ALASKA LEGISLATURE COMMITTEE FILES 1987-1988 8672
4705 HJUD HB 322

277

Sec. 10.06.360. Prohibited Distribution: Inability to Meet Maturing Debts and Liabilities
Sec. 10.06.363. Prohibited Distribution of Junior Shares: Liquidation Preference
Sec. 10.06.365. Prohibited Distribution to Junior Shares; Ratio of Retained Earnings
Sec. 10.06.368. Exception for Purchase or Redemption of Shares of Deceased Shareholder
Sec. 10.06.370. Inapplicability to Regulated Investment Company
Sec. 10.06.373. Share Dividends; Restrictions
Sec. 10.06.375. Additional Restrictions in Articles, Bylaws, Indentures or Agreements
Sec. 10.06.378. Liability of Shareholders Receiving Prohibited Distributions; Suit Against Shareholders
Sec. 10.06.380. Identification of Distribution in Notice to Shareholders
Sec. 10.06.383. Inapplicability to Winding up and Involuntary or Voluntary Dissolution
Sec. 10.06.385. Redemption of Shares at the Option of Corporation; Manner
Sec. 10.06.388. Acquisition of Corporation's Own Shares; Reissuance or Retirement
Sec. 10.06.390. Capitalization of Retained Earnings

ARTICLE 5. SHAREHOLDERS

Sec. 10.06.405. Meetings of Shareholders
Sec. 10.06.408. Closing of Transfer Books and Fixing Record Date
Sec. 10.06.410. Notice of Shareholders' Meeting
Sec. 10.06.413. Voting List; Liability
Sec. 10.06.415. Quorum of Shareholders
Sec. 10.06.418. Proxies
Sec. 10.06.420. Voting of Shares
Sec. 10.06.423. Actions Taken Without Meeting: Written Consent; Revocation of Consent
Sec. 10.06.425. Voting Trusts and Agreements Among Shareholders
Sec. 10.06.428. Shareholders' Preemptive Rights
Sec. 10.06.430. Books and Records
Sec. 10.06.433. Annual Report to Shareholders: Content; Financial Statement on Request
Sec. 10.06.435. Shareholders' Derivative Action
Sec. 10.06.438. Liability of Shareholders and Subscribers

ARTICLE 6. DIRECTORS AND OFFICERS

Sec. 10.06.450 Board of Directors: Duty of Care; Right of Inspection; Failure to Dissent
Sec. 10.06.453. Number and Election of Directors
Sec. 10.06.455. Classification of Directors
Sec. 10.06.458. Vacancies on the Board
Sec. 10.06.460. Removal of Director Without Cause
Sec. 10.06.463. Removal of Director by Superior Court
Sec. 10.06.465. Vacancies and Resignation; Special Meeting of Shareholders
Sec. 10.06.468. Executive and Other Board Committees
Sec. 10.06.470. Meetings: Call, Place, Notice, and Waiver
Sec. 10.06.473. Quorum of Directors
Sec. 10.06.475. Informal Action by Directors
Sec. 10.06.478. Director Conflicts of Interest
Sec. 10.06.480. Liability of Directors
Sec. 10.06.483. Officers: Tenure, Resignation, Agency, Duty of Care
Sec. 10.06.485. Loans to Directors, Officers, and Employees
Sec. 10.06.488. Secondary Liability of Directors and Officers
Sec. 10.06.490. Indemnification of Officers, Directors, Employees, and Agents: Insurance

ARTICLE 7. AMENDMENTS AND CHANGES

Sec. 10.06.502. Authorization: Permitted and Prohibited Amendments
Sec. 10.06.504. Procedure to Amend Articles of Incorporation
Sec. 10.06.506. Class Voting on Amendments
Sec. 10.06.508. Greater Voting Requirements
Sec. 10.06.510. Articles of Amendment
Sec. 10.06.512. Filing of Articles of Amendment
Sec. 10.06.514. Effect of Certificate of Amendment
Sec. 10.06.516. Restated Articles of Incorporation
Sec. 10.06.518. Filing of Restated Articles of Incorporation
Sec. 10.06.520. Effect of Issuance of Restated Certificate of Incorporation
Sec. 10.06.522. Amendment of Articles of Incorporation in Reorganization Proceeding
Sec. 10.06.524. Filing of Amendment of Articles in Reorganization Proceedings
Sec. 10.06.526. Effect of Issuance of Certificate of Amendment in Reorganization Proceedings

ARTICLE 8. ORGANIC CHANGE

Sec. 10.06.530. Merger
Sec. 10.06.532. Procedure for Merger
Sec. 10.06.534. Consolidation
Sec. 10.06.536. Procedure for Consolidation
Sec. 10.06.538. Share Exchange
Sec. 10.06.540. Procedure for Share Exchange
Sec. 10.06.542. Disparate Treatment of Shares of the Same Class or Series Prohibited: Exceptions
Sec. 10.06.544. Notice to and Approval by Shareholders
Sec. 10.06.546. Manner of Approval by Shareholders
Sec. 10.06.548. Abandonment of Plan of Merger, Consolidation, or Exchange
Sec. 10.06.550. Articles of Merger, Consolidation, or Exchange
Sec. 10.06.552. Filing of Articles of Merger, Consolidation, or Exchange
Sec. 10.06.554. Merger of Subsidiary Corporation
Sec. 10.06.556. Procedure for Merger of Subsidiary Corporation
Sec. 10.06.558. Filing of Articles of Merger of Subsidiary Corporation
Sec. 10.06.560. Effect of Merger, Consolidation, or Exchange
Sec. 10.06.562. Merger, Consolidation, or Exchange of Shares between Domestic and Foreign Corporation
Sec. 10.06.564. Reorganization: Disclosure of Alien Affiliates
Sec. 10.06.566. Sale of Assets in Regular Course of Business; Mortgage or Pledge of Assets
Sec. 10.06.568. Sale of Assets not in Regul[illegible] Course of Business
Sec. 10.06.570. Approval of Transaction by Shareholders
Sec. [illegible]06.572. Abandonment of Transaction by Board
Sec. 10.[illegible].574. Right of Shareholders to Dissent
Sec. [illegible].576. Rights of Dissenting Shareholders: Procedure to Enforce Shareholder's Right to Receive Payment for Shares; Withdrawal of Demand
Sec. 10.0[illegible] [illegible]er and Payment to Dissenting Shareholders; Circumstances Where Prohibited
Sec. [illegible]. Action to Determine Value of Shares Upon Failure to Accept Corporate Offer
Sec. 10.[illegible].582. Status of Shares Acquired From Dissenting

Shareholders

ARTICLE 9. DISSOLUTION

Sec. 10.06.605. Voluntary Dissolution by Vote, Written Consent of Shares, or Election of the Board
Sec. 10.06.608. Certificate of Election: Contents, Signing, Verification and Filing
Sec. 10.06.610. Certificate of Revocation of Election: Contents, Signing, Verification, and Filing
Sec. 10.06.613. Effect of Certificate of Revocation of Election
Sec. 10.06.615. Commencement and Conduct of Voluntary Proceedings for Winding up; Cessation of Business; Notice
Sec. 10.06.618. Judicial Supervision of Winding up: Petition and Notice; Order Protecting Shareholders and Creditors
Sec. 10.06.620. Articles of Dissolution: Contents
Sec. 10.06.623. Filing of Articles of Dissolution
Sec. 10.06.625. Effect of Certificate of Dissolution
Sec. 10.06.628. Involuntary Dissolution by Verified Complaint: Filing; Intervention by Shareholder or Creditor
Sec. 10.06.630. Avoiding Dissolution by Verified Complaint; Purchase of Plaintiff's Shares; Determination of Fair Value; Stay; Appraisal; Award; Appeal
Sec. 10.06.633 Involuntary Dissolution by the Commissioner: Grounds, Procedure, Reinstatement
Sec. 10.06.635. Commissioner's Authority to Bring Action for Involuntary Dissolution: Grounds; Relief
Sec. 10.06.638. Venue and Process for Commissioner's Action
Sec. 10.06.640. Appointment of Provisional Director: Deadlock
Sec. 10.06.643. Appointment of Receiver: Application, Hearing and Notice, Security, Qualifications, Powers, Compensation
Sec. 10.06.645. Decree for Winding up and Dissolution: Further Judicial Relief
Sec. 10.06.648. Commencement and Conduct of Involuntary Proceedings for Winding up; Cessation

of Business; Notice
Sec. 10.06.650. Jurisdiction of Court
Sec. 10.06.653. Claims Against Corporation; Court and Non-Court Directed Winding up; Presentation; Notice; Payment; Secured Claims; Rejected Claims
Sec. 10.06.655. Order Declaring Corporation Wound up and Dissolved; Declaration; Effect; Additional Orders; Discharge of Directors
Sec. 10.06.658. Filing of Decree of Dissolution
Sec. 10.06.660. Powers and Duties of Directors in Dissolution Proceedings
Sec. 10.06.663. Proceeding to Determine Identity of Directors or to Appoint Directors
Sec. 10.06.665. Distribution of Corporate Assets Among Shareholders; When to be Made
Sec. 10.06.668. Provision for Payment of Debt or Liability
Sec. 10.06.670. Distribution in Money or in Kind; Installments
Sec. 10.06.673. Plan of Distribution; Adoption; Binding Effect; Notice; Payment of Dissenting Shareholders; Abandonment
Sec. 10.06.675. Recovery of Amounts Improperly Distributed
Sec. 10.06.678. Continued Existence of Dissolved Corporations; Purposes; Abatement of Action; Distribution of Omitted Assets

ARTICLE 10. FOREIGN CORPORATIONS

Sec. 10.06.705. Admission of Foreign Corporation
Sec. 10.06.710. Liability for Transacting Business Without Certificate of Authority
Sec. 10.06.713. Transacting Business Without Certificate of Authority as a Bar to Right to Sue
Sec. 10.06.715. Transacting Business Without Certificate of Authority not Affecting Contracts and Right to Defend Action
Sec. 10.06.718. Activities not Constituting Transacting Business in This State
Sec. 10.06.720. Corporate Name of Foreign Corporation
Sec. 10.06.723. Assumed Corporate Name
Sec. 10.06.725. Change of Name by Foreign Corporation
Sec. 10.06.728. Application for Certificate of Authority
Sec. 10.06.730. Contents of Application
Sec. 10.06.733. Execution and Filing of Application for

Certificate of Authority

Sec. 10.06.735. Effect of Certificate of Authority
Sec. 10.06.738. Amended Certificate of Authority
Sec. 10.06.740. Powers of Foreign Corporation
Sec. 10.06.743. Revocation of Certificate of Authority
Sec. 10.06.745. Limitations on Revocation of Certificate of Authority
Sec. 10.06.748. Issuance of Certificate of Revocation
Sec. 10.06.750. Effect of Certificate of Revocation
Sec. 10.06.753. Registered Office and Registered Agent of Foreign Corporation
Sec. 10.06.758. Change of Registered Office or Registered Agent of Foreign Corporation
Sec. 10.06.760. Filing of Statement of Change
Sec. 10.06.763. Service of Process on Foreign Corporation
Sec. 10.06.765. Service on Commissioner
Sec. 10.06.768. Records Kept by Commissioner
Sec. 10.06.770. Procedure not Exclusive
Sec. 10.06.775. Organic Change of Foreign Corporation
Sec. 10.06.778. Withdrawal of Foreign Corporation
Sec. 10.06.780. Contents of Application for Withdrawal
Sec. 10.06.783. Form of Application for Withdrawal
Sec. 10.06.785. Filing of Application for Withdrawal
Sec. 10.06.788. Effect of Certificate of Withdrawal

ARTICLE 11. REPORTS, FEES, AND PENALTIES

Sec. 10.06.805. Biennial Report of Domestic and Foreign Corporations
Sec. 10.06.808. Contents of Biennial Report
Sec. 10.06.811. Filing of Biennial Report
Sec. 10.06.813. Filing Notice of Change of Officers, Directors, Five Percent Shareholders, and Alien Affiliates
Sec. 10.06.815. Penalty for Failure to File Biennial Report
Sec. 10.06.818. Interrogatories by Commissioner; Judicial Proceeding to Contest
Sec. 10.06.820. Confidentiality of Information Disclosed by Interrogatories
Sec. 10.06.823. Failure to Answer Interrogatories
Sec. 10.06.825. Penalties Imposed Upon Officers and Directors
Sec. 10.06.828. Incorporation or Filing Fees
Sec. 10.06.830. Fees on Appointment or Revocation of Appointment of Process Agent or Change of Agent's Address

Sec. 10.06.833. Fees and Penalties Payable on Withdrawal of Foreign Corporation
Sec. 10.06.835. Fees on Dissolution of Domestic Corporation
Sec. 10.06.838. Taxes, Penalties, and Fees on Filing Certificate of Dissolution of Foreign Corporation
Sec. 10.06.840. Fees for Certified Copies of Document
Sec. 10.06.843. Other Filing Fees
Sec. 10.06.845. Biennial Corporation Tax; Penalty for Nonpayment
Sec. 10.06.848. Failure to Pay Tax or Make Report as Precluding Suit by Corporation
Sec. 10.06.850. Commissioner to Institute Suits to Compel Payment
Sec. 10.06.853. Failure to Pay Tax as Evidence of Insolvency
Sec. 10.06.855. Payments to be Made in Advance
Sec. 10.06.858. Accounting for and Disposition . Taxes and Fees
Sec. 10.06.863. Appeal From Revocation of Certificate of Authority
Sec. 10.06.865. Cancellation of Certificates Issued and Filings Accepted
Sec. 10.06.868. Forms to be Furnished by the Commissioner
Sec. 10.06.870. Identification Code

ARTICLE 12. MISCELLANEOUS PROVISIONS

Sec. 10.06.905. Voting of Shares; Quorum; Status of Disqualified Shares
Sec. 10.06.910. Processing of Writings Filed With the Commissioner
Sec. 10.06.915. Disapproval of Writing by Commissioner; Appeal
Sec. 10.06.920. Writings; Corrections
Sec. 10.06.925. Writings as Evidence
Sec. 10.06.930. Corporate Seal as Evidence
Sec. 10.06.935. Waiver of Notice

ARTICLE 13. GENERAL PROVISIONS

Sec. 10.06.950. Powers of Commissioner
Sec. 10.06.953. Regulations
Sec. 10.06.955. Applications
Sec. 10.06.958. Provisions Construed as Restatements and

Continuation

Sec. 10.06.960. Corporations Organized Under P.L. 92-203
Sec. 10.06.963. Severability
Sec. 10.06.965. Reservation of Power
Sec. 10.06.968. Signature
Sec. 10.06.970. Rules of Construction and Interpretation
Sec. 10.06.990. Definitions
Sec. 10.06.995. Short Title

* Sections 2-4 amend the references to the present corporation code in three statutory sections.

* Sec. 5. Repealer

* Sec. 6. Application of Provisions to Domestic and Foreign Corporations

* Sec. 7. Exercise of Reserve Power

* Sec. 8. Application to Articles of Existing Corporations

* Sec. 9. Amendment of Articles of Incorporation

* Sec. 10. Indemnification by a Corporation

* Sec. 11. Distributions and Reacquisition of Shares

* Sec. 12. Tenure of Officers Preserved

* Sec. 13. Existing Actions

* Secs. 14-35 describe how the proposed new code amends the state's court rules

* Sec. 36. Effective date section.

ALASKA CODE REVISION COMMISSION

COMMENTARY TO ACCOMPANY

PROPOSED BILL ON THE

ALASKA CORPORATIONS CODE (ACC)

MAY 1987

Official Comment to ACC Section 10.06.050. PURPOSES.

SCOPE: ACC sec. 005 permits an Alaska corporation to be formed for any lawful purpose(s) other than insurance and banking. Stock and mutual insurance companies are formed under AS 21.69; the companies are of a corporate nature and are governed by the ACC to the extent provided in sec. 21.69.020, the "bridge" statute. Reciprocal insurance companies, noncorporate in nature, are formed under AS 21.75.

CHANGE IN FORMER ALASKA LAW: ACC sec. 005 alters the content of former AS 10.05.003 to conform to the content of Section 3 of the Model Business Corporation Act (MBCA).

Official Comment to ACC Section 10.06.010.

GENERAL POWERS.

SCOPE: In the earliest societal experience corporations were chartered by the sovereign for limited purposes and had, correspondingly, limited powers. Such concepts have been totally supplanted by general incorporation statutes which typically confer upon corporate entities all of the powers of a natural person. ACC sec. 010 adheres to this contemporary practice. However, it is not necessary that a corporation enjoy the plenary powers conferred by the ACC, and sec. 010 makes it clear that these powers may be curtailed, modified, or eliminated by aptly drafted provisions of the articles of incorporation.

CHANGES IN FORMER ALASKA LAW: ACC sec. 010 is predicated upon former AS 10.05.009 and Section 4 of the MBCA. The introductory phrase is adopted from Section 207 of the

California General Corporation Law (CGCL or GCL) and makes explicit that the general powers are subject to limitation by provisions in the articles of incorporation or other laws. Subsection (5) makes direct reference to the new provision on loans to officers and directors (ACC sec. 485). Subsection (15) adds "stock option plans" to the list of incentive plans which a corporation formed under the ACC may establish for its directors, officers and employees.

Official Comment to ACC Section 10.06.015.

DEFENSE OF ULTRA VIRES.

SCOPE: ACC sec. 015 governs the limited circumstances in which a claim of "ultra vires" may affect the rights of third parties who have dealt with a corporate entity and the impact of such behavior in creating liability on the part of corporate officers and directors to the corporation. While the concept of "ultra vires" is frequently included in the discussion of agency problems within the corporate framework, properly understood it is not a traditional doctrine of agency law. A transaction is ultra vires when it is beyond the powers of the corporation as those powers are conferred by law and the terms of the articles of incorporation. Within the constructs of the law of agency the corporation, acting through its board, is the principal and the officers are its agents. Sec. 015 is not concerned with restrictions upon the authority of these agents which may be defined by the articles, the bylaws or resolutions of the board. Rather, concern is with transactions to which they have committed the corporate entity which exceed the power of that corporate principal.

For the purpose of determining the powers of a corporation, reference must be made to ACC sec. 010 (general powers) and to the articles of incorporation of that entity. From these two sources one can determine the extent of the express real authority which the corporate officers and directors may exercise in the service of the corporate principal. To these express powers are to be added authorization to enable the corporate agents to efficiently and effectively carry on the purposes or tasks for which the corporation was created. Physical necessity and business custom are the traditional fonts of this evidence. See Park v. Alta Ditch & Canal Co., 458 P.2d 625 (Utah, 1969). For the purpose of minimizing the assertion of "ultra vires" charges, effective

limitations upon the powers of the corporation may not be placed in the corporate bylaws. See, ACC sec. 210(1)(F). Accord, Jennings v. Ruldoso Racing Ass'n., 441 P.2d 42 (N.M., 1968); and, In re Dinkard, 25 A.D.2d 34, 280 N.Y.S.2d 959 (1967).

Sec. 015(a)(1) governs a derivative action by a shareholder to enjoin the doing of any act or the transfer of real or personal property or by or to the corporation on the theory that the transaction is ultra vires to the entity. In the extent that the activity of which complaint is made involves the rights of third parties, sec. 015 remits the matter to the equity powers of a reviewing court. There is an express limitation that the court, in computing and awarding damages to any party, may not include the "expectation interest", being the anticipated profits of the ultra vires transaction. Unaffected by this statutory limitation are damages calculated upon a theory of restitution (quasi-contract) and reimbursement (costs incurred in good faith detrimental reliance).

Sec. 015(a)(2) grants standing for either a direct or derivative action to obtain judgment in the name of the corporation against such officers and directors who may be guilty of the ultra vires act. Compensatory damages for any loss or damage sustained by the corporate entity (including any liability incurred by the corporation to a third party under sec. 015(a)(1) would be the appropriate remedy under sec. 015(a)(2).

Sec. 015(a)(3) coordinates with the authority of the commissioner to bring action for involuntary dissolution of any corporation which has continued to exceed or abuse the authority conferred upon it by law. ACC sec. 633(a)(2).

Sec. 015(b) extends the provisions of sec. 015(a) as consequence of an ultra vires contract or conveyance made by a foreign corporation within the State of Alaska or of real estate within the State of Alaska.

CHANGE IN FORMER ALASKA LAW: ACC. sec. 015(a) is predicated upon Section 203 of the New York Business Corporation Law (NYBCL or BCL). It is a modified version of former AS 10.05.018 and Section 7 of the MBCA. Sec. 015(b) is new and is taken from Section 208 of the GCL.

Official Comment to ACC Sections 10.06.020--025.

LIMITATIONS ON AUTHORITY OF CORPORATE AGENTS: CONTRACTS OR CONVEYANCES BINDING DOMESTIC AND FOREIGN CORPORATIONS.

SCOPE: Unlike transactions or conduct assailed as beyond the powers of the corporation, a subject covered by ACC sec. 015, sec. 020 deals with the consequences of an abuse of authority which was within the power of the corporate principal to confer. The provisions of sec. 015 confront the common law of agency as it has been applied to the unique problems generated by an artificial, corporate person as a principal. The basic premises if agency law are unquestioned. A corporate principal is liable for any authorized conduct of its agents. This authority may be either express (imparted by the terms of the articles, bylaws, board resolution or [where competent] a shareholders' agreement); or, implied as being sanctioned by either custom or necessity in the agent's otherwise uninstructed pursuit of the goal defined for accomplishment by the principal. When a corporate agent acts within the scope of either express or implied authority, authorities speak of the "real authority of the agent."

ACC sec. 020 presumes that a corporate agent has acted without real authority (express or implied) from the corporate principal. Notwithstanding, if "apparent authority" supported the transaction, the statute makes it clear that the third party acquires the full liability of the betrayed corporate principal upon the executory terms of the unauthorized agreement. In the event such liability is asserted, the language also makes clear that the corporation acquires full rights upon all terms of the unauthorized agreement.

In many jurisdictions "apparent authority" is a poorly understood concept. Alaska is an exception. In 1967, and again in 1973, the Supreme Court clearly defined and applied the concept. "Apparent authority to do an act is created as to third persons by written or spoken words or any other conduct of the principal which, reasonably interpreted, causes the third person to believe that the principal consents to have the act done on his behalf by the person purporting to act for him." Perkins v. Willacy, 431 P.2d 141, 142 (1967). Accord. Bruton v. Automatic Welding & Supply Corp., 513 P.2d 1122, 1125 (1973). These cases clearly indicate that apparent authority must be traced to

appearances created by the principal. It cannot arise upon the statements, acts or representations of the agent. Further, the belief of the third party as to the real authority of the agent must go beyond the "white heart and empty head" standard of subjective "good faith" and rise to the level of "reasonable belief." Such language is intended to embrace cases demanding proof that a reasonable person, situated as was the third party and exercising reasonable prudence in evaluating not only the indications of the principal's consent but also those which would warn of a lack of authority, would have formed a belief as to the real authority of the agent. See Walker v. Pacific Mobile Homes, Inc., 68 Wash.2d 623, 347 P.2d 677 (1962). The burden of proof to establish these elements is that of the third party. Booth v. Litchfield, 201 N.Y. 466, 469 94 N.E. 1078 (1911).

Within the realm of litigation against corporate defendants, peculiar problems arise as to the agency status of officers. Unlike a human being, a corporation cannot act directly but must rely upon the actions of officers and employees. The contact with the law of agency is inevitable. Generally speaking, if a corporation confers an office upon an individual, that act alone clothes the officer with such powers of agency as are necessary to accomplish his or her duties. Carney v. New York Life Insurance Co., 162 N.Y. 453, 57 N.E. 78 (1900). If these powers are not expressly articulated they represent a specie of implied real authority. The "president of a corporation" enjoys the broadest grant of implied real authority in the absence of limiting instruction. Joseph Greenspon's Sons Iron & Steel Co. v. Pecos Valley Gas Co., 34 Del. 567, 156 A.2d 350 (1931). Such powers are not mandatory and as with any agent may be curtailed by the principal. However, if such limiting instructions are secret and the officer acts in dealings with third parties in the marketplace who are unaware of them, the corporate principal is liable on a theory of apparent authority. Lee v. Jenkins Brothers, 156 F.Supp. 358 aff'd. 268 F.2d 357 (2d Cir. 1959). The "profile of authority" of other corporate officers is obviously of a lesser magnitude. Many valuable authorities are collected and reviewed in Goldenberg v. Bartell Broadcasting Corporation, 47 Misc.2d 105, 262 N.Y.S.2d 274 (1965), which is commenced as sound in every aspect save for the confusing formulation of the concept of apparent authority as ". . . the authority which the principal permits the agent to represent that he possesses." 262

N.Y.S.2d at 282. To the extent that this language suggest that apparent authority can be constructed upon the statements of the agent, it is misleading. See Perkins v. Willacy, supra, 431 P.2d at 142.

Sec. 025 recognizes "ratification" as an independent basis for establishing the liability and rights of the corporate principal for an unauthorized act or transaction. Bruton v. Automatic Welding & Supply Corp., 513 P.2d 1122 (Alaska 1973), has defined that doctrine in accordance with the better common law authorities. Ratification is an after-arising manifestation by a betrayed principal who has become aware of the unauthorized nature and content of the transaction in question that he intends to be bound by its terms. Aildrin v. Lucas, 260 Or. 373, 490 P.2d 141, 144-45 (1971). While it is generally in the form of an express manifestation of the intention to be bound, ratification may be implied from the principal's knowing acceptance of the benefits of the unauthorized transaction. When an unauthorized transaction is ratified, the want of authority in the agent is "cured" and the liability of the principal upon all of the terms of the previously unauthorized contract "relates back" to the date of its formulation by the faithless agent. Rakestraw v. Rodrigues, 8 Cal.3d 67, 500 P.2d 1401, 1404-05 (1972).

While unmentioned in sec. 025, the ACC does not intend to arrest the common law development of estoppel as a means of imposing liability upon a principal who becomes aware of an unauthorized transaction and then watches the third party change position in detrimental reliance incurring out of pocket expenses which could have been avoided by a timely warning from the betrayed principal. In these fact patterns liability is not upon the terms of the unauthorized contract but is limited to making the third party whole for the out of pocket expenditures or loss which were foreseeable in their nature, reasonable in their magnitude, and avoidable by a timely indication from the principal that the transaction was unauthorized and would not be ratified.

Peculiar to corporate practice is the concept of "adoption." This doctrine arises when an individual associated with the formation of a corporation attempts to contract or otherwise incur liability in its name at a point in time before corporate existence has begun. An after-arising corporation could not "ratify" such a contract for at the time it was made there was no corporate principal betrayed by the agent.

However, that corporation can become liable upon the terms of the transaction by an express manifestation of a willingness to "adopt" it. The knowing receipt of the fruits of a pre-incorporation transaction has been held sufficient to work an implied adoption. Air T[illegible] [illegible] & Service Corp. v. Fay, 90 U.S. App. D.C. 319, [illegible] F.2d 40 (1952); and Gardiner v. DuPont, 250 Fed. 227 (2d Cir. 1918).

Recognizing the intrinsic difficulty of agency qu[illegible]stions in the corporate context and the desire of third parties to eliminate the possibility of the corporation successfully contesting liability, sec. 483(d) was added to the ACC. This innovative provision establishes for the first time a strategy which will insure the liability of a corporate principal which has two officers, one of whom is the chairman of the board, the president or any vice president and the other the secretary, any assistant secretary, the treasurer or any assistant treasurer. See the official comment to ACC sec. 483.

CHANGE IN FORMER ALASKA LAW: ACC sec. 020 and 025 are both taken from California GCL Section 20[illegible] and are new to Alaska statutory la[illegible].

Official Comment to ACC Section 10.06.105.

CORPORATE NAME.

SCOPE: Because a business conducted in the corporate form is an entity with rights and liabilities distinct from those of its shareholders, it is imperative that third parties have notice of this status. The requirement that the name contain the word "corporation," "company," "incorporated" or "limited" (or an abbreviation of one of these words) is intended to provide that basic notice. ACC sec. 105 also forbids the corporate name to be misleading as to the nature of the business or to be the same as or deceptively similar to that of another corporation, foreign or domestic, authorized to do business in Alaska. Specifically precluded under sec. 105(b) is the inclusion of the word "city," "borough," or "village" in a corporate name or any other wording which would imply that the corporation is a municipality.

CHANGE IN FORMER ALASKA LAW: ACC sec. 105 is a reenactment of former AS 10.05.021 as amended, and is modification of

Section 8 of the MBCA. No substantive change in prior Alaska law is intended in the enactment of ACC sec. 105.

Official Comment to ACC Sections:

Sec. 10.06.110. RESERVATION OF CORPORATE NAME;
Sec. 10.06.115. APPLICATION TO RESERVE CORPORATE NAME;
Sec. 10.06.120. TRANSFER OF RESERVED NAME.

SCOPE: ACC secs. 110, 115, and 120 set forth the natural or corporate persons who may reserve a corporate name, the procedure to be followed, and the rights thereby acquired.

CHANGE IN FORMER ALASKA LAW: ACC secs. 110, 115, and 120 are reenactments without change of former AS 10.05.024, 027, and 030 and are based upon Section 9 of the MBCA.

Official Comment to ACC Sections:

Sec. 10.06.125. REGISTRATION OF CORPORATE NAME;
Sec. 10.06.130. USE OF SAME OR DECEPTIVELY SIMILAR NAME;
Sec. 10.06.135. PROCEDURE FOR REGISTRATION OF CORPORATE NAME;
Sec. 10.06.140. FEE FOR AND DURATION OF REGISTERED NAME;
Sec. 10.06.145. RENEWAL OF REGISTERED NAME.

SCOPE: ACC secs. 125, 130, 135, 140, and 145 provide for the registration, protection, duration and renewal of a corporate name. Registration of a corporate name presupposes the existence of a corporation; thus only a reservation of a corporate name under ACC secs. 110-120 may be accomplished prior to incorporation. Registration has a longer duration than reservation of a corporate name and is subject to different fees, which may be established by regulation. Under sec. 130, registration of a corporate name gives the registered holder the right to seek an injunction against the use of that name or a deceptively similar name by another. The registered name must be renewed each year under sec. 145.

CHANGE IN FORMER ALASKA LAW: ACC secs. 125, 130, 135, 140, and 145 are reenactments of former AS 10.05.033, 034, 036, 039, and 042 and are based on Sections 10 and 11 of the MBCA. Minor language changes have been incorporated to recognize the recently enacted scheme to allow the

Department of Commerce and Economic Development to determine various fees by administrative regulation.

Official Comment to ACC Section 10.06.150.

REGISTERED OFFICE AND REGISTERED AGENT.

SCOPE: ACC sec. 150 establishes the requirement that a corporation maintain both a registered office and a registered agent in the State of Alaska. The agent is necessary for service of process; and, the office is required to serve as the depository for various books and records as provided or required by the ACC.

CHANGE IN FORMER ALASKA LAW: ACC sec. 150 is a reenactment without change of former AS 10.05.045 which was based upon Section 12 of the MBCA.

Official Comment to ACC Section 10.06.155.

REGISTRATION OF AGENT BY NONRESIDENT WITH CONTROLLING INTEREST.

SCOPE: In order that the commissioner may readily establish official contact with a nonresident possessed of a controlling interest (sec. 955(12)) in any corporation subject to the reporting requirements of the ACC, sec. 155 requires such a person to designate an agent within the State of Alaska upon whom notice and process may be served. Note that while the ACC, sec. 955(29) defines "person" to include, in addition to natural persons, business vehicles whether or not generally recognized as having entity status, sec. 155(a) makes explicit reference to foreign corporations not authorized to do business in Alaska. The inclusion of this last reference is a deliberate duplication of the concept of a "person" intended to draw attention to the presence of this important ACC requirement.

Service on the sec. 155 agent is equivalent to personal service on the controlling nonresident. Sec. 155(b) enforces this requirement by forbidding, in the event of noncompliance with sec. 155(a), either the controlling person or the controlled corporation use of the courts of the State of Alaska. Such noncompliance would not defeat the right of a plaintiff to commence an action against

either the controlling person or controlled corporation, but would preclude an Alaska court from entertaining any counterclaim or affirmative prayer for relief by such defendants.

For the purpose of sec. 155 it will be noted that the reference is to the more restrictive concept of "controlling interest" (sec 955(12)) and not to the ACC's general concept of "control" as defined in sec. 955(11).

CHANGE IN FORMER ALASKA LAW: ACC sec. 155 is a reenactment without substantive change of former AS 10.05.791 as amended in 1980. A rewording has been undertaken to make it explicit that the designated agent must be within the State of Alaska.

Official Comment to ACC Section 10.06.160.

FILING LIST OF REGISTERED CORPORATIONS WITH SUPERIOR COURT; UPDATING AND PUBLISHING.

SCOPE: It is vital that the practicing attorney be able to quickly ascertain information concerning the name, address of registered office, and the name and address of the registered agent of both domestic and authorized foreign corporations. Both geographical and communications considerations have dictated that such information be available locally and updated frequently. ACC sec. 160 imposes the duties of filing, updating, and annually compiling such information upon the commissioner.

CHANGE IN FORMER ALASKA LAW: ACC sec. 160 is a reenactment of former AS 10.05.040 which has been changed to require yearly compilation and weekly updating of the stipulated information.

Official Comment to ACC Section 10.06.165.

CHANGE OF REGISTERED OFFICE OR AGENT.

SCOPE: ACC sec. 165 establishes the procedure whereby a domestic or foreign corporation may change its registered office or registered agent.

<u>CHANGE IN FORMER ALASKA LAW</u>: ACC sec. 165 is a reenactment of former AS 10.05.031 which was based upon Section 13 of the MBCA.

<u>Official Comment to ACC Section 10.06.170</u>.

CHANGE OR RESIGNATION OF REGISTERED AGENT.

<u>SCOPE</u>: ACC sec. 170 establishes the procedure by which a registered agent may change address or resign. Section 170(a) creates a duty in a registered agent who desires to change address. Such a change may be effected only by executing a statement disclosing the name of the agent, the current address, the proposed new address, and the corporation or corporations served as registered agent. This statement executed by an individual agent or by the president or vice president of a corporation serving in that capacity shall be delivered to the commissioner for filing in accordance with the standard procedures of the ACC. Unless and until the registered agent follows the procedures outlined in sec. 170(a), the commissioner may continue to regard the last address of record as effective for all notice provisions under the ACC. The risk of nonfeasance or misfeasance of a registered agent is that of the corporate principal and not that of the State of Alaska.

Sec. 170(b) sets forth the procedures which must be observed in order for a registered agent to effectively resign. Unless and until such procedures are followed the commissioner may continue to deal with the agent and effectively notice or bind the corporate principal. In the event that such an agent ceases to function without observing the provisions of sec. 170(b) there would be a breach of the contract of agency with the corporation but such a breach would not serve as a defense to the corporate principal in dealing with or accounting to the commissioner.

<u>CHANGE IN FORMER ALASKA LAW</u>: ACC sec. 170 is a reenactment of former AS 10.05.034 which was based on Section 13 of the MBCA. The final sentence has been changed to permit a resignation of the registered agent to become effective sooner than 30 days after the filing of written notice with the commissioner if the corporation appoints a successor within this shortened period. This change is based upon Section 57.070(3) of the Oregon Revised Statutes.

Official Comment to ACC Section 10.06.175.

SERVICE OF PROCESS ON CORPORATION.

SCOPE. ACC sec. 175 establishes the registered agent as the person upon whom process, notice or demand may be served with the consequence that it is effective upon the corporation. If a corporation does not maintain a registered agent or if the designated agent cannot be located, service may be made on the commissioner as provided in sec. 175(b).

CHANGE IN FORMER ALASKA LAW: ACC sec. 175(a), (c), and (d) are a reenactment of former AS 10.05.057 and are based upon Section 14 of the MBCA. ACC sec. 175(b) is new to the law of Alaska. It is taken from Section 57.075(3) and (4) of the Oregon Revised Statutes and eliminates the commissioner's burden under prior law to transmit process served on the commissioner in default of a registered agent. Under ACC sec. 175(b) that burden is placed upon the party seeking to initiate litigation against the corporation (the moving party). To assure that notice sent to a corporation without a registered agent is the best available under the circumstances, sec. 175(b)(2)(B) requires that the moving party send notice to such address as it knows or, on the basis of reasonable inquiry, has reason to believe is most likely to result in actual notice. Under sec. 175(b)(3) the moving party is obliged to file proof of the attempted service in the appropriate superior court or other tribunal.

Official Comment to ACC Section 10.06.205.

INCORPORATORS.

SCOPE: One or more incorporators compile and file the articles of incorporation which initiate the attempt to form a de jure corporation. Beyond framing and filing the articles of incorporation, the acts of incorporators may be of little significance or lasting effect in the corporation's life. The articles of incorporation may be amended by the board prior to the issuance of stock; after stock is issued, a majority of the shares must agree to amendment. Any bylaws which the incorporators adopt may be amended or repealed by either the board or the shareholders. By following the procedures outlined in ACC Article Three, an incorporator does not subject himself to personal

liability, although he must pay filing fees and franchise taxes to successfully perfect the application for the certificate of incorporation.

If there are dealings between the incorporator(s) and third parties on behalf of the not yet formed corporation, care must be taken to avoid personal liability as a "promoter." While not defined in the ACC, ". . . In a comprehensive sense, 'promoter' includes those who undertake to form a corporation and to procure for it the rights, instrumentalities and capital by which it is to carry out the purposes set forth in its charter, and to establish it as fully able to do its business . . . ." 1 Hornstein, CORPORATION LAW AND PRACTICE, 92, Section 91 (1959). From this definition it is evident that an incorporator will evolve into the status of a "promoter" by attempting to deal on behalf of the yet to be formed corporation with third parties. As demonstrated by cases such as O'Rorke v. Geary, 207 Pa. 240, 56 A. 541 (1903); and King Features Synd. v. Courier, 241 Iowa 870, 875, 43 N.W. 2d 718, 41 A.L.R.2d 467 (1950), such preincorporation transactions are fraught with a danger of personal liability to the promoter.

Preincorporation contracts can only be made on behalf of, not with, a yet to be formed corporate entity. Any transaction prior to the issuance of the certificate of incorporation, ACC sec. 218, is thus a preincorporation transaction. During this period liability on the part of third parties can only be gained in exchange for the personal preincorporation liability of those who would act on behalf of the after arising entity. In this connection, see ACC sec. 220, infra, and the official comment thereto.

ACC sec. 205 requires that incorporators be "natural persons", which would preclude a corporate entity from acting in this role.

CHANGE IN FORMER ALASKA LAW: ACC sec. 205 is a reenactment of former AS 10.05.252 as amended by sec. 6, ch. 170, SLA 1976. The minimum age for an incorporator has been reduced from 19 to 18 to bring sec. 205 in line with the general state policy on legal majority. ACC sec. 205 varies from section 53 of the MBCA in the requirement that incorporators be natural persons. This is a continuation of prior Alaska law. The original articles of incorporation and a photocopy or xerographic copy of the original are to be delivered to

the commissioner instead of duplicate originals, the former requirement.

Official Comment to ACC Section 10.06.208.

ARTICLES OF INCORPORATION.

SCOPE: Within the governance structure of any particular corporation the articles of incorporation function much like a constitution. Because they are far more difficult to amend than the bylaws (which are thus analogous to statutes), the articles are deemed the appropriate place to cement the basic structure of the corporation. In company with other modern statutes, the ACC requires that fundamental decisions concerning the purpose for which the corporation is organized, its stated duration, and the number of shares into which the ownership claims will be divided (including whether they will be distinguished into "classes") be articulated in the articles. This requirement accomplishes two goals.

First, sec. 208 enables the potential investor to have recourse to a single document which imparts much of the basic information needed to evaluate a decision whether or not to become a shareholder.

Second, once shares are outstanding the relative difficulty encountered in any attempt to amend the articles insures stability with respect to these basic decisions. To lay the foundation for this statutory scheme, ACC sec. 208 denominates six fundamental items which must be addressed in the articles.

Peculiar to ACC sec. 208 is the requirements of subsection (4) that the articles state the name and address of each alien affiliate or a statement that there are no such affiliates.

CHANGE IN FORMER ALASKA LAW: ACC sec. 208(1), (2), and (3) are predicated upon former AS 10.05.255(1), (3), and (10) which were derived from Section 54 of the MBCA; subsections (4) and (5) are taken from Section 202 of the GCL; subsection (6) reenacts former AS 10.05.255(13) as amended. The format of the ACC governing the content of the articles is modeled upon Sections 202 and 204 of the GCL. In addition to the specific changes noted, infra, secs. 208 and

210 make vital a drafting decision which was unimportant under prior Alaska law. As noted, sec. 208 requires that several fundamental decisions be addressed in the articles. While the provisions may be amended by following the procedures outlined in the ACC, at all times the subject matter content of sec. 208 must be defined in the current corporate articles.

Sec. 210 enumerates provisions which are optional as contents of the articles. The critical point is that if the subject matters enumerated in sec. 210(1) are not settled by the initial or amended provisions of the articles they may not be resolved or governed by the bylaws, shareholder agreements, or any other form of treaty. Former Alaska law did not make this critical distinction.

Two provisions of the ACC are relevant to corporate purpose. Sec. 208(2) requires that the articles set forth the purpose or purposes for which the corporation is organized. Such statement may be a declaration that the corporation is organized to transact any and all lawful business permitted under the ACC. Such an open ended statement of purpose is not mandatory; but, if the articles contain a more precise statement of purpose but do not explicitly declare that the corporate entity is limited within this defined scope, operations undertaken in the good faith judgment of the board which go beyond the defined scope are not necessarily ultra vires. Doubt can be resolved by following sec. 210(1)(F) and inserting "a provision limiting or restricting the business in which the corporation may engage or the powers which the corporation may exercise or both . . . ."

In sec. 208(5) references to "par value" have been removed in a departure from former AS 10.05.255. This change follows the elimination of par value as a concept basic to the financial accounting of a corporation. See the introductory and specific comments to provisions of Article Four, the "Financials of the ACC." A statement of par value in the articles is not prohibited, but it will have no legal significance.

Sec. 208(6) makes minor changes in prior law. It has been organized to parallel Section 202 of the GCL. Questions of designation, rights, privileges, preferences and restrictions which multiple classes or multiple series create may be either settled in the articles or left to board resolution by a provision in the articles specifically

empowering the board. Notwithstanding, only the articles may fix the number of shares in a class. This power may not be delegated to the board. While the tolerance of article provisions delegating the determination of restrictions and privileges of various classes and series of shares is consistent with prior Alaska law, the requirement that the number of shares in a class be fixed in the articles is new.

ACC sec. 208(6) continues prior Alaska law's concern regarding alien affiliates and adds language which directs the drafter to state that the corporation has no such affiliates if such is the case.

Official Comment to ACC Section 10.06.210.

ARTICLES OF INCORPORATION: OPTIONAL PROVISIONS.

SCOPE: ACC sec. 210 expressly permits the inclusion of a variety of provisions in the articles. No provision covered in sec. 210 must be included in the articles to procure a certificate of incorporation. However, for purposes of sound corporate planning, the drafter should carefully review the matters covered in sec. 210 due to the principle there established that the subjects enumerated by subsection (1) can only be ordered or determined by provisions of the articles. The attempt to govern any subject denominated by sec. 210(1) by a provision in the bylaws, an extrinsic shareholder resolution, agreement, or treaty would be totally ineffective.

The common law doctrine of "pro tanto amendment" of the articles established in some jurisdictions is expressly disapproved by the legislature in the course of enacting ACC sec. 210. Under that doctrine a judicial inquiry is made to determine if a sufficient voting power of the directors and shareholders have acted so that, had they styled their attempt an "amendment of the articles" it would have been effective. If so, the doctrine would recognize such an effort as a "pro tanto" amendment and entitled to the dignity of a de jure provision in the articles.

The provisions for framing the initial content and thereafter amending the articles are explicit and simple under the ACC. They reflect a legislative evaluation of competing interests and procedures best adapted to insure informed decision making within Alaska corporations. Such

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ACC sec. 208(6) continues prior Alaska law's concern regarding alien affiliates and adds language which directs the drafter to state that the corporation has no such affiliates if such is the case.

Official Comment to ACC Section 10.06.210.

ARTICLES OF INCORPORATION: OPTIONAL PROVISIONS.

SCOPE: ACC sec. 210 expressly permits the inclusion of a variety of provisions in the articles. No provision covered in sec. 210 must be included in the articles to procure a certificate of incorporation. However, for purposes of sound corporate planning, the drafter should carefully review the matters covered in sec. 210 due to the principle there established that the subjects enumerated by subsection (1) can only be ordered or determined by provisions of the articles. The attempt to govern any subject denominated by sec. 210(1) by a provision in the bylaws, an extrinsic shareholder resolution, agreement, or treaty would be totally ineffective.

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The provisions for framing the initial content and thereafter amending the articles are explicit and simple under the ACC. They reflect a legislative evaluation of competing interests and procedures best adapted to insure informed decision making within Alaska corporations. Such

210 make vital a drafting decision which was unimportant under prior Alaska law. As noted, sec. 208 requires that several fundamental decisions be addressed in the articles. While the provisions may be amended by following the procedures outlined in the ACC, at all times the subject matter content of sec. 208 must be defined in the current corporate articles.

Sec. 210 enumerates provisions which are optional as contents of the articles. The critical point is that if the subject matters enumerated in sec. 210(1) are not settled by the initial or amended provisions of the articles they may not be resolved or governed by the bylaws, shareholder agreements, or any other form of treaty. Former Alaska law did not make this critical distinction.

Two provisions of the ACC are relevant to corporate purpose. Sec. 208(2) requires that the articles set forth the purpose or purposes for which the corporation is organized. Such statement may be a declaration that the corporation is organized to transact any and all lawful business permitted under the ACC. Such an open ended statement of purpose is not mandatory; but, if the articles contain a more precise statement of purpose but do not explicitly declare that the corporate entity is limited within this defined scope, operations undertaken in the good faith judgment of the board which go beyond the defined scope are not necessarily ultra vires. Doubt can be resolved by following sec. 210(1)(F) and inserting "a provision limiting or restricting the business in which the corporation may engage or the powers which the corporation may exercise or both . . . ."

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Sec. 208(6) makes minor changes in prior law. It has been organized to parallel Section 202 of the GCL. Questions of designation, rights, privileges, preferences and restrictions which multiple classes or multiple series create may be either settled in the articles or left to board resolution by a provision in the articles specifically

policies would be subverted by the concept of pro tanto amendment which would substitute the expense and uncertainty of litigation for the procedures outlined in this chapter.

ACC sec. 210(1)(A) protects the expectation of a purchaser of shares that once the purchase price has been paid in full there is no further liability by way of financial assessments. Cases such as *Watson v. Santa Carmelita Mutual Water Co.*, 58 C.A.2d 709, 137 P.2d 757 (1943), holding a purchaser of stock in a water corporation to be charged with knowledge of the inherent assessability of his shares, are reversed. Under ACC sec. 210(1)(A) the articles must affirmatively permit assessability for the power to exist.

ACC sec. 210(1)(B) continues former AS 10.05.255(8), which required that preemptive rights obtain unless explicitly removed by a provision in the articles. See also, ACC sec. 428.

ACC sec. 210(1)(C) establishes that, absent an express provision in the articles, corporations may not create special qualifications for persons who may be shareholders. See also, the discussion on restrictions on transferrability, infra.

ACC sec. 210(1)(D) requires that, absent an express limitation on the duration of the corporation being set forth in the articles, the corporation is to endure until dissolved pursuant to the ACC.

ACC sec. 210(1)(E) requires that if there is to be restriction or elimination of the concurrent, independent power of the board and the outstanding shares to adopt, amend or repeal bylaws such provision must be made in the articles.

ACC sec. 210(1)(F) permits a corporation to depart from the majority.

ACC sec. 210(1)(G) is the appropriate place to define enforceable limitations upon the business which the corporation may pursue. Activities beyond such express limitations would be ultra vires to the corporation. See the comment to ACC sec. 208 for a further discussion of this point.

ACC sec. 210(1)(H) establishes the proposition that, absent an express provision in the articles, holders of corporate debt instruments do not have voting rights with respect to the election of directors or other matters committed by the ACC to shareholder decision.

ACC sec. 210(1)(I) furthers the policy of sec. 335 in recognizing that absent an express provision in the articles, the board, and not the shareholders, shall determine the consideration to be received for the issuance of shares.

AAC sec. 210(1)(J) reflects the policy of sec. 450(a) which vests control and management of the corporation in the board of directors. However, by the terms of an express provision in the articles, any corporate action may be subjected to a prior requirement that it receive the approval of the shareholders (sec. 990(6)) or the approval of the outstanding shares (sec. 990(5)). If the requirement is the latter, then the requirement is for approval by an absolute majority of the outstanding shares with voting rights.

Absent an affirmative provision under ACC sec. 210(1)(K), a corporation is without power to redeem its shares as provided in sec. 325.

ACC sec. 210(1)(L) permits any corporation with fewer than 100 shareholders of record to include an express provision in its articles exempting itself from the annual report requirements of ACC sec. 433(a). In this particular ACC sec. 210 differs from GCL Sections 204 and 1501 which permit the requirement of an annual report to be waived in the bylaws. It was the judgment of the legislature that it is better to require that such a waiver be placed in the articles; otherwise, incumbent directors would be competent to pass a bylaw waiving a requirement intended to provide a check on the board.

Finally, ACC sec. 210(1)(M) requires that any delegation of board powers, duties, or privileges to delegates, as permitted by ACC sec. 450, be set forth in an explicit provision in the articles.

It will be noted that the remaining provisions of sec. 210 do not contain the injunction that they cover subjects which can only be determined by provisions of the articles..

ACC sec. 210(2) confronts the difficult subject to restrictions on the free transferrability of shares. By declaring that there may only be "reasonable restrictions" the legislature intends to venerate the traditional bias of the law in favor of free alienation of property interests. However, this bias must be balanced against recognition that there may be valid business objectives furthered by restrictions. See V. & H. Warehouse, Inc. v. Atlas Van Lines, Inc., 490 F.2d 816 (5th Cir. 1974).

Note that no restriction on transferrability adopted after shares are outstanding may bind holders of those shares unless they have affirmatively voted for the restriction. While the language of sec. 210(2) would not prohibit transfer restrictions from being introduced in a bylaw, it would have to be a bylaw adopted by the vote or consent of the shareholders and could not bind shares outstanding prior to its adoption which neither voted for nor consented to such a scheme. Tu-Vu Drive-In Corp. v. Ashkins, 61 Cal.2d 283, 38 Cal. Rptr. 348, 391 P.2d 828 (1964), is thus disapproved and its holding precluded under sec. 210(2).

ACC sec. 210(3) permits the names and addresses of initial directors to be included in the articles. Former AS 10.05.255(1) required that this information be included in the articles.

ACC sec. 210(4) permits any other provision, not in conflict with law, pertaining to the management of the business and the conduct of its affairs, including any provision required or permitted by the ACC to be stated in the bylaws, to be included in the articles.

CHANGE IN FORMER ALASKA LAW: ACC sec. 210 is based upon GCL Section 204, Delaware Section 102(b)(4) and (5), and former AS 10.05.255 which it replaces. The changes have been incorporated in the scope note to this section and the ACC sec. 208.

Official Comment to ACC Section 10.06.213.

FILING OF ARTICLES OF INCORPORATION.

SCOPE. ACC sec. 213 contains a self-explanatory procedure for filing the articles of incorporation with the commissioner.

CHANGE IN FORMER ALASKA LAW: ACC sec. 213 reflects without substantive change procedures set forth in former AS 10.05.258 and Section 55 of the MBCA. The section reflects the general scheme of the ACC to standardize the procedures for filing with the commissioner as set forth in ACC sec. 910.

Official Comment to ACC Section 10.06.215.

DISCLOSURE OF CORPORATE PURPOSES.

SCOPE: Under ACC sec. 208(2) a corporation may fulfill the statutory requirement of a statement of purpose in its articles with a declaration that it intends to engage in "any lawful purpose." Notwithstanding, the Department of Commerce and Economic Development is interested in gathering information about the actual business in which incorporated entities intend to engage.

ACC sec. 315 supports this interest by imposing an obligation to disclose the activities in which the corporation will initially engage. This statement does not bind the corporation as to the future although it must be accurate as of the time of utterance at peril of providing the commissioner with grounds for involuntary dissolution under ACC sec. 630(6). If a corporation subsequently changes or expands the focus of its business activity, an "updating" of its disclosure of corporate purpose is required in the biennial report under ACC sec. 508(3).

CHANGE IN FORMER ALASKA LAW: ACC sec. 215 is a reenactment without change or former AS 10.05.259 as amended in 1980.

Official Comment to ACC sec. 10.06.218.

EFFECT OF ISSUANCE OF CERTIFICATE OF INCORPORATION.

SCOPE: ACC sec. 218 fixes the issuance of the certificate of incorporation as the point in time when the de jure existence of a corporation commences. In adopting this "bright line", rule the legislature has gone beyond the text of Section 56 of the MBCA, and former AS 10.05.310, to expressly abolish the common law doctrines of de jure compliance, de facto incorporation, and corporation by estoppel.

The liability consequences befalling individuals who have sought the advantages of incorporation while failing to follow the statutory requirements for the creation of such a vehicle have plagued courts. Notwithstanding the evident attempt of the Model Act to focus upon the issuance of the certificate of incorporation as the event which effectuated de jure formation, courts have been uncertain and inconsistent in reacting to recurrent conflicts among third parties (who thought they were dealing with a corporate entity); enterprisers who purported to act for the defectively formed corporation (who may include individuals unaware of any defect); and, the state.

Assuming that there has been defective compliance with statutes on corporate formation, the following questions recur. Do the enterprisers achieve limited liability with respect to transactions carried on in the name of the purported corporation? If they do not, is their liability joint and several as would be the case if they were partners? May the defectively formed entity sue or be sued? If defective incorporation is later remedied, does the corporate entity then formed achieve automatic succession to the rights and liabilities which had been attempted by the defective predecessor?

Although the terminology adopted in decisional law has not been consistent, the common law reaction is generally categorized under three overlapping doctrines: de jure compliance; de facto incorporation; and, corporation by estoppel.

At least two of these doctrines have been reviewed by Alaska courts. <u>Swindel v. Kelly</u>, 499 P.2d 291, n.8 (1972); and, <u>Willis v. City of Valdez</u>, 546 P.2d 570, 574 (1976), illustrate that the de facto and corporation by estoppel doctrines have intruded into the decisional law of this jurisdiction. The conclusions suggested in those opinions as well as the more extensive treatment of these topics in the decisional law of Oregon and Washington are repealed with the legislative enactment of sec. 113.

In framing the terms of the ACC the legislature has simplified the steps required to form a corporation and defined a bright line event upon which the corporate existence begins. That event is the issuance of the certificate of incorporation. Once issuance has taken place all of the attributes of corporate status (including limited

liability) are attained. Third parties are precluded from pointing to any other defect as a means of gaining the personal liability of any or all of the corporate enterprisers. The event cuts both ways. If corporate existence is attained under sec. 218, there can be no denial on the part of that entity or any investor that actions taken by its agents would obligate the corporation.

Sec. 218 was adopted with the view that incorporation is a privilege and compliance with this section is the minimum price tag exacted for that privilege. Failing issuance of the certificate of incorporation, it is the intention of the legislature that no attributes of corporate status may be claimed by any party. Cases such as Timberline Equipment Co., Inc. v. Davenport, 267 Or. 64, [illegible] and, Cranson v. International Business Machines Corp., 234 Md. 477, 200 A.2d 33 (1964), are totally inconsistent with the content of sec. 218. The rationales of these decisions which dwell upon the intention of the third party claimant to deal with a corporate entity are rejected.

Issues of the intention of private parties or the materiality of the failure to comply with statutory norms are an invitation to litigation which is needlessly consumptive of public time and convenience.

CHANGE IN FORMER ALASKA LAW: ACC sec. 218 is a reenactment of former AS 10.05.261 (based on Section 56 of the MBCA) with modifications intended to preclude recognition of any legal status for an entity which has not obtained the issuance of a certificate of incorporation.

Official Comment to ACC Section 10.06.220.

ASSUMPTION OF PURPORTED POWERS OF NONEXISTENT CORPORATION: LIABILITY.

SCOPE: ACC sec. 220 determines the liability consequences of persons who assume to act as a corporation for which there has been no issuance of a certificate of incorporation (sec. 218). While this section is based upon Section 146 of the MBCA, it has been modified to resolve conflicting interpretations of that section with respect to promoter's liability. See e.g., Heintze Corp. v. Northwest Tech-Manuals, Inc., [illegible] Wash.App. [illegible] P.2d [illegible] (Div.One, 1972) (holding that language predicated upon Section 146

codified the common law rule on promoter's liability); and, Sherwood & Roberts-Oregon, Inc. v. Alexander, 269 Or. 389, 525 P.2d 135 (1974) (noting that language based on Section 146 had nothing to do with promoter's liability but was aimed at extinguishing the doctrine of de facto incorporation).

Under the ACC, common law doctrines respecting defective incorporation are extinguished by sec. 218. Sec. 220 resolves the liability of persons who assume to act as a corporation for which there has been no issuance of the certificate demanded in sec. 218. Under subsection (a) they are jointly and severally liable for debts and liabilities incurred or arising as a result of that action. The fact that the third party may have understood that no corporation was yet extant does not preclude the liability created by sec. 220 from arising or being asserted. To the extent that it is inconsistent with this position, Sherwood & Roberts-Oregon, Inc. v. Alexander, supra, is disapproved.

Under subsection (b) it is possible for the liability created by sec. 220 to be modified or precluded, but it must be terms of a written contract.

Subsection (c) makes it clear that oral promises, agreements, or understanding are not effective to modify or preclude the liability created by (a) of sec. 220.

CHANGE IN FORMER ALASKA LAW: ACC sec. 220 is a modification of former AS 10.05.310 which had expressed the text of Section 146 of the MBCA. The change substitutes an explicit reference to the certificate of incorporation (ACC sec. 218) for the words ". . . without authority . . . ", and expressly focus the section upon the liability of promoters.

Official Comment to ACC Section 10.06.223.

ORGANIZATION MEETING.

SCOPE: ACC sec. 223 defines the transition by which the entity being formed passes from the control of incorporators to that of the initial board of directors. Mandatory provisions set a minimum agenda for this initial meeting, requiring that directors be elected (if not named in the articles), bylaws be adopted, and officers be elected.

The naming of initial directors in the articles is optional under ACC sec. 210. If directors are so named, it is they who hold the organizational meeting at the call of their majority. If directors have not been named, the organizational meeting is to be held by the incorporators at the call of their majority. While postponing the decision as to the identity of the initial directors to the organizational meeting may be desirable in some instances, under ACC sec. 225 the powers of incorporators are limited to perfecting the organization of the corporation, adopting the amending bylaws and electing directors.

The first sentence of sec. 223 makes it unambiguous that the organization meeting is not a second step in the attainment of corporate existence. Existence is achieved in a single step by issuance of the certificate of incorporation under sec. 218. If incorporators should attempt to do business for a corporate entity following issuance of the certificate but before the election of directors at the organization meeting their acts would be ultra vires their licit powers and the source of personal liability under sec. 015.

In the event they were to transact business, incorporators would also be exposed to secondary liability under sec. 448(a). However, the corporate existence having been attained with the issuance of the certificate, the irregular actions of the incorporators in conducting business would not preclude either the corporation or third parties from acquiring de jure rights.

CHANGE IN FORMER ALASKA LAW: ACC sec. 223 is a reenactment of former AS 10.05.267 and is based upon Section 57 of the MBCA. Language modifications have been made to coordinate with sec. 210(3), which makes optional the naming of initial directors in the articles, and the phrase in the first sentence which is intended to preclude a construction of sec. 223 as a precondition to the attainment of corporate existence.

Official Comment to ACC Section 10.06.225

POWER OF INCORPORATORS BEFORE DIRECTORS' ELECTION.

SCOPE: Since the naming of initial directors in the articles is optional under ACC sec. 210, sec. 225 is necessary in order to define the powers which incorporators

shall have until such time as a board of directors is elected. These powers are of a very limited nature. The incorporators may perfect the organization of the corporation, adopt bylaws and elect directors; they may do no more in the name of the corporation. The limitation on their exercise of additional powers is rooted in the policy of permitting a corporation to do business only when its board has been properly elected.

CHANGE IN FORMER ALASKA LAW: ACC sec. 225 is new and without precedent in the former code due to the now discarded requirement that directors be named in the articles. ACC sec. 225 derives from Section 210 of the CGCL and Section 107 of the General Corporation Law of the State of Delaware. It has been altered from the form in which it is found in the California and Delaware acts by the omission of the election of officers as a power permitted incorporators.

This deletion is intended to preclude an abuse of the corporate structural norm whereby incorporators could elect officers who would begin to transact business and then omit to formally elect directors. Such an arrangement would frustrate the scheme of the ACC which is to make the board serve as the corporate principal and officers as agents of the corporation in conducting its business operations.

Official Comment to ACC Section 10.06.228.

BYLAWS: ADOPTION, AMENDMENT OR REPEAL.

SCOPE: In determining the status of shareholders with respect to the power of the board of directors, few provisions are of greater importance than those determining the power to adopt, amend or repeal the content of the bylaws. Absent provision in the articles, ACC sec. 228 vests equal powers in the board and the shareholders with respect to determining the content of the bylaws. However, the articles are competent to restrict or eliminate the power of either the board or the outstanding shares.

There are thus three possibilities: (1) concurrent, independent power in the board and the outstanding s[illegible]es (the default rule); (2) an article provision rest[illegible] or eliminating the power of the board; or, (3) an arti[illegible] provision restricting or eliminating the power of the

outstanding shares. Note that a corporation organized and existing under the former provisions of AS 10.05 has five years following the effective date of the ACC to comply with AS 10.06.208 and 10.06.210. See * Sec. 5, Application to Articles of Existing Corporations.

Pending the expiration of this five year period the corporation may continue to observe the machinery and procedures for adopting, amending or repealing bylaws permitted under former AS 10.05. If, upon the expiration of the five year period, the corporation has not amended its articles to restrict or eliminate the powers conferred by sec. 228, shareholders shall achieve a concurrent, independent power over the content of the bylaws.

By way of general comment, the bylaws of a corporation are regarded as a contract between the corporation and its members. Dentel v. Fidelity Savings and Loan Assn., 539 P.2d 649 (1975). As such they are to be construed according to the general rules governing the construction of statutes and contracts. American Center for Education v. Cavnar, 26 Cal.App.3d 26, 102 Cal. Rptr. 575 (1972). The intent and understanding of the parties at the time of adoption is generally controlling. Area Inc. v. Stetenfeld, 541 P.2d 755 (Alaska 1975).

The wisdom of bylaws is generally to be weighed and evaluated by the contracting parties and not a reviewing court. Leon v. Chrysler Motors Corporation, 359 F.Supp. 877 (D. N.J. 1973); aff'd 474 F.2d 1340 (3rd Cir. 1973). Courts interfere only upon finding that powers were exercised in an unlawful, arbitrary or malicious fashion and in such manner as to affect property rights of the person complaining. STP Corp. v. U.S. Auto Club, Inc., 286 F.Supp. 146 (D. Ind. 1968).

Absent an ability of the opponent of a bylaw to demonstrate one of these grounds, bylaws may be amended freely and shareholders have no vested right in having any bylaw remain in force. Superior Bedding Co. v. Serta Associates, Inc., 353 F.Supp. 1143 (D. Ill. 1973). Notwithstanding these rules, no provision of the bylaws may infringe upon the content of the articles or any provision of the ACC.

CHANGE IN FORMER ALASKA LAW: ACC sec. 228 is taken from Section [illegible] of the GCL and works a major change in former AS 10.05.135. Under the former Alaska scheme the power to

adopt, amend, and repeal provisions of the bylaws was vested exclusively in the board unless reserved to the shareholders in the articles of incorporation. Under the ACC, as noted, the power is shared equally subject to the power of the articles to limit or extinguish it in the board but not the shareholders.

It should be noted that shareholder action on the bylaws must be accomplished by "approval of the outstanding shares." This requirement places the burden on proponents to obtain an absolute majority of the voting shares in favor of any change in the bylaws.

The ACC does not discuss or settle the issue of who is to prevail in the event of disagreement between the board and the shareholder over the content of the bylaws. Since in the absence of limitation in the articles the two have equal powers, the action last in time would establish the content of the bylaws. Relevant to any such disagreement would be the power of the shareholders under ACC sec. 460 to remove directors at any time for any reason.

Shareholders have a right under ACC sec. 410 to have management distribute, at the shareholder's expense, communications to other shareholders. This procedure may prove to be extremely useful in shareholder attempts to exercise power over the bylaws as conferred by sec. 228.

Official comment to AAC Section 10.06.230.

BYLAWS: NUMBER OF DIRECTORS AND OTHER CONTENT.

SCOPE: Bylaws are the depository for rules governing procedures for shareholder and director meetings, the qualifications, duties, authority and compensation of directors and officers, and such other matters relating to the day to day management of the corporation as are usefully stabilized in a formal treaty. The structure of Article 3 has made the number of directors, an issue of no small importance, a matter which may be settled by the bylaws.

To the extent that there is a conflict or overlap, any bylaw is limited by any article or statute on the same subject matter. It is important to note that the ability of the bylaws to take a position on numerous corporate characteristics has been eliminated by ACC sec. 210 (1)

which requires that certain fundamental matters be resolved in the articles and not elsewhere. See official comment to sec. 210. Also precluded is the common law doctrine which would treat bylaws as pro tanto amendments to the articles.

CHANGE IN FORMER ALASKA LAW: ACC sec. 230 is predicated upon Section 212 of the UCC and substantially enlarges the overage of former AS 10.05.135 which had been based on Section 27 of the MBCA.

Neither ACC sec. 208 nor 210 requires that the number of directors be established in the articles. If such provision has not been made under sec. 210 (4), the bylaws are required to resolve the question. Such flexibility was not available in prior Alaska law which required that the number of directors be established in the initial articles. The ACC provides latitude in planning the size of the board allowing the decision to be delayed until the organizational meeting and action by the incorporators. Flexibility is also provided by sec. 230(a) which permits the bylaws to set a minimum and maximum number of directors if an accompanying procedure for determining the exact number within those parameters is also provided.

Sec. 230(b) establishes an exception to the norm that, absent a provision in the articles, the power to adopt and amend bylaws resides both with the shareholders and the directors. After shares are outstanding, a bylaw altering the number of directors or the previously established formula for deriving that number can only be adopted by approval of an absolute majority of the outstanding shares with voting power.

Furthermore, protection of shareholder cumulative voting power is given in sec. 230(b)'s provision which permits a substantial minority to veto a change in the bylaws which would lower the number of directors below five. Former Alaska law provided much the same protection to minority interests by requiring that the number of directors be set in the articles and that a 2/3 vote of the shareholders was necessary to amend the articles.

The reader will note that ACC sec. 453(a) and (b) are also relevant to the issue of fixing the number of directors in the bylaws. If the articles or bylaws establish a formula under which the board may set the number of directors, this power must be exercised by a majority of the entire board

and may not be used to shorten the term of any incumbent director.

Official Comment to ACC Section 10.06.233.

BYLAWS TO BE KEPT AT OFFICE; INSPECTION BY SHAREHOLDERS.

SCOPE: Given their enhanced role regarding the content of the bylaws (ACC sec. 228), a plenary right of inspection is granted to shareholders by ACC sec. 233. The scope of this right extends to the original or copy of the original bylaws together with all amendments, whether currently in force or superseded to date. Such records are to be maintained, subject to inspection by any shareholder at all reasonable times, at the principal business office of the corporation in Alaska. If the corporation does not maintain its principal business office in Alaska, then it shall, upon the written request of any shareholder, furnish to such party a copy of the original bylaws together with all amendments to date.

Corporate officers refusing to follow the mandate of ACC sec. 233 would be subject to the same penalty and civil consequences as are imposed for violation of ACC sec. 430.

CHANGE IN FORMER ALASKA LAW: ACC sec. 233 is taken from Section 213 of the GCL. Under prior law, a right to inspect bylaws existed only under the general right of inspection of books and records under former AS 10.05.237-249.

ACC sec. 230 varies from section 213 of the GCL in that it makes explicit the requirement that the record of the bylaws include all prior provisions which have been amended or repealed.

Official Comment to ACC Section 10.06.305.

CREATION, CLASSES, AND ISSUANCE OF SHARES.

SCOPE: AAC sec. 305 permits great flexibility to the corporation in creating distinctions as among various classes or series of shares with respect to voting rights as well as preferences or privileges regarding distributions during the life or at the dissolution of the entity. Sec. 305(a) contains an important procedural restriction in the

requirement that these basic attributes of the shares must be stated or authorized in the articles of incorporation. Under ACC secs. 308 and 315 it is competent for the articles to delegate the function of determining the rights and preferences of various authorized classes or series of shares to the board of directors.

Sec. 305(b) expresses a substantive limitation with the command that all shares of the same class shall have identical rights, privileges, and restrictions unless that class shall have been subdivided into "series" in which case the section commands that shares within the same series be identical with respect to these particulars. See also ACC secs. 310 and 313.

CHANGE IN FORMER ALASKA LAW: ACC sec. 305 is premised upon GCL Section 400 with modification to accommodate MBCA Section 15 and 16, which were the basis of former Alaska law. Sec. 305(a) replaces former AS 10.05.060 without substantive change. Sec. 305(b) replaces former AS 10.05.069 without substantive change.

Official comment to ACC Section 10.06.308.

ISSUANCE OF PREFERRED OR SPECIAL CLASSES OF SHARES.

SCOPE: ACC sec. 305 generally allows the establishment of classes and series with varying rights and liabilities. Sec. 308 specified a number of particulars which may be the subject of variation between different classes. This list of particulars should aid the practitioner in discussing with his client what variations in rights and liabilities are possible in such areas as redemption, dividend preferences, liquidation preferences and conversions options.

CHANGE IN FORMER ALASKA LAW: This section is largely a reenactment of former AS 10.05.063 which was predicated upon Section 15 of the MBCA. Note that the second sentence of subsection (5) of the older section has been deleted as unnecessary under the new ratio assets surplus financial test which eliminates any necessity for the concept of par value and the limitations on share convertibility which accompanied the prior system's reliance on par value as a fundamental concept.

Official Comment to ACC Sec 10.06.310.

ISSUANCE OF SHARES IN SERIES.

SCOPE: This section makes clear that preferred and special classes of shares may be divided into series as well as the common class of shares.

CHANGE IN FORMER ALASKA LAW: ACC sec. 310 is based upon MBCA Section 16 and former AS 10.05.066 without substantive change.

Official Comment to ACC Section 10.06.313.

VARIATION IN RIGHTS AND PREFERENCES OF SHARES.

SCOPE: This section provides a list of rights and preferences which may vary between series of the same preferred or special class.

CHANGE IN FORMER ALASKA LAW: MBCA Section 16 and former AS 10.05.069 form the basis for the new ACC sec. 313. Subsection (7) which permits a variation to exist in voting rights if there are any in the preferred or special class is new to Alaska law. The provision was added to MBCA Section 16 in 1966, after enactment of former AS 10.05.069. The current amendment thus represents an updating of Alaska law to conform to the MBCA provision. The addition of subsection (7) provides further flexibility for the draftsman.

Official Comment to ACC Section 10.06.315

SERIES RIGHTS AND PREFERENCES ESTABLISHED BY BOARD.

SCOPE: This section specifies that the board may be granted power by the articles to divide a class into series and fix and determine the relative rights and preferences of the shares of a series. This power is subject to any limitation placed upon it by the articles or by ACC secs. 305-323. It should be noted that ACC sec. 208(5)(c) specifically allows an article which gives the board power to fix rights, preferences, privileges, and restrictions for a class as well as a series. Sec. 315 is not meant in any manner to limit this power.

CHANGE IN FORMER ALASKA LAW: ACC sec. 315 is predicated upon MBCA Section 16 and former AS 10.05.072. No change in prior law has been rendered by the reenactment of this section.

Official Comment to ACC Section 10.06.318.

MANNER OF ESTABLISHING SERIES.

SCOPE: This section simply specifies the procedure for establishing a series; it is a reenactment of prior law.

CHANGE IN FORMER ALASKA LAW: ACC sec. 318 is an enactment of MBCA Section 16 and former AS 10.05.075 without substantive change.

Official Comment to ACC Section 10.06.320.

FILING OF STATEMENT BEFORE ISSUANCE OF SERIES.

SCOPE: The manner in which the equity interests of a corporation are held, including the relative rights and preferences of the various classes and series into which such interests have been divided, is traditionally a subject of interest to the state. Under the ACC this information is supplied by the articles or any amendment thereto in cases not involving board power to fix the relative rights and preferences. However, when the power has been delegated to the board (sec. 208(5)(B)(C)), it is necessary to have statutory machinery requiring this information be supplied to the state. ACC sec. 320 requires filing with the commissioner.

CHANGE IN FORMER ALASKA LAW: ACC sec. 320 is essentially a reenactment of former AS 10.05.078 which was predicated upon MBCA Section 16. A modification has been made to the language of sec. 320(a) to accord with the broader power of delegation to the board to fix by resolution unissued class (sec. 208(6)). Sec. 320(b) reflects the streamlining made possible by sec. 910.

Official Comment to ACC Section 10.06.323.

EFFECT OF FILING STATEMENT.

<u>SCOPE</u>: ACC sec. 323 delays the effective date of a board resolution exercising the powers delegated under sec. 208(5) until the time that the commissioner has filed the statement whereupon it has the effect of an amendment to the articles of incorporation.

<u>CHANGE IN FORMER ALASKA LAW</u>: ACC sec. 323 is a reenactment of former AS 10.05.084 which was modeled upon Section 16 of the MBCA. A wording change has been made to reflect the broader power of delegation to the board to fix by resolution the rights and privileges of an authorized but wholly unissued class provided in the ACC (sec. 208(5)).

<u>Official Comment to ACC Section 10.06.325</u>.

REDEMPTION OF SHARES; CREATION OF SINKING FUND; REPURCHASE AGREEMENTS.

<u>SCOPE</u>: ACC sec. 325 covers three crucial questions:

(1) it establishes the right of the corporation to create classes or series of shares which are redeemable at the option of the corporate issuer; (2) it forbids (subject to an exception for an open-end investment company) the creation of shares which vest a right to demand redemption in the shareholder; and (3) it permits the creation outside of the terms of the articles agreements which provide for the redemption or repurchase of shares of the corporate issuer.

The first and second of the topics covered by sec. 325 are sufficiently detailed as to clearly indicate the disposition of the legislature toward case law. The third topic, covered by the provisions of sec. 325(c), address a matter of some complexity and disparate case law development. In general the ACC treats either the redemption or repurchase of shares by the corporate issuer as a "distribution" and thus makes it subject to the financial restraints of Article 4, secs. 358-390.

Beyond these limitations it is the intention of the legislature to subject the decision to redeem or repurchase shares to the duties of care and loyalty otherwise imposed upon directors and corporate officers. Such concepts have been clearly recognized by the Supreme Court of Alaska as impacting upon those who de jure or de facto exercise the

powers of corporate management. See Wolf v. Arctic Bowl, Inc., 560 P.2d 758, 770 (1977).

Granting full recognition to such fiduciary duties does not support the conclusion that either redemption or repurchase must, in all circumstances, be employed on a pro rata basis to all shares of the class or series. Cases such as General Investment Co. v. American Hide & Leather Co., 98 N.J.Eq. 326, 331, 129 A.2d 244, 246, 44 A.L.R. 60 (1925), to the extent that they would establish such an absolute proposition, are disapproved.

If those vested with the powers of corporate management can establish a valid business purpose for the entry into an agreement to redeem or repurchase some but not all of the shares of a given class or series those who are not extended the terms of such a transaction have no complaint. See Martin v. American Potash & Chemical Corp., 33 Del.Ch. 234, 92 A.2d 295, 302 (Sup.Ct. 1952).

CHANGE IN FORMER ALASKA LAW: ACC Sec. 325 is new and has no precedent in former Alaska law. It is taken from GCL Section 402(a), (b) and (d), with the deletion of subsection (c) which makes explicit the requirement that in every corporation there be at least one class or series of shares which bear the ultimate financial risks of the enterprise and are thus nonredeemable. This provision was considered unnecessary in the former California Act, has never been litigated, and is deemed implicit in the ACC without the need of further expression.

Official Comment to ACC Section 10.06.328.

IRREVOCABILITY OF SUBSCRIPTIONS FOR SHARES.

SCOPE: A subscription for shares of a corporation to be organized is basically a promise to buy shares of that corporation when it is organized under specified terms. Under many common law cases, a subscription is considered to be an offer and as such remains inherently revocable until accepted. In order to settle the issue of the nature of a subscription, to provide a fair result to those who act in reliance on subscriptions and to put an end to any litigation over the question of the binding effect of a subscription, sec. 328 makes the subscription irrevocable for a period of six months.

Since both the corporation or its promoters and other subscribers may be relying on a subscription, the consent of all subscribers is required for a revocation of a subscription by agreement. The terms of the subscription agreement may alter the presumption or irrevocability established by this section.

CHANGE IN FORMER ALASKA LAW: ACC sec. 328 is a verbatim reenactment of former AS 10.05.087 which is modeled after MBCA Section 17.

Official Comment to ACC Section 10.06.330.

PAYMENT OF SUBSCRIPTION FOR SHARES.

SCOPE: This section places the power to determine the time of payment for subscriptions for shares with the board unless the subscription agreement provides otherwise. A call for payment by the board shall be uniform as to all shares of the same class or series.

CHANGE IN FORMER ALASKA LAW: ACC sec. 330 is in substance a reenactment of former AS 10.05.090. Minor changes have been made in language to conform Alaska law to the MBCA's Section 17.

Official Comment to ACC Section 10.06.333.

FORFEITURE OF SHARES FOR DEFAULT IN PAYMENT.

SCOPE: ACC sec. 333 establishes the general rights of the corporate issuer in the event of default by a subscriber in the payment obligation for shares. The scheme is to recognize that the payment obligation has the dignity of any debt due and owing to the corporation and as such may be asserted in any general civil process. In addition, the bylaws may have provided further remedies which are subject to the general policy of the law that consequences are to be remedial rather than punitive in character. The test for punitive qualities would be an exaction of any sum greater than the consequential and incidental damages inflicted upon the corporate issuer by virtue of the breach.

Sec. 333 reflects the legislature's appreciation that shares allotted to a subscriber who has breached his contract

inhibit the corporate efforts to raise capital; thus there is an explicit provision for the forfeiture of rights upon the observance of the statutory notice and grace period. There is a split among common law authorities as to whether a corporate issuer which has exercised a right to forfeit the subscriber's interest in shares may seek further recovery in the event of a deficiency after resale of the shares.

In furtherance of the general policy aimed at compensation of the aggrieved issuer, damages which are not recoverable through forfeiture and resale may be asserted against the breaching subscriber. Cases such as Atlantic Dynamite Co. v. Andrews, 97 Mich. 466, 56 N.W. 858 (1893), are approved and those typified by American Well & Prospecting Co., 184 Cal. 343, 193 P. 779, 19 A.L.R. 1037 (1920) are disapproved.

CHANGE IN FORMER ALASKA LAW: ACC sec. 333 is a reenactment of former AS 10.05.093 which was premised upon Section 17 of the MBCA. There is no substantive change. The terms "penalties" and "penalty" have been changed to "remedies" and "remedy" to reflect the approved case law construction.

Official Comment to ACC Section 10.06.335.

CONSIDERATION FOR SHARES.

SCOPE: Sec. 335 recognizes two modes for fixing the amount of consideration (expressed in dollars) for the issuance by the corporation of shares. Unless the power has been reserved to the shareholders by a provision of the articles (sec. 210(1)(H)), the power is vested in the board. The exercise of this power is subject to the Fraud Standard set forth in sec. 340.

CHANGE IN FORMER ALASKA LAW

ACC sec. 335 retains the essence of former AS 10.05.096, which was derived from MBCA Section 18. Much of the former section has been deleted in the wake of the new financials (secs. 358-370 of this Article) which has eliminated the concepts of par value, treasury shares, stated capital and surplus accounts.

Official Comment to ACC Section 10.06.338.

PAYMENT FOR SHARES.

SCOPE: ACC sec. 338 specifies what may and may not be received as consideration for shares. Common law authorities which have attempted to prevent "watered down shares" by requiring that consideration be limited to cash are rejected in favor of a more realistic recognition that the corporation may be advantaged by the receipt of other valuable property (tangible and intangible) as well as services.

Sec. 338(b) continues the prohibition against the receipt of a promissory note or pledge of future services as payment in whole or in part for shares. This section is not intended to overrule the decision in Area, Inc. v. Stetenfeld, 541 P.2d 755, 760 (S. Ct. Alaska 1975), which held that shares issued in exchange for a promissory note (and thus in violation of the statute) are not void but are voidable at the instance of the corporate issuer and that once the promissory note was fully paid the defect was cured beyond the capacity of the issuer to thereafter complain.

CHANGE IN FORMER ALASKA LAW: ACC sec. 338 is a verbatim reenactment of former AS 10.05.099 which was derived from Section 19 of the MBCA.

Official Comment to ACC Section 10.06.340.

JUDGMENT OF BOARD OR SHAREHOLDERS AS TO VALUE OF CONSIDERATION CONCLUSIVE.

SCOPE: ACC sec. 340 sets proof of fraud as the standard necessary to overturn a determination of the value of consideration received by the corporate issuer of shares. This standard was established in recognition of the reality that differences of opinion as to the value of property or services are commonplace and that a strict standard for misfeasance is necessary in order to prevent inordinate amounts of litigation over this issue. The most common victim of an improper valuation is a creditor whose claims against the corporation go unsatisfied in the wake of a corporate bankruptcy, dissolution, or simple door-closing.

The ACC provides considerable protection to creditors in its provisions on financials in the Article and in sec. 488 on the secondary liability of officers and directors. These

provisions substantially mitigate the harshness of the fraud standard provided by sec. 340.

<u>CHANGE IN FORMER ALASKA LAW</u>: ACC sec. 340 is a reenactment of former AS 10.05.102 which is modeled upon Section 19 of the MBCA.

<u>Official Comment to ACC Section 10.06.343</u>.

STOCK RIGHTS AND OPTIONS.

<u>SCOPE</u>: Unless otherwise defined or restricted in the articles of incorporation ACC sec. 343 gives the corporation, acting through its board, broad powers to create and issue rights or options covering authorized but unissued shares of any class or classes. The only substantive command of sec. 343 is that if such rights or options are to be made available to directors, officers, or employees of the corporation or any subsidiary (sec. 990 (42)(A)) and not to the shareholders generally then their issuance shall not be licit until approved by the affirmative vote of the holders of a majority of the shares or authorised by and consistent with a plan approved or ratified by a vote of the shareholders.

Consistent with the policy reflected in sec. 340, the judgment of the board as to the adequacy of the consideration received for such rights or options may not be overturned except upon proof of fraud in the transaction.

Unless they have been eliminated or curtailed by provisions of the articles, the general power of a corporation to create options or rights in unissued or treasury shares is subject to the preemptive rights of existing shareholders (sec. 428). If the issuance of the rights or options is pursuant to a plan of executive compensation approved by the shareholders, such shareholder approval would eliminate the preemptive rights as to shares covered by that approved plan. See ACC sec. 428(B)(A).

<u>CHANGE IN FORMER ALASKA LAW</u>: ACC sec. 343 is new to Alaska law and is predicated upon Section 20 of the MBCA with a modification eliminating the final sentence of the Model Act provision to conform to the financial provisions of the ACC. Under prior Alaska law the right of a corporation to issue stock rights and options may have existed under the general

power to contract. ACC sec. 343 was adopted to clarify and regulate the exercise of this power.

Official Comment to ACC Section 10.06.345.

EXPENSES OF ORGANIZATION, REORGANIZATION, AND FINANCING.

SCOPE: ACC sec. 345 recognizes that there are costs incurred in the issuance and marketing of shares and protects the purchasers of such shares from further liability to the corporation on the theory that since it received only a "net amount" from the gross price paid that the shares are not "fully paid" and thus "assessable."

CHANGE IN FORMER ALASKA LAW: ACC sec. 345 is a reenactment of former AS 10.05.111 with a minor language modification, the changing of "nonassessable" to "assessable," so that the section parallels MBCA Section 22.

Official Comment to ACC Section 10.06.348.

CERTIFICATES REPRESENTING SHARES.

SCOPE: ACC sec. 348 is designed to facilitate the trend toward electronic substitutes for the traditional share certificate by permitting the seal of the corporate issuer to be affixed in a facsimile form and to permit the signatures of corporate officers to be facsimiles so long as the "certificate" is countersigned by a transfer agent or a registrar who is not an employee of the corporation.

CHANGE IN FORMER ALASKA LAW: ACC sec. 348 is a verbatim reenactment of former AS 10.05.114 and is modeled upon Section 23 of the MBCA.

Official Comment to ACC Section 10.06.350.

INFORMATION REQUIRED TO BE STATED ON CERTIFICATE.

SCOPE: ACC sec. 350(a) recognizes that information regarding the rights, preferences, and limitations of the shares is of great importance to shareholders. If the corporation is authorized to issue only one class of stock such shares enjoy all attributes of participation, control,

and ownership defined by this chapter. However, if the corporate articles authorize the issuance of more than one class it is both possible and likely that the relative rights, privileges, preferences, and limitations on the classes will differ. In this instance, sec. 350(a) requires that the corporation furnish to each shareholder either a statement or summary of the designations, preferences, limitations, and relative rights of shares of the class of shares he has purchased and similar basic information regarding the shares of any other authorized class.

In the case of preferred or special classes which may be divided into series with variant rights and privileges the corporation must provide a full or summary statement of such variations. The information required by sec. 350(a) may be printed on the certificate or the certificate may be imprinted with a statement that the corporation will furnish to any shareholder so requesting and without charge such summary or full statements.

In adopting the language of sec. 350(a) the legislature intends to approve the holding in Hampton v. Tri-State Finance Corp., 30 Colo.App. 420, 495, P.2d 566 (1972), that the failure of the corporation to furnish the information required renders the stock contract voidable at the option of the aggrieved shareholder but that it does not bar enforcement of the restrictions upon the shares.

CHANGE IN FORMER ALASKA LAW: ACC sec. 350 is a verbatim reenactment of former AS 10.05.117 with the deletion of paragraph (4) regarding par value which is no longer a matter of consequence under the ACC. With this modification sec. 350 is predicated upon Section 23 of the Model Act.

Official Comment to ACC Section 10.06.353.

FULL PAYMENT REQUIRED FOR CERTIFICATE.

SCOPE: As in text.

CHANGE IN FORMER ALASKA LAW: ACC sec. 353 is a reenactment of former AS 10.05.120 which is predicated upon Section 23 of the MBCA.

Official Comment to ACC Section 10.06.355.

ISSUANCE OF FRACTIONAL SHARES OR SCRIP.

SCOPE: ACC sec. 355 provides two basic options to the board of directors under which it may deal with claims to fractional share ownership: the board may issue a certificate for a fractional share in which case the holder is entitled to the privileges conferred by shares of that class; or, the board may issue scrip entitling the holder to receive a certificate for a full share upon surrender of scrip aggregating a full share.

If the second alternative is employed the holder of the scrip is not entitled to the privileges of share ownership until the exchange of scrip aggregating a full share. Under sec. 355(c) the board may establish machinery to eliminate the outstanding scrip so long as that machinery is noticed on the scrip at the time of issuance.

CHANGE IN FORMER ALASKA LAW: ACC sec. 355 is a verbatim reenactment of former AS 10.05.123 and as such is a modified version of Section 24 of the MBCA. The essential difference lies in the omission of the Model Act's option in the board to eliminate fractional shares by simply paying in cash the fair value of fractions. Given the difficulties experienced with this option, see Teschner v. Chicago Title & Trust Co., 59 Ill.2d 452, 322 N.E.2d 54 (1974), appeal dismissed, 422 U.S. 1002, 45 L.Ed.2d 666, 95 S. Ct. 2623 (1975), it was decided that the protection of minority interests were better served by its continued omission from Alaska law.

Official Comment to ACC Sections 10.06.358-383.

INTRODUCTION: STATUTORY RESTRAINTS UPON THE DISSIPATION OF CORPORATE ASSETS--THE "FINANCIALS" OF THE ALASKA CORPORATIONS CODE.

The seemingly innocent act of a corporation distributing assets to the holders of its voting stock, whether by dividend or share repurchase, poses grave dangers. The parties in harm's way are the creditors of the corporate entity and the holders of what are termed "senior securities." To the degree that assets are dissipated through distribution to the voting shareholders, the corporate debtor may be rendered unable to meet its obligations to creditors or to deep faith with the pledge to meet the contractual preferences granted to holders of senior

shares. The case for legal intervention is premised upon a recognition that the holders of the voting shares control election of the directors who, in turn, make the decision to distribute assets. The parties with an adverse interest in this distribution are generally nonparticipants in the selection of directors.

Thus to please their constituency directors are likely to err on the side of generosity to the holders of voting shares. In the nineteenth century corporate financial manipulations left many a victim from schemes which followed this plot.

AN HISTORICAL OVERVIEW: Prior law, whether statutory or judge-made, has proven less than a match for directors bent upon dissipation of corporate assets. The initial position was that a distribution of assets which rendered the corporation bankrupt was a fraud upon the rights of creditors. Since this test was applied only after the fact, it had little value as a deterrent.

In the 1870's there emerged a refinement of the insolvency test. It was recognized that the assets of a corporation should be divided into two categories: fixed assets for which there was no ready ability of the market to convert them into cash; and "liquid or current assets" which could easily be exchanged for money. The dissipation of assets in the form of dividends directly drew down the cash reserves of the corporation. In so doing, it threatened to leave the corporation unable to meet its current liabilities in the normal course of business.

A corporation which could not pay its debts as they became due was "equitably insolvent" and a faithless debtor. Creditors were forced to either postpone repayment or force the corporate debtor into bankruptcy. It was a no win situation viewed from the perspective of the public interest: disappointed creditors might default upon their own obligations; bankruptcy of the entity produced unemployment and eliminated a competitor from the marketplace.

New York was among the first jurisdictions to build a statutory scheme beyond the insolvency test. Still in use in that jurisdiction, it has come to be known as the "Balance Sheet Surplus Test." This legislation forbade a distribution to shareholders unless the assets of the

corporation exceeded its liabilities to all third parties and an amount attributable to "stated capital." When the balance sheet test was first promulgated, it sought security for creditors by taking advantage of a popular custom to issue corporate stock with a high "par value."

Par value was a concept tricky at best. Many investors showed a preference for high par value on the theory that it somehow reflected an intrinsic worth for the new issue. What it in fact did was to play into the hands of the New York legislation. "Stated capital" was an accounting entry equal to that fraction of the total sum of the monies received by the corporate issuer amounting to the "par value" of the shares. If the corporation sold the shares for a price above the "par value" such additional consideration was carried on the books as "paid-in surplus" (referred to as "capital surplus" in other jurisdictions following essentially the same legislative scheme).

The board of directors was free to declare and pay dividends out of assets attributable to paid-in surplus, but they could licitly go no further. The net effect of the balance sheet surplus test was to create a cushion for creditors and holders of senior securities. Their protection was founded in the command that the assets of the corporation could not be drawn down to the point where they were no longer equal to total liabilities and stated capital.

No sooner was this statute in place than ways were devised to minimize, if not mock, its effectiveness. The Great Depression inadvertently helped by disabusing the public of the notion that there was much to the concept of "par value." Gilt-edged certificates with a par value of $1,000 were used to paper not a few bathrooms. In the post-World War II expansion of the economy, the public showed a willingness to purchase low or nominal par stock. The impact of this appetite created a remarkably thin cushion in the form of a stated capital account.

In the 1950's "no par" stock gained acceptance. The New York legislation was adjusted so that the board was given power to allocate the consideration received for no par shares between stated capital and paid-in surplus accounts. Such license permitted the board to make only a nominal attribution to state capital reducing the protection afforded creditors to de minimus dimensions.

By the time no par stock had come on the scene, many critics were calling for replacement of the balance sheet surplus test with a more meaningful statutory scheme. The resul was the creation of the "Earned Surplus Test." Illinois was one of the first jurisdictions to adopt this approach and the Model Act, expanding upon the Illinois scheme, spread the new test. The gist of the new test was the belief that the board should have an unfettered discretion to distribute assets to common shareholders only so long as such assets were taken from the net corporate earnings.

Thus the assets realized from the sale of stock were not to be distributed to shareholders because such a move was correctly perceived as a partial liquidation--a return of as opposed to on shareholders' investments. In its most vigorous form, the earned surplus test would have denied the board discretion to pay a dividend unless corporate assets exceeded total liabilities to third parties and a further sum equal to the total consideration for the sale of shares.

If the earned surplus tests had been maintained without exceptions it would have gone far beyond the balance sheet surplus test in constructing a cushion for creditors and the holders of senior securities. Instead, the test has been riddled with exceptions.

Under Section 46 of the MBCA, a corporation was permitted to make a distribution of assets notwithstanding the fact that there were no net earnings during the accounting period. Such a distribution could be charged against capital surplus (funds attributable to the sale of shares) if the holders of a majority of the outstanding shares affirmatively voted for the distribution; or, if the articles contained a provision empowering the board to make distributions chargeable against capital surplus. If there was an outstanding class of preferred (senior) shares there could be no distribution chargeable to capital surplus without first having paid all accrued preferential dividends. This limitation functioned to protect the interests of senior securities while leaving creditors helpless to protest unless the distribution from capital surplus threatened equitable insolvency.

A further exception proved useful if the corporation had experienced a net operating loss. One might suppose that such a loss would have to be made up in future years before the board could gain the discretion to pay further dividends. The Model Act was more generous. Under Section

70, the board was able to meet this adversity by simply passing a resolution to apply any part or all of its capital surplus to the reduction or elimination of the deficit arising from such a loss. If in the succeeding accounting period there were net profits, dividends could be paid out of this "earned surplus." There was no requirement that the capital surplus account ever be restored to its original dimension. A return of capital had been accomplished and the creditor's cushion reduced for all times.

If business reverses were so severe that operating losses reduced assets below the total of liabilities plus stated capital, the board was without power to pay a dividend unless, pursuant to Section 69 of the Model Act, the shareholders were to concur in the generation of a "reduction surplus." The essence of this scheme was a permanent reduction in stated capital. The "surplus" so generated would become "capital surplus" and available for distribution as such.

The only limitation was a command that stated capital could not be reduced to an amount less than the aggregate preferential amounts payable to all shares having preferential right in the assets of the corporation in the event of involuntary liquidation, plus the aggregate par value of all issued shares having no such preferential rights. When it is recalled that par value of such shares was likely to be nominal it can be seen that the interests of creditors were protected by little more than the insolvency prohibition.

If the board was unable to gain the concurrence of the shareholders (including the voting by class of any holders of senior securities) in the creation of a reduction surplus, it was forced to enter the succeeding accounting period with "impaired stated capital." There would be no further licit dividends until future net earnings increased the assets of the corporation to the point at which they again exceeded total liabilities plus stated capital. Directors in such circumstances were likely candidates for defeat in the next election by disappointed shareholders.

The latest step in relaxing the earned surplus test was the creation of a concept aptly termed "nimble dividends." For the directors of a corporation with impaired stated capital it came as manna from heaven. Under an optional version of Section 45 of the Model Act, if a corporation has net

earnings for two consecutive fiscal years, then, notwithstanding a continued impairment of stated capital, a dividend could be declared by the board and charged against the current net earnings.

While a rationale may be offered in support of each of these exceptions, their net effect upon the earned surplus test has been characterized by critics as the creation of a watch dog with no bite and little bark.

THE RATIO/ASSETS SURPLUS TEST: In the mid-1970's the California Legislature joined the bar association in the creation of a committee to study, with a view toward revision, the California Corporations Code. At that time California law relied upon the earned surplus test burdened by the possibilities of reduction surplus and nimble dividends. There were two major criticisms of the status quo: (1) the existing restraints upon dissipation of corporate assets afforded insufficient protection to corporate creditors; and (2) the language of the law meant little to accountants who were relied upon to prepare and audit the books and records.

After substantial debate, the 1977 California Corporations Code was framed in a manner designed to meet both of these problem areas. The earned surplus test was junked. Also disregarded were the concepts of par value, stated capital and all manner of capital surplus. In their place was substituted what is termed a "ratio/assets surplus test." For the purpose of complying with this test, the books of California corporations were to be kept in accordance with Generally Accepted Accounting Principles (GAAP).

In 1980 the Alaska Code Revision Commission concluded that both the substantive scheme and deference to the accounting profession pioneered in California were worthy models for the new Alaska Corporations Code. While this recommendation was pending in the legislature, a final recommended draft of the Revised Model Business Corporation Act was published. The official comment to Section 6.40 makes it clear that the framers of that recommended statute agree that classical concepts of legal accounting predicated upon various types of "surplus" are to be discarded.

However, the Revised Model Act relies upon an equitable insolvency test rather than the ratio/assets surplus standard pioneered in California. Further, the Revised

Model Act would not require utilization of Generally Accepted Accounting Principles, insisting only upon "practices and principles that are reasonable in the circumstances . . . ."

In 1984, the Commission considered the position of the framers of the Revised Model Act and partially concurred in their judgment. They rejected total reliance upon an equitable insolvency test and continued to recommend adoption of the ratio/assets surplus test now embodied in sec. 358. The Commission noted that the ratio/assets surplus test of Section 500 of the California General Corporation Law has been in effect in that jurisdiction since 1977 and appears quite successful. Not a single reported case exists suggesting that the concept is difficult to comprehend or apply. By contrast, there is no experience with the test suggested by the Revised Model Act.

Finally, the protection of creditors afforded by requiring the retention of five dollars in assets for every four dollars in corporate liabilities was judged part of the prudent balance sought between the legitimate quest for entrepreneurial activity and fiscal responsibility. Under the scheme of the ACC, the criteria of sec. 358 are supplemented by the equitable insolvency test embodied in sec. 360, and the protection of liquidation preferences for senior shares contained in sec. 363.

However, sec. 970(5) was amended to remove the general insistence upon the obligatory utilization of Generally Accepted Accounting Principles. For an elaboration of the standard now embodied in that section, see the specific official comment, infra. However, note that in certain sections (e.g., 358(c)), observance of Generally Accepted Accounting Principles for specific determinations is required. Accordingly, with the modifications hereinafter noted, Alaska has become the second state to adopt the ratio/assets surplus test.

<u>THE TEST</u>: As with the balance sheet and earned surplus tests, the ACC builds upon the basic injunction that no distribution (defined by sec. 990(17) as a transfer of cash or property by a corporation to its shareholders, without consideration, by way of dividend or the purchase or redemption of its shares) may be undertaken when the result would produce equitable insolvency. The content of the

equitable insolvency restraint has been altered in several particulars by ACC sec. 360:

> Neither a corporation nor any of its subsidiaries shall make any distribution to the corporation's shareholders (sec. 990(17)) if the corporation or the subsidiary making the distribution is, or as a result thereof would be, likely to be unable to meets its liabilities as they mature.

Two significant changes are incorporated in this statute.

The "likelihood" element of this formula is intended to be more restrictive than the traditional inquiry. Former Alaska law, AS 10.05.201, asked whether the corporation is now, or, giving effect to the dividend, would be insolvent. ACC sec. 360 is more cautious, prohibiting distributions if the corporation likely is, or, giving effect to the distribution, likely would be unable to meet its liabilities as they mature.

Substantively, the inclusion of subsidiaries is a restriction of greater importance. A parent corporation and its subsidiaries are to be considered as a unit; the various corporate shells are disregarded in favor of viewing the financial position of total operations of an affiliated group. For the definition of "subsidiary" see ACC sec. 990(42). For the differences between ACC sec. 360 and ACC Section 501, see the official comment to sec. 360, infra.

Assuming that insolvency within the meaning of ACC sec. 360 is not threatened, sec. 358 establishes two circumstances under which the board of directors enjoys discretion to declare and pay a distribution to shareholders.

Distributions in cash or other assets may be declared and paid against "retained earnings" (sec. 358(a)(1)). Like the earned surplus test, this requirement reflects a legislative judgment that routine distributions should only be made from operating profits. Unlike the Model Act, the ACC contains no provision for permitting net operating losses to be charged off by writing down capital surplus. There is no such concept. If the corporation cannot make the dividend payment out of assets charged against retained earnings, the ACC employs a revolutionary approach toward partial liquidations.

Under sec. 358(a)(2), a corporation which has no retained earnings may make a distribution if, immediately after giving effect to the plan, both prongs of a ratio/assets test are met.

The first requirement is that the assets of the corporation be at least equal to 1.25 times liabilities. Compliance with this rule guarantees a minimum cushion to creditors in that the corporation must continue to hold five dollars of assets for every four dollars of liabilities.

The second requisite focuses upon current liquidity of the corporation. The general rule requires that a corporation's "current assets" be at least equal to "current liabilities." Both terms are defined by Generally Accepted Accounting Principles. Special concern is manifest for corporations which have a recent history of paying more in interest on their debt than their earnings would reflect if interest and taxes were not deducted in computing net profits.

Such corporations must comply with a further requirement that current assets be at least 1.25 times current liabilities. This mandate is in addition to the equitable insolvency test defined in ACC sec. 360. It is a more stringent guarantee of liquidity, going beyond the somewhat ambiguous requirement of meeting debts as they mature by requiring that the dimension of current liabilities be reckoned and this figure exceeded by a ratio of 1.25:1.

In adopting the content of ACC secs. 358 and 360 the legislature has intended that corporate creditors attain a more reliable protection than that found in prior Alaska law which followed the Model Act. The virtue of the new provisions is their ease of application. Their strength is the absence of exceptions.

PROTECTION THE INTEREST OF SENIOR SHARES: In the initial passage of this comment it was asserted that the distribution of assets to holders of voting stock threatened two groups--creditors and the holders of "senior securities." The basic thrust of the three contemporary statutory restraints unon distributions (balance sheet, earned and ration/asset surplus tests) has been the protection of creditors. This emphasis is natural, for by definition the creditor is an "outsider" devoid of a voice in management. The ACC also focuses upon the second set of

adversaries, the quasi-outsiders who have purchased shares with either a dividend or a liquidation preference.

Senior shares achieve this status by dent of a contract between the corporate issuer and the holders of the securities. The specific term used to identify this arrangement is "indenture." While the content of an indenture may reflect tailor-made understandings between the potential investors and the corporation, most are comprised of either or both of the following elements: the holders of this class of stock are "guaranteed" a dividend preference (usually the dimension of this dividend pledge is specified; e.g., the holders of these shares shall be paid an annual dividend of $4.00 per share); in the event of corporate dissolution the holders are guaranteed a preferential claim to assets which exceed the claims of all creditors (a liquidation preference).

While it varies with the content of particular indentures, it is common that holders of senior securities do not have a voice in the election of directors. This common arrangement sets the stage for conduct by the board which, while responding to the needs and interests of the holders of the voting shares, may prejudice either the will or ability of the corporation to keep faith with the indenture. The most common harm is that dividends are paid to the holders of common (or "junior") shares in such generous measure as to prejudice the ability of the corporation to meet its dividend obligations to the senior shares in subsequent accounting periods.

In Model Act jurisdictions, Section 46 makes it relatively easy for the board to pay a dividend on senior shares which must be charged against capital surplus. To pay such a dividend to holders of common stock the board had to have shareholder authorization (with senior shares being privileged to vote as a "class" and there being no operative consent unless that class voted affirmatively) or an enabling provision in the articles of incorporation. To invade such surplus to meet indenture obligations, the board could proceed on its own motion with the only statutory injunction being that specific notice must be given to the shareholders that this "dividend" was in fact a return of capital (a partial liquidation).

Section 46(c) of the Model Act declares that dividends chargeable to capital surplus may never be paid until all

"cumulative dividends accrued to all preferred or special classes of shares entitled to preferential dividends shall have been fully paid." Finally Section 46(d) prohibits any distribution charged against capital surplus if the effect would be to reduce remaining assets of the corporation below the aggregate preferential amount payable in the event of involuntary liquidation to the holders of shares having preferential rights to the assets of the corporation in such an eventuality.

These protections of the Model Act, which were reflected in the content of former AS 10.05.207 and .210, have been strengthened by ACC secs. 363 and 365.

ACC sec. 365 restricts the board's authority under sec. 358 so that there can be no distribution to junior shares unless the amount of retained earnings of the corporation immediately prior thereto equals or exceeds the amount of the proposed distribution plus the aggregate amounts of cumulative dividends in arrears on all shares having a dividend preference. The net effect of ACC sec. 365 is to foreclose the use of partial liquidations under 358.

The liquidation preference of senior shares is guarded by ACC sec. 363. By its terms neither a corporation nor any of its subsidiaries may make any distribution to any junior shares if, after giving effect to the proposed distribution, the excess of corporate assets over liabilities would be less than the liquidation over the class or series to which the distribution is made.

CHANGE IN FORMER ALASKA LAW: Prior to the enactment of the ACC, Alaska used a mid-1950's version of the Model Act. Former AS 10.05.201 imposed an equitable insolvency injunction for distributions of dividends while former AS 10.05.012 and .309 imposed this limitation upon redemption or repurchase of shares. The test imposed was the classical "inability of the corporation to pay its debts as they became due in the regular course of business."

Former AS 10.05.369 the board was permitted to eliminate an operating deficit by simply writing down or "reducing" capital surplus. Any subsequent net profits were then free to be distributed as earned surplus notwithstanding the historical deficit. Such a provision reflected the content of Model Act Section 70.

The possibility that dividends might be distributed by a corporation which has no earned surplus is provided by Section 46 of the Model Act. It was carried into former Alaska law and expanded by the terms of former AS 10.05.207. Unlike the Model Act, which permitted such distributions only if they could be charged against capital surplus, former .207 permitted distributions to be charged against stated capital or capital surplus. It would appear that the genesis of this extraordinary provision was Oregon's Section 57.221.

As is the case under the Model Act, under former Alaska law if the distribution attributable to capital accounts was to be made to holders of voting shares, the board had to obtain the affirmative vote of shareholders or act pursuant to an enabling provision of the articles. If recourse had to be made to shareholder approval, Alaska differed from the Model Act's requirement of a simple majority by demanding the authorization of at least two-thirds of the outstanding shares of each class whether or not entitled to vote by the provisions of the articles. This last provision reflected concern for the holders of senior shares who normally do not have voting rights.

Former Alaska law did not have a nimble dividends provision such as that suggested by alternative Section 45(a) of the Model Act.

As noted, protection for the holders of senior shares was provided by former AS 10.05.207 and .210 which had adopted the content of Section 46. There could be no distributions chargeable to capital accounts unless all cumulative dividends accrued on all preferred shares had been fully paid (.207(3)). No such distribution was licit if the effect was to reduce the remaining net assets of the corporation below the aggregate liquidation preference of any senior shares (.207(4)).

If the invasion of the capital accounts was for the purpose of honoring the corporation's indenture obligation to pay a dividend on preferred shares, former .210 permitted the board to take such action without shareholder approval or affirmative provisions of the articles. In such cases there was a mandatory requirement that the holders of the senior shares receive a specific notice to the effect that the dividend represents a return of capital by way of partial liquidation.

Official Comment to ACC Section 10.06.358.

DISTRIBUTIONS; CONDITIONS.

SCOPE: ACC sec. 358 specifies the financial conditions which must obtain before a corporation may make a licit distribution (defined in ACC sec. 990(17)) to its shareholders. Assuming that a corporation is equitably solvent under sec. 360, and subject to secs. 363 and 365, sec. 358(1) permits distribution to be made to the extent of retained earnings (defined in ACC sec. 990(33)).

If a corporation has insufficient retained earnings to make a proposed distribution, a distribution in partial liquidation is authorized as permitted by sec. 358(a)(2). A distribution in partial liquidation is licit if, immediately after giving effect to the plan of distribution, both criteria of the ratio/assets surplus test are met. The first prong, sec. 358(a)(2)(A), attempts to guarantee that after the distribution there will remain within the possession of the corporation "real" assets which exceed all liabilities to nonshareholders by a ration of 1.25 to 1.

To insure the soundness of this calculation the ACC specifies "assets" which may not be included because of their ephemeral quality or nonsusceptibility to being realized in cash. It is important to note that under sec. 358 the "paid-in capital" account (defined in ACC sec. 990(27)) is counted neither as an asset nor a liability.

The second restraining criteria imposed by the ACC is sec. 358(a)(2)(B) which focuses upon the current liquidity of the corporation. The norm established is that, after giving effect to the distribution (typically made in the most common of current assets, cash), the current assets of the corporation must be at least equal to current liabilities. Current assets and current liabilities to the extent they are not regulated by sec. 358(b)(2)(C), are to be defined according to Generally Accepted Accounting Principles (see ACC sec. 970(5)).

If the earnings of a corporation (before taxes and before interest expenses) for the two preceding fiscal years was less than the cost of debt service during that period the entity must pass a more stringent ratio whereby current assets must exceed current liabilities 1.25 to 1.

Sec. 358(b)(2)(C) specifies the accounting treatment to be applied in certain transactions. In the computation of corporate assets, profits realized from an exchange of assets are not to be included unless currently realizable in cash. However, "current assets" may be augmented by net amounts which the board reasonably expects to be realized during the 12-month period used in calculating current liabilities from existing contractual relationships. If this accounting is used, then costs anticipated over that same period with respect to those contracts must be included as "current liabilities."

In the event the corporation elects to make a distribution of property to shareholders, the value of that distribution is determined according to the value at which the property is carried in current corporate financial statements, as governed by Generally Accepted Accounting Principles.

CHANGE IN FORMER ALASKA LAW: ACC sec. 358 supplants the earned surplus test of former AS 10.05.234(1) (payment of dividends) and .012 (repurchase of shares). With the additions and deletions hereafter noted, it is premised upon the amended version of Section 500 of the ACC.

ACC sec. 358(a)(2)(A)'s mandate to exclude ". . . evidence of debts owing from directors or officers or secured by the corporation's own shares . . ." is unique to Alaska law. Under the ACC loans to a defined class of corporate insiders are treated as distributions. See ACC sec. 485 and official comment.

A significant deletion from the language of GCL Section 500 involves a concession to utility companies.

Finally, it should be noted that ACC sec. 990(33) defines "retained earnings," a term which is not defined in the GCL which leaves its meaning to Generally Accepted Accounting Principles. The sec. 990(33) definition is derived from Section 2 of the MBCA and former AS 10.05.325. Deleted from these parent definitions was language which permitted a corporation to "eliminate" a deficit against the earned surplus account.

The new definition makes clear that losses must be taken into account in a calculation of retained earnings and cannot be ignored. A definition was adopted so that corporations desiring to avoid accounting expenses could

Official Comment to ACC Section 10.06.358.

DISTRIBUTIONS; CONDITIONS.

SCOPE: ACC sec. 358 specifies the financial conditions which must obtain before a corporation may make a licit distribution (defined in ACC sec. 990(17)) to its shareholders. Assuming that a corporation is equitably solvent under sec. 360, and subject to secs. 363 and 365, sec. 358(1) permits distribution to be made to the extent of retained earnings (defined in ACC sec. 990(33)).

If a corporation has insufficient retained earnings to make a proposed distribution, a distribution in partial liquidation is authorized as permitted by sec. 358(a)(2). A distribution in partial liquidation is licit if, immediately after giving effect to the plan of distribution, both criteria of the ratio/assets surplus test are met. The first prong, sec. 358(a)(2)(A), attempts to guarantee that after the distribution there will remain within the possession of the corporation "real" assets which exceed all liabilities to nonshareholders by a ration of 1.25 to 1.

To insure the soundness of this calculation the ACC specifies "assets" which may not be included because of their ephemeral quality or nonsusceptibility to being realized in cash. It is important to note that under sec. 358 the "paid-in capital" account (defined in ACC sec. 990(27)) is counted neither as an asset nor a liability.

The second restraining criteria imposed by the ACC is sec. 358(a)(2)(B) which focuses upon the current liquidity of the corporation. The norm established is that, after giving effect to the distribution (typically made in the most common of current assets, cash), the current assets of the corporation must be at least equal to current liabilities. Current assets and current liabilities to the extent they are not regulated by sec. 358(b)(2)(C), are to be defined according to Generally Accepted Accounting Principles (see ACC sec. 970(5)).

If the earnings of a corporation (before taxes and before interest expenses) for the two preceding fiscal years was less than the cost of debt service during that period the entity must pass a more stringent ratio whereby current assets must exceed current liabilities 1.25 to 1.

ascertain the general meaning of this accounting term which is of such crucial importance to sec. 358.

Official Comment to ACC Section 10.06.360.

PROHIBITED DISTRIBUTION: INABILITY TO MEET MATURING DEBTS AND LIABILITIES

SCOPE: The "equitable insolvency" test was historically the first restriction placed on a corporation's right to make distributions; today, the ability of a corporation to meet its liabilities as they become due remains the initial check upon any plan of distribution.

CHANGE IN FORMER ALASKA LAW: ACC sec. 360 replaces AS 10.05.201; it is based on GCL Section 501. The "equitable insolvency" test created by sec. 360 differs from prior Alaska law in several particulars. Prior law prohibited distributions to a corporation which was insolvent or would be rendered insolvent by the making of the distribution. The new test errs on the side of caution by prohibiting a distribution that would be likely to leave the corporation unable to meet its liabilities as they mature.

Sec. 360 in combination with sec. 970(5) requires that the determination of the issue of solvency take into account both the corporation's and either its subsidiary's or parent's solvency; the entire corporate family's financial health is to be evaluated, not merely that of the most sound member.

ACC sec. 360 differs from GCL Section 501 in that it omits language which created an exception for liabilities "whose payment is otherwise provided for"; the deletion of this language reflects a concern about its ambiguity and potential for abuse.

Official Comment to ACC Section 10.06.363.

PROHIBITED DISTRIBUTION OF JUNIOR SHARES: LIQUIDATION PREFERENCE.

SCOPE: ACC sec. 363 gives limited protection to liquidation preferences of senior shares by forbidding any corporate

distribution which would dissipate corporate assets to such an extent that the remaining "real" assets did not equal or exceed the sum of "real" liabilities and the amount of the liquidation preference of all shares having a preference on liquidation over the class or series to which the distribution relied upon a positive figure in the "retained earnings" account (sec. 358(a)(1)), or was a partial liquidation as permitted under sec. 358(a)(2).

CHANGE IN FORMER ALASKA LAW: ACC sec. 363 is taken from GCL Section 502. It replaces former AS 10.05.207(4). Although sec. 363 uses the same basic formula as prior law to protect dividend preferences, it strengthens the operative effect of that formula by excluding "paper assets" and distant and uncertain liabilities from the calculus. Note that the treatment of evidences of debts owing from directors and officers is treated as a "paper asset" in this section as in sec. 358. This is a variation from GCL Section 502 accomplished for reasons stated in the comment to ACC Section 358.

Section 363 does not protect liquidation preferences when a distribution is made to either shares of the same class or series or to a class with superior preferences upon liquidation. Thus, a repurchase of shares with the same liquidation preference is permitted under sec. 363 and may be harmful to the liquidation rights of the remaining shares in that class. Alert draftsmanship as permitted under secs. 210 and 375 may be used to prevent any inequity which could otherwise occur under the statutory protections provided in sec. 363.

Official Comment to ACC Section 10.06.365.

PROHIBITED DISTRIBUTION TO JUNIOR SHARES; RATIO OF RETAINED EARNINGS.

SCOPE: As a further limitation upon the power of a corporation to make a distribution under ACC sec. 358, sec. 365 imposes restrictions designed to protect shares with a dividend preference. Distributions to junior shares may not be made except from retained earnings (as opposed to a permitted partial liquidation) and then only if the amount of retained earnings immediately prior to the proposed distribution equals or exceeds the amount of that proposed distribution plus the aggregate amount of the cumulative

dividends in arrears on all shares having a dividend preference over the class or series to which the distribution is to be made.

<u>CHANGE IN FORMER ALASKA LAW</u>: ACC sec. 365 adopts the language of GCL Section 503 and supplants former AS 10.05.207(3). The new provision gives a corporation greater flexibility than prior law since it merely requires that a portion of the retained earnings account be reserved to legitimate a distribution to junior shares. Prior Alaska law required that such dividend preferences be paid before any distribution to junior shares.

<u>Official Comment to ACC Section 10.06.368</u>.

EXCEPTION FOR PURCHASE OR REDEMPTION OF SHARES OF DECEASED SHAREHOLDER.

<u>SCOPE</u>: It is often desirable in smaller corporations to provide for the death of a shareholder with a plan permitting the corporation to purchase or redeem the shares of the deceased; such a plan prevents the potentially troublesome problems of having the deceased's heirs participating in the business. A common method used in deploying such plans is for the corporation to purchase insurance on the shareholder's life, naming the corporation as the beneficiary. The insurance proceeds are to be used for the purchase or redemption.

Sec. 368 anticipates the problem of a corporation which receives insurance proceeds under such a plan but is in such poor financial condition that it cannot licitly purchase or redeem the deceased's shares under secs. 358-365. The statute strikes a balance between the protection of creditors and senior shares and the execution of the share acquisition plan by permitting the amount of the proceeds from the policy in excess of the total amount of the premiums paid by the corporation to be freely used to purchase or redeem the deceased's shares. Any purchase or redemption in excess of this amount must be licit under secs. 358-365.

<u>CHANGE IN FORMER ALASKA LAW</u>: ACC sec. 368 is new to Alaska Law; it is taken verbatim from GCL Section 503.1.

Official Comment to ACC Section 10.06.370.

INAPPLICABILITY TO REGULATED INVESTMENT COMPANY.

SCOPE: In order to avoid any conflict with federal law an exception to the provisions of ACC sec. 358 is made for corporations defined as regulated investment companies under the United States Internal Revenue Code.

CHANGE IN FORMER ALASKA LAW: ACC sec. 370 is new to Alaska law; it is derived from UCL Section 504.

Official Comment to ACC Section 10.06.373.

SHARE DIVIDENDS: RESTRICTIONS.

SCOPE: Share dividends do not represent an immediate threat to the security of creditors since they constitute a further division of shareholder interests in the entity. If a share dividend is declared and paid with respect to a class or series which has a "fixed dividend" obligation there is potential harm to creditors in the enhanced number of shares asserting this claim. However, creditors are protected by ACC sec. 358's ratio/assets surplus test which, irrespective of the terms of any share indenture, disciplines the circumstances under which a distribution may be made.

The thrust of ACC sec. 373 is not with respect to the protection of creditors but rather with the integrity of share classification. If the board of directors were competent to declare and pay to the holders of common shares a dividend comprised of shares of a preferred class, the opportunities for undermining the position of those who parted with valuable consideration for the preferred shares would unfold in unfair distributions of the senior shares to common. In addition, dilution of the original senior shareholders percentage holdings of the senior shares with new shares held by holders of common might change the "class vote" of the preferred class in circumstances where such a class would be enfranchised, such as amendments to the articles and organic changes. To obviate these dangers, ACC sec. 373 erects a prohibition against a dividend payable in shares of a class to holders of shares of another class. The command is not absolute and if the articles so provide or there is an affirmative vote or written consent of the holders of the class of shares in which the dividend is to

be paid in advance of the distribution such an arrangement is licit.

CHANGE IN FORMER ALASKA LAW: ACC sec. 373 is a reenactment without change of former AS 10.05.204(5) and is predicated upon Section 45(e) of the MBCA.

Official Comment to ACC Section 10.06.375.

ADDITIONAL RESTRICTIONS IN ARTICLES, BYLAWS, INDENTURES OR AGREEMENTS.

SCOPE: ACC sec. 375 makes it explicit that the provisions of the ACC on the declaration of dividends and purchase or redemption of shares do not "occupy the field" and thereby prevent further regulation of those issues by the articles, bylaws, indentures or agreements.

CHANGE IN FORMER ALASKA LAW: This section does not change prior Alaska law; it merely makes the law explicit.

Official Comment to ACC Section 10.06.378.

LIABILITY OF SHAREHOLDERS RECEIVING PROHIBITED DISTRIBUTIONS: SUIT AGAINST SHAREHOLDERS.

SCOPE: ACC sec. 378 provides a nonexclusive remedy against shareholders who have received any distribution with knowledge of facts indicating the impropriety thereof. The remedy runs to the corporation and may be asserted to the use of the corporation by any creditor for a violation of secs. 358 or 360 provided that the creditor's claim had arisen prior to the time of the distribution of which complaint is made and to which he did not consent.

Under sec. 378(b)(2) holders of senior shares may commence the action for violation of secs. 363 or 365 provided that the senior shares were held at the time of the distribution of which complaint is made and to which he did not consent. Note that the provisions of sec. 435 relating to derivative suits have been exempted for any action commenced under sec. 378.

The liability created by sec. 378 is not strict in the sense that the shareholder must have had knowledge of facts

indicating the impropriety of the distribution. Cases such as Williams, Recr. v. Boice, 38 N.J.Eq. 364 (Ch. 1884), which imposed strict liability are thus rejected in framing the content of sec. 378. Likewise rejected are the old "trust fund" cases such as those reviewed in Wood v. National City Bank, 24 F.2d 661 (2d Cir. 1929). However, the standard created by sec. 378 is not that of a "white heart and empty head." A shareholder is liable within the meaning of sec. 378 if a reasonable person in like circumstances exhibiting reasonable effort would have recognized an indication of impropriety in the distribution.

Note that ACC sec. 378(a) creates liability, under designated circumstances, for the amount of an "improper" distribution. In adopting this language the legislature intends to approve the holding in Gray v. Sutherland, 124 Cal.App.2d 280, 268 P.2d 754 (1954), that a distribution is improper not only in the circumstances of a violation of the act's "financials" but also when it violates any other provision of the general corporation law. For example, if the distribution was declared under irregular circumstances by the directors it would be "improper" notwithstanding the absence of offense to sec. 358. In such circumstances the suit in the name of the corporation could be brought by either a contemporaneous and nonconsenting shareholder or a creditor.

To reduce duplicative litigation, sec. 378(c) provides that any shareholder sued may implead all other shareholders as liable under the section and compel contribution from such shareholders either in the present or an independent action.

CHANGE IN FORMER ALASKA LAW: ACC sec. 378 is new to Alaska law. CCL Section 506 provides the basis for its current form and content. It supplements the provisions of ACC sec. 480(b) which is a reenactment of former AS 10.05.225 which allowed directors sued for illicit distributions to seek contributions from shareholders who knowingly accepted them.

Official Comment to ACC Section 10.06.380.

IDENTIFICATION OF DISTRIBUTION IN NOTICE TO SHAREHOLDERS.

SCOPE. In order to set the stage for recovery of illicit distribution under ACC sec. 378 and to inform shareholders

be paid in advance of the distribution such an arrangement is licit.

CHANGE IN FORMER ALASKA LAW: ACC sec. 373 is a reenactment without change of former AS 10.05.204(5) and is predicated upon Section 45(e) of the MBCA.

Official Comment to ACC Section 10.06.375.

ADDITIONAL RESTRICTIONS IN ARTICLES, BYLAWS, INDENTURES OR AGREEMENTS.

SCOPE: ACC sec. 375 makes it explicit that the provisions of the ACC on the declaration of dividends and purchase or redemption of shares do not "occupy the field" and thereby prevent further regulation of those issues by the articles, bylaws, indentures or agreements.

CHANGE IN FORMER ALASKA LAW: This section does not change prior Alaska law; it merely makes the law explicit.

Official Comment to ACC Section 10.06.378.

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The liability created by sec. 378 is not strict in the sense that the shareholder must have had knowledge of facts

when a dividend represents a partial liquidation of the corporation as opposed to a pro rata distribution of corporate profits, ACC sec. 380 requires that management identify the source and accounting treatment of a dividend charged against any source other than the retained earnings account.

CHANGE IN FORMER ALASKA LAW: ACC sec. 380 is taken from GCL Section 507. It replaces former AS 10.05.207(5) which required identification of distributions in partial liquidation of the corporation as "partial liquidations."

Official Comment to ACC Section 10.06.383.

INAPPLICABILITY TO WINDING UP AND INVOLUNTARY OR VOLUNTARY DISSOLUTION.

SCOPE: The provision of Article 9 for the winding up of corporate affairs and the involuntary or voluntary dissolution of the corporation are plenary in their coverage; no additional law is required to protect the interest of creditors and the holders of senior shares. Thus, the provisions of secs. 358-365 are made inapplicable to such procedures by this section.

In order that there is not time during which neither the provisions of Article 4 nor the provisions of Article 9 are operative, it is the intent of the legislature in enacting this provision that the exemption from secs. 358-365 which is created does not take effect until either a certificate of election of voluntary dissolution is delivered to the commissioner in accordance with ACC sec. 608(c), the issuance of a certificate of involuntary dissolution by the commissioner under sec. 630(c) or a decree of involuntary dissolution rendered by a superior court under ACC sec. 633. Any stay of a certificate of involuntary dissolution or a decree of involuntary dissolution shall also stay the exemption from Article 4 created by sec. 383.

CHANGE IN FORMER ALASKA LAW: ACC sec. 383 is taken from GCL Section 508 with no change whatsoever.

Official Comment to ACC Section 10.06.385.

REDEMPTION OF SHARES AT THE OPTION OF CORPORATION; MANNER.

SCOPE: ACC sec. 385 creates a statutory procedure for redemption. The notice provisions of subsection (b) are subject to modification by the articles of incorporation.

CHANGE IN FORMER ALASKA LAW: Prior Alaska law provided no statutorily approved procedure for the redemption of shares. ACC sec. 385 is derived from GCL Section 509 with the deletion of language in subsection (c) which would have, nonsensically, required a corporation to send a notice to itself if it did not have the shareholder's address.

Official Comment to ACC Section 10.06.388.

ACQUISITION OF CORPORATION'S OWN SHARES; REISSUANCE OR RETIREMENT.

SCOPE: ACC sec. 388 specifies the treatment to be given redeemed or repurchased shares. They revert to the status of authorized but unissued shares unless the articles of incorporation prohibit reissuance. If reissuance is prohibited, the article stating the number of authorized shares must be amended to reflect the lowered number. Such an amendment of the articles must be filed with the commissioner. Shareholder approval of the required amendment is not necessary.

While sec. 388 abolished the antiquated accounting concept of "treasury shares", nothing in this section is intended to prejudice the present or contingent contract rights which pre-ACC corporations may have created in reacquired shares described as "treasury shares".

CHANGE IN FORMER ALASKA LAW: ACC sec. 388 is taken from GCL Section 510. It continues prior Alaska law (former AS 10.05.312-345) in requiring a filing with the commissioner of an amendment to the articles. It departs from and simplifies prior law by the elimination of the concept of "treasury shares."

Official Comment to ACC Section 10.06.390.

CAPITALIZATION OF RETAINED EARNINGS.

SCOPE: This section permits the board of directors to pass a resolution which transfers amounts properly allotted to the retained earnings account into the paid-in account. The effect of such a transfer would be to limit the ability of

the board in the future to make distributions under secs. 358-365.

CHANGE IN FORMER ALASKA LAW: ACC sec. 390 continues the policy of prior law which permitted directors to increase either the stated capital (former AS 10.05.108) or the capital surplus (former AS 10.05.366) accounts by charging the earned surplus account. There is no corresponding statute in the GCL financials.

It is here noted that the accounting provisions of former law required that an amount equal to the total par value of shares distributed as dividends be transferred to the stated capital account from a surplus account (AS 10.05.204(4)(A)). No such accounting treatment is required under the ACC since the use of par value has been eliminated. Thus, the capitalization of earnings traditionally represented by the issuance of a share dividend is never required by the new law. Sec. 390 permits the continued use of this tradition.

Official Comment to ACC Section 10.06.405.

MEETINGS OF SHAREHOLDERS.

SCOPE: ACC sec. 405 installs a requirement that the shareholders of any corporation organized under or subject to this Chapter must meet at least once annually. If management defaults in calling this meeting sec. 405 provides summary measures by which any shareholder may apply to the superior court for an order convening the annual meeting. The statute also determines standing to call special meetings of the shareholders.

CHANGE IN FORMER ALASKA LAW: ACC sec. 405 is predicated upon Section 28 of the Model Act and Section 600(d) of the GCL. It replaces former AS 10.05.138. For the first time in Alaska law a shareholder is provided with standing to seek a summary court order to convene an annual meeting if such a meeting has not been held within the prior thirteen month period. The former declaration in AS 10.05.138 that the failure to hold the annual meeting did not work a forfeiture or dissolution of the corporation has been omitted in sec. 405.

ACC sec. 405(c) differs from the Model Act in conferring the power to summon special meetings of the shareholders upon

the chairman of the board and the president of the corporation. Former AS 10.05.138 conferred such power upon the president but did not reach the chairman of the board.

Official Comment to ACC Section 10.06.408.

CLOSING OF TRANSFER BOOKS AND FIXING RECORD DATE.

SCOPE: One of the essential attributes of corporate status is the free transferrability of share interests. Such ongoing transactions threaten havoc when it is necessary to determine the identity of shareholders who may be entitled to vote in an annual or special meeting or to participate in a distribution.

Sec. 408 provides three alternatives for effecting a determination as to share membership for these purposes. Under the first alternative the board may simply close the stock transfer books. Such a closure inhibits trading in the shares and hence the statutory limitation on the period of time during which the transfer books may be closed (70 days). A second alternative is for the board to simply declare a "record date" for such determination. Shares traded after that date may be effectively transferred, but the corporation is under no obligation to recognize the transferee for the purpose for which the record date has been declared. Here, too, sec. 408(b) imposes a maximum of 60 days before the action requiring determination of shareholders upon the power of the board to close the stock transfer books.

Finally, if the board had neither closed the transfer books nor declared a record date, the default mode for determining the shareholders is to adopt the date on which the notice of the meeting is called or the resolution of the board declaring the distribution is adopted. Shareholders of record on those dates only would be recognized.

CHANGE IN FORMER ALASKA LAW: ACC sec. 408 is predicated upon Section 7.05 of the Revised Model Business Corporation Act with one modification. In both subsections (a) and (b) the Model Act's ten day minimum period before the action is taken has been extended to twenty (20) days in sec. 408. Former AS 10.05.144 had utilized the Model Act's ten day period. The change in ACC sec. 408 was adopted in order to further the general use of twenty day notice periods which

are deemed a more realistic accommodation to physical and climactic barriers to communication in Alaska. Seventy and sixty day limitations have replaced the fifty day formula in former Alaska law respecting the closing of transfer books or fixing of a record date. This change brings Alaska law into compliance with the terms of the Revised Model Business Corporation Act, Section 7.05.

Finally, the ACC follows the Revised Model Act in making a shareholder list compiled from the closed transfer books or by virtue of the record date effective as to any adjournment of the meeting. The phrase in former AS 10.05.144 which modified this concept in the event of closure of the stock transfer books has been eliminated.

Official Comment to ACC Section 10.06.410.

NOTICE OF SHAREHOLDERS' MEETINGS.

SCOPE: ACC sec. 410 establishes the minimum content and the minimum and maximum time restraints on written or printed notice for annual or special meetings. Such notice must be "delivered" not less than twenty (20) nor more than sixty (60) days before the date of either an annual or a special meeting. In every instance the notice must state the place, day and hour of the meeting. With respect to special meetings only, the notice must also declare the purpose(s) for which the shareholders are being convened. Note that the general provisions of sec. 410 are subject to specific notice requirements of other sections of this Chapter.

Assuming that there has been compliance with the terms of this section, the risk of delay or nondelivery of the notice by the postal authorities is borne by the addressee. An affidavit which complies with this section is prima facie evidence that such steps have been taken and notice thereby effected. Such a prima facie showing may be overcome by contrary evidence adduced to the satisfaction of the trial court.

CHANGE IN FORMER ALASKA LAW: ACC sec. 410 is predicated upon Section 7.05 of the Revised Model Business Corporation Act, Section 605 of the New York Business Corporation Law, and former AS 10.05.141. Unlike the recommended content of the RMBCA, sec. 410 sets a twenty (20) day minimum for the delivery of notice as opposed to the previously stated ten (10) day minimum. The sixty (60) day maximum was adopted

from the RMBCA. The provision detailing the address to be used in communicating with shareholders and the prima facie evidence of compliance achieved by the officer's affidavit are taken from the BCL.

Official Comment to ACC Section 10.06.413.

VOTING LIST; LIABILITY.

SCOPE: ACC sec. 413 counters a potential disposition on the part of incumbent management to keep to itself the shareholder list showing the names, addresses and number of shares held by each shareholders. The historical inclination of management not to favor access to this information is rooted in recognition that it is the precise data which a shareholder intent upon challenging incumbents would desire to obtain in order to calculate strategy.

Sec. 413 mandates that at least twenty days prior to each meeting (annual or special) of the shareholders the officer or agent having charge of the stock transfer books shall make a list of all shareholders entitled to vote (sec. 408), and that this list shall be kept open and subject to inspection by a shareholder at any time during usual business hours for a period of twenty days prior to the meeting. The right of inspection prior to the meeting may be exercised by an agent or attorney of the shareholder. Once the meeting is convened, the shareholder list shall be kept open for inspection by shareholders.

Sec. 413(c) imposes a civil penalty of $5,000 upon an officer or agent having charge of the stock transfer books who refuses to prepare, preexhibit and exhibit such a list as provided in sec. 413(a). The penalty shall be paid to the shareholder or divided between or among the shareholders making written request for performance of the duties imposed by this section. Note that a written request is not necessary to invoke the powers of inspection conferred by this section but is required as a predicate for gaining the remedy imposed by sec. 413(c).

CHANGE IN FORMER ALASKA LAW: ACC sec. 413 is predicated upon former AS 10.05.147 which was based on the pre-1962 version of Section 31 of the Model Act. The legislature has elected to retain the explicit requirement of an exposition of the shareholder list for a period prior to the meeting.

The ten day minimum period of former AS 10.05.147 has been supplanted by a twenty (20) day minimum period in ACC sec. 413.

ACC sec. 413(c) is based upon Model Act Section 31 and former AS 10.05.150. There are two changes. One reflects the enlargement of the preexhibition period from ten (10) to twenty (20) days. The second change inheres in the provision of a $5,000 penalty as a civil liability for failure to observe the duties prescribed by this section in the face of a written request that this be done.

In enacting this section it is the intention of the legislature to grant shareholders an absolute right of inspection during the stipulated periods. Such right is not subject to the "proper purpose" line of common law authorities.

Official Comment to ACC Section 10.06.415.

QUORUM OF SHAREHOLDERS.

SCOPE: ACC sec. 415 confronts two problem areas: the minimum attendance necessary to convene a meeting of shareholders and the power of a minority of that number to destroy the ability of the majority to transact business by simply "walking out," thus reducing the number remaining to less than a quorum. Sec. 415(a) is highly permissive of provisions in the articles or bylaws which establish greater than majority quorum requirements. The articles, but not the bylaws, are competent to reduce the quorum requirement from the presumption of an absolute majority to as little as one-third of the voting shares but no further. Sec. 415(a) establishes the norm that the vote of a majority of a quorum constitutes the act of the shareholders.

Sec. 415(b) addresses the "walk out." Once a quorum has been established it is not possible for a disgruntled minority to defeat the capacity of the majority to transact business by simply walking out of the meeting so long as the vote of those remaining would be sufficient to constitute a majority of a quorum. Under these terms the walk out of a sizeable block of shareholders which left those remaining divided on an issue could see the majority fail to muster the needed affirmative vote.

CHANGE IN FORMER ALASKA LAW: ACC sec. 415(a) is predicated upon Model Act Section [illegible] and former AS 10.05.153. Sec. 415(b) is predicated upon Section 602(b) of the GCL. Sec. 415(a) reflects no change in prior Alaska law; Sec. 415(b) is new and unprecedented.

Official Comment to ACC Section 10.06.418.

PROXIES.

SCOPE: ACC sec. 418 permits a shareholder to create a legal power in a nominee to vote his or her shares. The life of a revocable proxy is limited by the statute to eleven months, a provision deliberately designed to preclude its being cast at two successive annual meetings. Sec. 418 follows the common law and earlier statutory development in treating a revocable proxy as destructible at the will of the proxy giver. The statute now regulates the circumstances or acts which will "revoke" the proxy, thus disabling management from recognizing the power of the nominee to cast the votes represented by the shares.

For the first time Alaska law contains explicit provisions defining the circumstances under which a proxy may be made irrevocable. These provisions are intended to be exclusive and to bar the application of any common law precedent which in circumstances other than those defined in sec. 418(e) would recognize a proxy as being coupled with an interest.

Finally, sec. 418(f) opts for the rights of an innocent transferee who has acquired the shares without knowledge or, as a reasonable person, has no reason to know that such transfer is in violation of an "irrevocable proxy." The proxy holder can gain protection from this rule by causing the fact of the proxy and its irrevocability to be physically noted on the certificate(s) representing such shares.

CHANGE IN FORMER ALASKA LAW: ACC sec. 418 is taken from GCL Section 705 with a modification to eliminate Section 705(e)(3) (on the rights of creditors). Sec. 418 replaces former AS 10.05.159 and .168 which had been based on Section 33 of the Model Act. In framing the ACC the provisions of the California code were preferred because of the explicit treatment of the question of "revocation" and the circumstances under which a proxy might be made

"irrevocable" by agreement of the shareholder and specified proxy holders. These provisions are unprecedented in former Alaska law which limited the life of a proxy to eleven months and, subsequent to a 1972 amendment, appears to have made the concept of an irrevocable proxy impossible. This prohibition was felt to be at variance with legitimate commercial needs. The dangers which are inherent in the unrestricted recognition of irrevocable proxies (divorcing voting rights from the other beneficial incidents of share ownership) have been avoided by subjecting the practice to exclusive statutory regulation.

Official Comment to ACC Section 10.06.420.

VOTING OF SHARES.

SCOPE: ACC sec. 420 establishes a cumulative voting scheme designed to enhance the opportunity for minority share interests to obtain board representation as the presumptive norm. Such a cumulative voting scheme may be eliminated in the articles of incorporation but, as a safeguard to minority interests, such a provision of the articles may not be introduced by an amendment if the number of votes cast against the amendment would have been sufficient to elect one director if voted cumulatively at an election of the entire board. Sec. 420 establishes the right of a shareholder to vote in person or by proxy (the validity of proxies being governed by sec. 418).

Sec. 420(b) mandates that shares held by the corporation or by a subsidiary corporation in which a majority of the shares enfranchised to elect directors is controlled by the corporation may not be voted in or counted toward the outstanding shares entitled to vote. Further provisions of sec. 420 govern the voting of shares held by administrators, executors, guardians, conservators, trustees, or receivers. Until shares have been transferred into the name of a pledgee, the shareholder who has pledged the stock shall have the voting rights. Finally, redeemable shares are disenfranchised by an effective notice of and adequate financial provision for a redemption.

CHANGE ON FORMER ALASKA LAW: ACC sec. 420 is predicated upon Model Act Section 33, with the exception of subsections (d) and (i). Sec. 420(d) is predicated upon GCL Section 708(a). Replaced are former AS 10.05.156-168. While former Alaska law also made cumulative voting optional, it

permitted it to be eliminated by amendment to the bylaws. ACC sec. 420(d) makes cumulative voting optional and presumptive unless eliminated by a provision of the articles. It goes beyond the Model Act to provide that if elimination of cumulative voting is sought via an amendment to the articles such an amendment shall not be effective if a sufficient number of voted are cast against it as would elect a single director if voted cumulatively in an election for the entire board.

Sec. 420(i) respecting the disenfranchising of redeemable shares is new and unprecedented in former Alaska law.

Official Comment to ACC Section 10.06.423.

ACTIONS TAKEN WITHOUT MEETING; WRITTEN CONSENT; REVOCATION OF CONSENT.

SCOPE: Unless extinguished by provisions of the articles or bylaws, ACC sec. 423 is tolerant of informal action by shareholders. Note that the tradeoff for the absence of a formal meeting is the requirement that the action be taken by the unanimous written consent of the shares. Sec. 423(b) governs the circumstances under which a written consent, once given, may be revoked.

CHANGE IN FORMER ALASKA LAW: ACC sec. 423(a) is predicated upon Section 145 of the Model Act and former AS 10.05.807. Language has been added to make it clear that the written consents are invalid unless of identical content as to all shareholders. Sec. 423(b) is adapted from GCL Section 603(c) and is unprecedented in former Alaska law.

In revising the ACC the legislature considered and rejected the California and Delaware positions which would tolerate informal action by less than unanimous consent of the shares. It was felt that the requirement of unanimous consent was a valid tradeoff for the abolition of the formal meeting where the voices of doubt and dissent might have influenced for the formation of opinion.

Official Comment to ACC Section 10.06.425.

VOTING TRUSTS AND AGREEMENTS AMONG SHAREHOLDERS.

SCOPE: The voting trust enjoys a long and troubled history both at common law and under statutory regulation. See

Abercrombie v. Davis, 36 Del.Ch. 371, 130 A.2d 338 (1956). The essence of a voting trust may be found in any agreement wherein the voting rights are separated from the other incidents of stock ownership. Tankersley v. Albright, 514 F.2d 956, 969 (7th Cir. 1975). This is objectionable from a fundamental premise: the theory of corporate law is that the shareholders will exert residual control over the entity. To do this they exercise the voting rights implicit in the common shares. If these rights can be vested in some party who does not enjoy the other attributes of share ownership, there is danger that the decisions reached by this "stranger" will be motivated by goals and aspirations other than those implicit in the assumed conduct of shareholder.

There is a further danger in that these devices are frequently employed to consolidate voting strength within the family of shareholders so as to "lock in" a particular majority. If the shareholders can enter binding agreements wherein their shares are precommitted to an individual or faction, there is again a transgression of the basic assumption that in voting the shareholders will use their honest judgment to determine on an issue-by-issue, term-by-term basis what they think best for the corporation and their own self-interest. If one adds to this picture the element of secrecy, the dangers are compounded and take on the sinister prospect that innocent parties may purchase stock in a corporation ignorant of a hidden agreement which precludes any "democracy" in the governance of the entity.

Standing in opposition to these classical objections are the asserted needs of the business community whereby a desire for continuity is said to demand the fusion of share interests. Litigation such as Abercrombie, supra. illustrates patterns of investment which have been extended upon the assumption that society would respect a binding voting agreement.

Sec. 425 of the ACC attempts to accommodate these competing goals by accepting the voting trust and then regulating its duration and mandating disclosure of its terms and members. Aside from these statutory requirements, parties to a voting trust may regulate both the substance and mechanics by contract.

Clarke Memorial College v. Monoghan Land Co., 257 A.2d 234, [illegible] (Del.Ch. 1969). While sec. 425(a) requires that shares committed to a voting trust be surrendered to the trustee in

exchange for trust certificates, all incidents of share ownership other than voting rights remain with the shareholder/participants. Winitz v. Kline, 238 A.2d 456, 459 (Del.Ch. 1971).

Sec. 425(b) leaves to common law development the development of limitations upon agreements between or among shareholders which fall short of a voting trust. Pooling agreements (State ex rel. Everett Trust & Savings Bank v. Pacific Waxed Paper Co., 22 Wash.2d 844, 157 P.2d 707 (1945); and Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling, 29 Del.Ch. 610, 53 A.2d 441 (1947)); and share classification (Lehrman v. Cohen, 222 A.2d 800 (1966)) are illustrative of arrangements which are unobjectionable and meant to be tolerated under the umbrella of sec. 425(b).

CHANGE IN FORMER ALASKA LAW: ACC sec 425(a) is taken from Model Act Section 34 and former AS 10.05.171. Unlike former Alaska law, sec. 425(a) has adopted the Model Act language designed to require disclosure by the trustee of both the terms of the trust and the identity of the shares and shareholders committed. The Model Act language on the extension of voting trusts has not been adopted in the belief that at the end of the ten year maximum life the parties are capable of forming a new trust. Sec. 425(b) is taken from GCL Section 706(d) and is unprecedented in Alaska law.

Official Comment to ACC Section 10.06.428.

SHAREHOLDERS' PREEMPTIVE RIGHTS.

SCOPE: Few issues divide the desires of shareholders from those of incumbent management more than whether existing shareholders shall have an enforceable right to first refusal upon the further issuance of shares of stock in the corporation. These are termed "preemptive rights." The recognition of preemptive rights protects from dilution two distinct interests of shareholders in the corporation: their proportionate equity (rights to distributions during the life of the corporation and a residual claim on corporate assets in the event of dissolution); and their proportionate voting strength. The classical objections of management are that preemptive rights frustrate a market for security offerings and hamper the ability to use shares of stock to fund various deferred compensation schemes.

ACC sec. 428 attempts to balance these interests. The statute establishes preemptive rights in certain shareholders to acquire under fair and reasonable terms unissued shares or securities convertible into such shares or carrying a right to subscribe to or acquire such shares. As a further statutory norm, preemptive rights do not exist in holders of any class of preferred shares, nor do the holders of common stock have preemptive rights with respect to the issuance of nonconvertible preferred shares. No preemptive rights exist as to shares issued for a consideration other than cash. If a majority of the shares approve or authorize the board, preemptive rights do not exist as to shares issued to directors, officers or employees. This provision is intended to facilitate the implementation of qualified deferred compensation schemes under the Internal Revenue Code. By its express terms, sec. 428 recognizes that the articles of incorporation are competent to enlarge or diminish the scope of preemptive rights.

In adopting sec. 428 the legislature intends to occupy the field with respect to circumstances under which preemptive rights are to be recognized. It does not, however, intend to hamper the persuasive reasoning or result articulated in Katzowitz v. Sidler, 24 N.Y.2d 512, 301 N.Y.S.2d 470, 249 N.E.2d 359 (1969). In Katzowitz the New York Court of Appeals recognized that while statutes may give protection against the dilution of voting strength (by establishing a right to acquire a proportionate number of the shares of the new issue), the exercise of this right is frequently a burden upon the shoulders of the existing shareholders. They must expend further sums to retain the status quo with respect to their equity interest. For this reason the court announced a common law scrutiny of share offerings to the end that management be prohibited from confronting shareholders with a new issue unless a valid business purpose can be established.

In other words, Katzowitz recognized that absent a valid business purpose an existing shareholder has an enforceable right not to be faced with the expenditure involved in purchasing further shares to maintain his or her proportionate interest. The terms of the new offering are also subject to judicial scrutiny with respect to the price to the end that the new shares not be offered at a price substantially below their true market value. Such an offering would further weaken the position of existing

shareholders who were financially unable to exercise their preemptive rights without gaining a legitimate advantage to the corporation. The lessons of Katzowitz would apply to offerings by the board of shares of a different class; for while they would not impact upon the general voting strength of holders of shares of another class, they do threaten the dilution of the equity interest.

CHANGE IN FORMER ALASKA LAW: ACC sec. 428 is predicated upon Model Act 26A and replaces former AS 10.05.129. Modified are the provisions of the former statute which excluded preemptive rights for shares sold to officer and employees (but omitting any reference to "directors") of the corporation or of its subsidiary if the terms and conditions of the sale had been approved by a vote of two-thirds of the voting shares or by the board pursuant to approval of the shares. Former Alaska law contained no provisions comparable to sec. 428's presumptions as to shares or offerings to which preemptive rights are not extended.

Official Comment to ACC Section 10.06.430.

BOOKS AND RECORDS.

SCOPE: ACC sec. 430 addresses the problematic question of access by shareholders and some others to the books and records of the corporation. The questions presented include: who shall have a "right" of access; under what circumstances may this right be asserted (time, place, and frequency); and to which books and records (shareholder lists, minutes of board, board committee and shareholder meetings, financials, etc.) does it extend. Subsidiary issues surround the consequences of a "wrongful" denial of access and the availability of judicial process to enforce the "rights" created or recognized.

The friction between the demands by shareholders and the attitude of incumbent management has led to considerable litigation. Indeed, the question of inspection now governed by sec. 430 was first addressed at common law. The classical problems involve the shareholder who desires to learn the identity of other shareholders so that he might launch a "take over bid" or a move to oust incumbent management. Less frequently encountered is the shareholder who desires to gain a list of clients to whom he can peddle insurance, etc. Looking beyond the shareholder list to

books and records the tension is between the right of a shareholder to gain access to proof of mismanagement or other wrongdoing and the possibility that a shareholder could use this right to vex or harass incumbent management in the hope that he would be "bought off." Another problem surrounds the corporate fear that the information gained through an exercise of a right of inspection will be used to harm or compete with the corporation. The real presence of these dangers accounts for the "proper purpose" limitation found in ACC sec. 430(b) and reflected in the defense by an officer or agent who has refused the right of inspection to the liability created by ACC sec. 430(c).

Sec. 430(a) creates the basic obligation of any corporation organized under this Chapter to keep specified books and records of account, minutes of proceedings, and a record of its shareholders, containing the names and addresses of all shareholders and the number and class of the shares held by each. A provision has now been made to facilitate the data collecting and keeping via electronic processing so long as such data can be reduced to writing. Sec. 430(b) creates the right of inspection as to the data described in sec. 430(a) and vests that right in the Department of Commerce and Economic Development and any shareholder. The shareholder inspection shall be upon a written demand which must state the purpose or purposes for which inspection is demanded. The inspection, which may be carried on in person, by agent, or attorney must be made at a reasonable time and for a proper purpose. By way of further limitation, the scope of the enforceable demand shall extend only to such sec. 430(a) data as is relevant to the stated purpose(s). Copies of any data to which the right of inspection attaches may be made.

In adopting Section 430(b) the legislature intends to approve the several distinctions and interpretations of the "proper purpose" doctrine as enunciated in the following cases. With respect to the shareholder list: a statement that the shareholder list is desired for the purpose of communicating with shareholders on matters of mutual interest to shareholders and for the purpose of [illegible]liciting proxies is sufficient to gain the right of insp[illegible]n. Credit Bureau Reports, Inc. v. Credit Bureau of [illegible] Paul Inc., 290 A.[illegible] (Sup. Ct. Del. [illegible]). A willingness of the corporation to mail the shareholder's material is not a valid reason to deny the right to inspect and copy the shareholder list. Kerkorian v. Western Airlines, Inc., 253

A.2d 221 (Del. Ch. 1969). The fact that a shareholder is frankly hostile to management or desires to gain control of the corporation does not constitute an improper purpose. State ex rel. Pillsbury v. Honeywell, Inc., 291 Minn. 322, 191 N.W.2d 406 (1971).

With respect to all other 430(a) data (books and records): a shareholder has every right to inspect books and records to protect his interest as a shareholder so long as he has an honest motive and is not proceeding for vexatious or speculative reasons. Briskin v. Briskin Mfg. Co., 6 Ill.App.3d 740, 286 N.E.2d [illegible]; Southern Acceptance Corp. v. Nally, 222 Ga. 334, 150 S.E.2d [illegible] (1966); Keeneland Ass'n v. Pessin, 484 S.W.2d 849 (Sup. Ct. Ky. 1972); and Campbell v. Ford Industries, Inc., 274 Or. 243, 546 P.2d 141 (1976). Prior to acceding to the demand, the corporation has a right to demand and receive assurances that the information disclosed is not used for the purpose of injuring corporate business or building up a rival concern. State ex rel. Armour and Co. v. Gulf Sulphur Corp., 233 A.2d 457 (Sup. Ct. Del. 1967). If the shareholder proposes to conduct the inspection or extracting other than in person the corporation is entitled to receive adequate proof of the agent's authority. Henshaw v. American Cement Corp., 252 A.2d 125 (Del. Ch 1969).

Sec. 430(c) creates personal liability in any officer or agent who denies a right of inspection which the shareholder can establish was properly demanded under sec. 430(b). It is an affirmative defense to this liability that the demanding shareholder has within the previous two years offered the shareholder list for sale, aided or abetted another in such an offer, or made improper use of information secured through prior examination of the books and records of account, or minutes, or record of shareholders of the corporation or any other corporation, or was not acting in good faith or for a proper purpose in making his demand. Although there would appear to be no direct common law precedent, it is the intention of the legislature in framing sec. 430(c) that a history of negligent or deliberate dissemination of confidential materials by the demanding shareholder would constitute "improper use of information" justifying a refusal of the demand and immunizing the corporate officer so refusing from liability.

Sec 430(c) makes it clear that nothing in this section shall preclude or inhibit the power of a competent court to enforce a right of inspection which the shareholder can establish as properly demanded under sec. 430 (b).

Sec. 430(e) goes beyond any other requirements to give a shareholder a right to receive, upon written request, a copy of the corporation's most recent financial statement.

CHANGE IN FORMER ALASKA LAW: ACC sec 430 is based upon Section 52 of the Model Act and former AS 10.05.237-249. Sec. 430(a) continues the former content of AS 10.05.237 with added provisions for the minutes of meeting of board committees and the permission that the data may be recorded in a written form or in any other form capable of being converted into written form within a reasonable time.

Sec. 430(b) continues the policy of recognizing a right of inspection in the Department of Commerce and Economic Development (as in former AS 10.05.237(b)) but has eliminated durational and numerical qualifications which obtained in former AS 10.05.240. Language has been added which restricts the right of inspection to data relevant to the proper purpose.

Sec. 430(c) continues the policies of former AS 10.05.243 respecting the liabilities of and defenses available to an officer or agent who refused a demand for inspection properly under sec. 430(b). The only change is to impose a minimum liability of $5,000 to the shareholder aggrieved by the refusal.

Sec. 430(d) had modified former .246 in view of the standing requirements eliminated under sec. 430(b). Sec. 430(e) adopts without change the content of former .249 on the right of a shareholder to demand a copy of the most recent corporate financial statements.

Official Comment to ACC Section 10.06.433.

ANNUAL REPORT TO SHAREHOLDERS: CONTENT, FINANCIAL STATEMENT ON REQUEST.

SCOPE: Recognizing that the residual powers of the shareholders cannot be exercised in an intelligent manner in the absence of a reliable stream of basic information, ACC