholder demanding a copy. A penalty of up to $1,500.00 per shareholder is provided for violation.

COMMENT: This is surely one of the "land mines" of the proposed statute, which would, on the one hand, blow the feet off a small corporation which fails to amend its Articles to avoid its onerous provisions or, on the other hand, create an entirely new and expensive level of reporting and penalties for corporations with more than 100 shareholders. It is unprecedented in Alaska law, and apparently draws on the "innovation" recently made in California law. No similar provision is contained in the Model Act.

The more one reads this proposed law, the more it appears that the drafter of it has a bias against corporations and an intention to "save" shareholders and others from the "ghastly beasts".

The proposed provision appears not only unnecessary but potentially very damaging. Any investor who buys stock in a large publicly-owned company is already protected by securities laws. Small closely-held corporations on the other hand are ordinarily not owned by other than those involved in the business closely enough to not require such "protection". Larger and publicly-owned corporations which must now comply with other regulation, such as securities laws, will be met in Alaska with an unnecessary additional layer of regulation which includes the costs of keeping and mailing additional financial reports to any shareholder who requests them. Would this add to what some feel is an "anti-business" attitude in Alaska? As earlier suggested, this proposal can only act to cause unnecessary potentially damaging problems to smaller corporations.

Again because the proposal, purportedly "adapted" from the new California law appears to be the words of the drafter, one can only begin to contemplate all of the new issues which might be raised and for which there would be no answer from other jurisdictions to guide the practitioner or businessman.

A.S. 10.06.435 SHAREHOLDERS' DERIVATIVE ACTION.

This is another proposal without precedent in Alaska statutory law. It is a four-page detailed scenario for the suing of a corporation by a disgruntled shareholder which requires eight pages of the official comment to describe. It sets out in detail some rules to be followed in pleading the action.

COMMENT: Provisions of this nature do not belong in the corporate statutory law. Rules of pleading in Alaska should be left to the court and the development of derivative actions to the common law. Again the proposal exhibits a bias against corporations by making it easier to bring and maintain such derivative actions. Again it is the words of the drafter, adapting the law of other jurisdictions, reportedly mostly New York and California, and accordingly will create problems of interpretation unique to Alaska.

A.S. 10.06.438 LIABILITY OF SHAREHOLDERS AND SUBSCRIBERS.

This proposal does not appear to change present statutory law, being almost verbatim.

COMMENT: The official comment suggests there are words in the proposal which I do not find, and the comment deals almost entirely with other liability which may arise under another section, Section 488.

ARTICLE 6. DIRECTORS AND OFFICERS
By: Julius J. Brecht

A.S. 10.06.450 Board of Directors: Duty of Care; Right of Inspection; Failure to Dissent.

Proposed 10.06.450(b) sets forth various individuals upon which a director may rely in performing his directorship functions. Subsection (c), however, removes the insulation from liability provided by Subsection (b) if the reliance is found to be "unwarranted". Substantial questions are therefore raised as to what protection, if any, is provided by the provision of Subsection (b).

A.S. 10.06.465. Vacancies and Resignation; Special Meeting of Shareholders.

Proposed 10.06.465(d) provides that a director may not be relieved from the responsibilities of his or her office until a qualified successor has been elected. Since the effective date of resignation is apparently unimportant for fixing liability, it is possible that a director who has resigned from the board will continue to be personally liable for board actions long after his active participation with the company has ended.

A.S. 10.06.488. Secondary Liability of Directors and Officers.

Proposed 10.06.488 imposes primary and secondary liability upon directors and officers which is an aberration and contrary to long standing corporate principals and judicial decisions. For all practical purposes, the distinction between "corporation" and "individual" has been lost in the proposed Senate Bill. This extension of liability is apparently designed to provide corporate creditors with an additional and/or secondary source for corporate business failures. As Mr. Reitman has indicated, these aberrations are almost guaranteed to generate traps for the unwary and result in a proliferation of litigation. Well known and understood business practices, such as personal guarantees have long been used to secure payment of corporate indebtedness. The liability of directors and officers is also a matter of long established statutory law and judicial precedent. The radical departure proposed by these sections should not be adopted without much additional study and justification. The potential impact of this provisioin was the subject of ample comment at the joint committee hearings in Anchorage on February 24, 1984, and will not be further developed here.

ARTICLE 7. AMENDMENTS AND CHANGES

By: Kenneth Eggers

AS 10.06.502 AUTHORIZATION: PERMITTED AND PROHIBITED AMENDMENTS.

Appears to be more confusing than is necessary. The MBCA (Revised Model Act) would appear to accomplish the same purpose in a more clear, streamline manner.

AS 10.06.504 PROCEDURE TO AMEND ARTICLES OF INCORPORATION.

Gives shareholders explicit power to initiate amendments. Merely need majority of shares entitled to vote as opposed to 2/3rds as required under present Alaska law unless otherwise provided.

AS 10.06.508 GREATER VOTING REQUIREMENTS.

If articles require super majority then amendment must be approved by same super majority. Consistent with MBCA.

AS 10.06.522 AMENDMENT OF ARTICLES OF INCORPORATION IN REORGANIZATION PROCEEDINGS.

Allows Amendment pursuant to order of Bankruptcy Court in reorganization proceeding. Section taken from MBCA.

ARTICLE 8. ORGANIC CHANGES
By: Kenneth Eggers

AS 10.06.542 DISPARATE TREATMENT OF THE SAME CLASS OR SERIES PROHIBITED: EXCEPTIONS.

New to Alaska, allows disparate treatment to preserve Sub S election, unanimous consent, or sound business reason. The last reason is undefined, leaves open the possibility of abuse and is an invitation to litigation.

AS 10.06.554 MERGER OF SUBSIDIARY CORPORATION.

Allows merger without shareholder vote if parent owns at least 90% of stock of subsidiary. Taken from Model Act. New to Alaska. Short form merger.

AS 10.06.556 PROCEDURE FOR MERGER OF SUBSIDIARY CORPORATION.

Premised on Model Act except require that provisions of 542 be met.

AS 10.06.562 MERGER, CONSOLIDATION, OR EXCHANGE OF SHARE DOMESTIC AND FOREIGN CORPORATION.

Domestic corporation must comply with Alaska law. If foreign corporation survives, it must comply with Alaska law for doing business. Must agree to pay dissenting shareholders. This section again calls into question the idea of imposing Alaska law on foreign corporation no matter how minimal their contract may be with Alaska. This could very well discourage foreign corporations from looking at Alaska corporations for merger partners and could adversely impact business opportunities for Alaska-owned corporation.

AS 10.06.566 SALE OF ASSETS IN REGULAR COURSE OF BUSINESS; MORTGAGE OR PLEDGE OF ASSETS.

New in that it ALLOWS MORTGAGE OR PLEDGE of any or all property and assets of corporation whether or not in the usual and regular course of business without shareholder approval. One must ask from a policy point of view if the directors of a corporation who need not have any financial interest in a corporation at all to hold office should have the power to mortgage all of the property of the corporation not in the usual and regular course of business without going to the shareholders. Obviously such decisions could lead to the bankruptcy of a corporation. While the Model Act has the same provision, it

specifically provides that shareholder approval can be required if such a provision is set forth in the Articles of Incorporation. At a minimum, the Alaska act should do the same.

AS 10.06.568 SALE OF ASSETS NOT IN REGULAR COURSE OF BUSINESS.

New in that it eliminates need for shareholder approval for mortgage or pledge of any or all property.

AS 10.06.570 APPROVAL OF TRANSACTION BY SHAREHOLDERS.

If Buyer in the sale is in control of or under the common control with the Seller 570(b) erects an extraordinary requirement of approval via at least 90% of the outstanding shares regardless of restrictions or limitations in the Articles or share indenture - UNPRECEDENTED IN ALASKA LAW. This gives minority shareholders (11%) tremendous power and one must question why a 2/3rds requirement is not sufficient and more practical.

AS 10.06.574 RIGHT OF SHAREHOLDER TO DISSENT.

No right in case of short merger (554) and shares traded on national securities exchange.

AS 10.06.582 ACTION TO DETERMINE VALUE OF SHARES UPON FAILURE TO AGREE.

Premised on Model Act. Burden on corporation to initiate action. A consolidated action. Corporation must bear costs and expenses unless shareholder acted in an arbitrary or vexatious manner or in bad faith. Costs exclude attorney fees and experts (except appraiser) unless fair value determined by court materially exceeds amount corporation offered to pay in which case, shareholders can obtain reimbursement for expenses. This is a very one sided provision in favor of the shareholders. Shareholders could recover costs from corporation even if corporation offer exceeded what the court ultimately awards. The effect of this section as written is to encourage dissent and unnecessary litigation. This section should be rewritten so that the possible risks are more fairly apportioned. This will serve to encourage settlement of any disputes which may arise.

ARTICLE 9. DISSOLUTION

By: Richard Rosston, Stanley Reitman,
Ray Gardner and Bruce Frenzel

A.S. 10.06.605. Section 605 permits the Board of Directors under specified circumstances to authorize involuntary dissolution without a shareholder vote by filing a petition on behalf of the corporation in the Bankruptcy Court. Without safeguards, the Board of Directors may usurp a corporate opportunity by dissolving the existing corporation and then forming their own corporation to take advantage of opportunities available to the previously existing corporation.

A.S. 10.06.635. Section 635(a)(2) confers broad authority on the state to involuntarily dissolve a corporation which "has continued to exceed or abuse the authority conferred upon it by law." Additionally, it should be noted that subsection (3) ambiguously refers to the imposition of involuntary dissolution by the state if "the corporation has seriously violated a statute regulating corporations." The Subcommittee considers the interpretation of a serious violation as opposed to a minor violation to be overly subjective.

A.S. 10.06.605. By comparing provisions of the exposure draft of the old Model Act, as distinguished from the ABA revised MBCA, with Section 605, the Subcommittee concluded that certain provisions in Section 605 are counterproductive. For instance, the old Model Act requires notice of pending dissolution to all of the shareholders, rather than just the voting shareholders as set forth in Section 605. Nonvoting shareholders should be informed of the pending dissolution of a corporation in which they have a beneficial interest. Additionally, Section 605 needlessly requires class voting for dissolution, whereas the old Model Act relies upon the Articles of Incorporation for the voting structure in order to avoid conflicts.

A.S. 10.06.608. The requirement to file a "certificate of election" with the commissioner in addition to the "Articles of Incorporation" is superfluous and will result in unnecessary administrative burden.

A.S. 10.06.615. Provisions of Section 615 permitting the conduct of business after dissolution only to preserve "goodwill or going concern value" are ambiguous insofar as they do not specify what business activities are authorized thereunder.

A.S. 10.06.628. Section 628 curtails the rights of creditors to initiate involuntary dissolution proceedings. The commentary justifies this revision of existing law on the basis of the proposed Section 488 imposition of liability on officers and directors. To the extent that the revision represented by Section 628 is predicated upon the adoption of Section 488, it is opposed by the Subcommittee.

A.S. 10.06.633. Section 633 permits the Commissioner to administratively initiate involuntary dissolution proceedings against the corporation if "a misrepresentation of material fact has been made in the application, report, affidavit or other document" submitted to the Commission. Neither the revised code nor the commentary indicate whether such liability may be imposed for innocent misrepresentation or whether a negligence standard applies. Additionally, Section 633's provisions for an administrative appeal by a trial de novo in Superior Court could create a substantial burden on both the Department of Commerce and the court system.

A.S. 10.06.645. By invoking the equity jurisdiction of the court, Section 645 injects an element of uncertainty into the dissolution process and increases the possibility of unnecessary litigation.

A.S. 10.06.653. Section 653 requires the Commissioner of Revenue to act as a stake-holder of corporate assets which are the subject of dispute between shareholders or creditors. This provision could involve the Commissioner of Revenue in litigation and may increase administrative burdens.

A.S. 10.06.663. It is doubtful that any qualified individual would accept an appointment as a director under Section 663 given the potential liability created by Section 488.

ARTICLE 10. FOREIGN CORPORATIONS

By: Richard Rosston, Stanley Reitman, Ray Gardner and Bruce Frenzel

A.S. 10.06.743. Section 743 permits the commissioner to revoke a foreign corporation's certificate of authority if "the corporation" is a party to an illegal combination in restraint of trade." No similar statutory provision exists with respect to domestic corporations, and the Subcommittee is unaware of any reason to discriminate against foreign corporations. Although the provision is in the existing statute, it should be eliminated pursuant to a comprehensive code revision.

A.S. 10.06.773. Although foreign corporations are not required to file their Articles of Incorporation with the Commissioner, Section 773 mandates the filing of amendments. The subcommittee recommends that if the Articles are not to be filed, then the requirement to file amendments should also be deleted.

A.S. 10.06.828. Section 828 provides that "the filing fee should be uniform and fixed without reference to the amount of authorized shares," whereas the commentary states that the filing fee shall be fixed "with reference" to the amount of authorized shares.

A.S. 10.06.955. Section 955 makes Section 488 liability to directors and officers applicable to foreign corporations doing business in the State of Alaska. The Subcommittee believes that such imposition of liability will have a significant "chilling effect" on outside investments in the state.

A.S. 10.06.960. Corporations organized under PL 92-203: It should be noted that the provisions in Section 960 protecting officers and directors of Native corporations under Section 10.06.488 does not extend to subsidiary corporations which are wholly or partially owned by corporations formed under the Alaska Native Claims Settlement Act. Additionally, Section 960 may violate the equal protection clauses of the U.S. and Alaska Constitutions.

HB 343 CSSB 246 (L&C)
on
Business Corporations

Summary

The bill provides for replacing the Alaska Business Corporation Act, AS 10.05, with the Alaska Corporation Code (ACC), a comprehensive revision.

The proposed ACC sets minimum requirements that must be met for the privilege of doing business in the corporation form.

Within limits it leaves to incorporators how to divide powers between shareholders and directors.

It standardizes reporting required to shareholders and the state.

It seeks to clearly define in what circumstances it is permissible to pay a dividend.

While maintaining the right of shareholders to sue corporate officers and directors in appropriate circumstances, it seeks to control the misuse of these "derivative suits."

It also seeks to control misuse of the limited liability of officers and directors that the corporate form provides.

In the covering letter at the start of the commentary in House and Senate Joint Journal Supplement No. 11, there is an expanded summary of the bill. Following that is a section analysis which includes the background and basis for choices that have been made in drafting the bill.

STATE OF ALASKA 1984 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date: January 31, 1984

REQUEST
Bill/Resolution No.: SB 246
Title: An act revising the Alaska Corporations Code.
Sponsor: Rules Committee
Requestor: Legislative Council
Date of Request: 4/8/83

FISCAL DETAIL
Agency Affected: Commerce and Economic Dev.
Program Category Affected: Consumer Protection.
BRU, Program or Subprogram(s) Affected: Banking, Securities and Corporations

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 84	FY 85	FY 86	FY 87	FY 88	FY 89
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 SUPPLIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS						
800 MISCELLANEOUS						
* TOTAL OPERATING	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
CAPITAL	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
REVENUE	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

* There will be no fiscal impact providing the adoption of the proposed amendment of the Alaska Code Revision Commission which deletes in Sec. 10.06.733 the words, "together with a verified copy of its articles of incorporation and all amendments to the articles."

ANALYSIS: Attach a separate page for analysis

Prepared By: Willis F. Kirkpatrick   Phone: 465-2521
Division: Banking, Securities and Corporations   Date: 1/31/84

Approved by Commissioner: Richard A. Lyon   Date: 2/3/84
Agency: Commerce and Economic Development

Distribution (by Agency preparing fiscal note):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

12/1/83

TESTIMONY OF JOHN W. ABBOTT, Chairman of the Alaska Code Revision Commission.

Subject: CSSB 246/HB 343

Delivered before a Subcommittee of the Senate Judiciary Committee, the Honorable Joseph P. Josephson presiding, Anchorage, Alaska, April 28, 1984.

MR. CHAIRMAN: My name is John W. Abbott, I am a resident of Anchorage, a member of the Alaska Bar Association and am the Chairman of the Alaska Code Revision Commission. I welcome the opportunity to appear before this Committee and to utilize this forum to respond on the record to the work product of the self-appointed ad hoc committee of Anchorage lawyers as well as several aspects of the conduct of members of that group as they have sought to influence legislative consideration of the proposed Alaska Corporations Code.

On February 24, 1984, Mr. Richard Block and Mr. Paul Kelly led a group of Anchorage attorneys in offering public commentary on S.B. 246 which had been favorably reported out of the Senate Labor and Commerce Committee following two hearings. The forum selected by the members of this self-appointed task force was a joint hearing conducted in Anchorage by the House Judiciary and Labor and Commerce Committees. At that time Mr. Block and his associates requested a thirty day grace period during which time they promised to prepare what was styled as "an economic impact" report on the pending legislation. On March 30, 1984, thirteen pages of cover letters accompanied a twenty-one page report

directed to committee chairmen in both the Senate and House. Rarely has such a diminutive substantive patty been served up on such a fluffy procedural bun. As a prelude to the Commission's response to that report I would like to comment upon several aspects of the public testimony given by task force members and written statements and representations made by Mr. Block and his confederate in this affair, Mr. Stanley Reitman, also of the Anchorage Bar.

Several of the witnesses, echoing the "if it ain't broke don't fix it" line, questioned the need for any legislative attention to Alaska statutory law respecting profit seeking corporations. Others questioned the role of the Code Revision Commission in terms which may have left members of the public and Legislature with the very inaccurate impression that the pending Alaska Corporations Code had been created in a vacuum with no previous exposure. With respect to the legal community in particular, the impression may have emerged that the Bar Association and its Business Law Section had been taken off-guard. Last, but perhaps most distressing, Mr. Reitman is responsible for repeated efforts to shift attention from the merits of the Commission's work to the identity of its consultant. In two letters intended for broad circulation among the leaders of both the Senate and House, Mr. Reitman insists upon terming S.B. 246 and H.B. 343 as the "Fessler Code." His most recent tactic is to question the identity of Professor Fessler and his influence over the members of the Commission and its work product. Let me take up these topics in the order which

I have raised them.

1. The Legislature's charge to the Code Revision Commission obligates it to undertake periodic review of the content of Alaska statutory law and, if it determines that conditions warrant, recommend revision of the law. Anyone who takes the time to review a transcript of the February 24 hearing will gain some interesting insight regarding the views of those who sought the thirty day grace period to perform their voluntary study of the proposed corporations code. Their admitted lack of familiarity with either the general goals or specific content of that reform effort is matched by their ignorance of the Legislature's decision to create a broadly based study group composed of both elected officials and appointed citizens and to charge that body with the task of reviewing the condition of Alaska statutory law, testing it against economic, demographic and theoretical developments and determining whether it continues to represent the best policy for this state and its citizens. The Code Revision Commission by law must include a member of the Senate and the House, a designee of the Court System, a representative of the Department of Law, a representative of the Alaska Bar Association, and three public members appointed by the Governor. While it has not always been the case, all but one of the current members of the Commission happen to be lawyers.

2. My letter of transmittal to Senator Ray dated March 3, 1983, sets forth the Commission's findings and conclusions respecting the need to revise the statutory law we borrowed from the State of Oregon at the time of statehood. The "ain't broke

don't fix it" school of thought has always left out the possibility that "it" might need fixing because "it" is simply worn out. Alaska's current statutory law on profit seeking corporations was adopted wholesale from a mid-1950's version of the Model Business Corporations Act. That Act was intended for the needs of no state but has enjoyed significant influence over the statutory content of smaller states of lesser economic consequence. If one is to be candid, it permitted the unstaffed part-time legislatures of such states to achieve legislation in the corporate area with little thought and little effort. Major states, such as New York and California, have always preferred to think matters through for themselves. Delaware, the most significant American state in terms of corporate law, has also preferred to create its own corporate law. Over the years the recommended content of the Model Act has been expanded. Even the "ain't broke" advocates were forced to admit at the February hearing that Alaska has been very tardy in considering, let alone adopting these amendments. Finally, in 1979, the American Bar Association acknowledged that the time had come to totally re-think the content of the Model Act. In the meantime few Alaskans need to be reminded that economic conditions in the mid-1980's bear little similarity to those of the late 1950's. It was in recognition of these factors that the Commission determined that it was appropriate to study with a view toward revision the profit seeking laws of this state.

The self-appointed task force has consumed thirty days of the public's legislative session and, far from supporting its

initial view that the law does not need revision, now advances specific proposals for change and urges that the Revised Model Business Corporations Act be adopted as the vehicle for that change. Given this apparent change of heart perhaps the Legislature will not be further impeded as it directs its attention to framing a code best suited to the needs of Alaskans.

3. Any impression that the Alaska Bar Association was not apprised of the Commission's work or that members were precluded from an opportunity to review and participate in the process is neither factual nor fair. The variety of witnesses who followed Mr. Block before the joint House Committee excused their ignorance of the proposed corporations code on the ground that it had only recently come to their attention. I find this remarkable. An exposure draft of the code was introduced as S.B. 873 in the Twelfth Legislature in March, 1982. At that time the Senate Journal Supplement carried several hundred pages of explanatory commentary. In May, 1982, a written summary of the Commission's proposed code was prepared for the state convention of the Alaska Bar Association held in Anchorage. In a further effort, the Commission directed its consultant, Professor Fessler, to present a two hour oral summary of highlights at that convention. Copies of S.B. 873 were made available at that meeting along with copies of the official comments. The Commission's Juneau office address was widely noted as well as the availability of both the bill and commentary at the various legislative information offices throughout the state.

In June, and again in July, 1982, Professor Fessler addres-

sed civic groups including both the Downtown and Matsu Valley Rotary Clubs. Again he was directed to spell out the highlights of the Commission's exposure draft.

In December, 1982, Professor Fessler returned to Anchorage this time at the invitation of the Business Law Section of the Bar Association. It is interesting to note that the individual most responsible for that invitation, and for discussing the scope of the two day seminar which spent half of its time focusing upon the new code, was Mr. Richard Block.

Members of the Legislature may wish to weigh these repeated and specific opportunities to gain knowledge and to participate against the transcript of professed surprise and ignorance on the part of individuals who would now like to appear highly motivated and public spirited.

It should also be remembered that these are members of the only profession in the state which, by law, is officially represented on the Commission. My colleague, Jerry Kurtz, has served on the Commission as the Bar Association's representative throughout the entire period when the current law was first evaluated and the proposed code was evolved. His background as a practicing lawyer specializing in a business related practice equals or exceeds that of any member of this self-selected task force. I might add that since concluding my period of service to the Alaska Supreme Court I have engaged in a private practice which has also concentrated on business matters.

4. Mr. Block's assertion that Professor Fessler was not available to meet with members of the ad hoc task force in time

to assist them is incorrect. As early as February 24, Professor Fessler in my presence informed Mr. Kelly and others of his willingness to meet with them either in person or by conference call. This was the same conversation in which, with my consent, he volunteered to forward the various working documents which had been used by the Commission in evolving the content of the current proposal. In telephone conversations with Judge Stewart, Mr. Reitman was also assured of Professor Fessler's strong desire to meet with members of the task force. The fact that no such meeting took place reflects a decision of Mr. Block and his colleagues and they ought to be sufficiently open with members of the Legislature to admit that fact.

5. Mr. Reitman's sudden curiosity concerning the identity and views of the Commission's consultant reveal a self-imposed ignorance which can quickly be dispelled.

On March 12, 1984, Mr. Reitman wrote to the Chairman of this Sub-Committee a nine page letter in which he outlined his views on the Model Act, the efforts to generate a revised version of that recommended legislation, the status of close corporations and his opposition to Section 488 (dealing with the secondary liability of officers and directors). He concluded by stating that ". . .nothing contained here is intended to downgrade the scholarship or craftsmanship of Professor Fessler, substantially relied on by the ACRC, nor of the laudable motives of the ACRC." In a footnote to that statement, Mr. Reitman reports his participation in a telephone conversation with Professor Fessler in which ". . .he [Fessler] was most gracious in answering

questions posed, and in correcting my [Reitman's] misreading or inadequate reading of a number of specific provisions thereof."

Eighteen days later, Mr. Reitman again corresponded with the Chairman of this Sub-committee and asked that his letters be made part of the public record. His attitude toward the Commission and Professor Fessler have undergone substantial change. An explanation for this change can be found in Reitman's reaction to a memorandum which Professor Fessler had prepared in 1981 as one of a series of study papers for the Commission. This particular one dealt with the topic of close corporations. Mr. Reitman could not have intended to portray himself as some investigative reporter for that would have been at variance with the truth. It is thus unfortunate that he did not tell Senator Josephson that he was reacting to a large volume of background papers which the Commission and Professor Fessler furnished the self-appointed task force in efforts to overcome their three year lack of interest and participation.

Mr. Reitman, the man who only days earlier was urging the Senate to look before it leapt, made no effort to contact me or any other member of the Commission concerning Professor Fessler or the reaction of the members to the specific memorandum concerning close corporations. Were it not that we would have to add it to a growing list of omissions one could assign this lack of contact to inadvertence. Since he appended the text of the memorandum I will not comment on it save to note that all references to "corporations" in Mr. Reitman's letter of March 30, 1984, should read to "close corporations." To suggest that Professor Fessler "does not approve of the corporate vehicle" is

thus fundamentally misleading. (Mr. Reitman owes the Senate, the Commission, and Professor Fessler an apology.)

Mr. Reitman does, however, raise a question as to Professor Fessler's background. Since he has asked that the question be spread on the public record it deserves a public response.

Daniel Fessler is a Professor of Law at the University of California, Davis. He has held that post since 1971. He was reared in a small town in Wyoming where his parents published a semi-weekly newspaper. A graduate of Wyoming public schools, he attended Georgetown University where he was graduated with honors in 1963. He then attended the Georgetown University Law Center and received his LL.B. degree with distinction in 1966. For five of the seven years spent in Washington, D.C. as a student he worked, in turn, for three members of the Congress. He served as a clerk to Representative William Henry Harrison and Senator Milward Simpson both of Wyoming. He also served as a law clerk to Senator Everett McKinley Dirksen, the Republican Minority Leader.

Following his graduation from Georgetown, Fessler was appointed as a law clerk to Judge James R. Browning of the United States Court of Appeals for the Ninth Circuit. Upon the expiration of that one year appointment he moved to Spokane, Washington, where he served on the faculty of Gonzaga University. While living in Spokane Fessler bec[illegible] active in the Rockefeller for President Committee and tra[illegible] extensively in Idaho, Oregon and eastern Washington. In 196[illegible] accepted an invitation from Professor David Cavers to become [illegible] fellow in urban legal studies