CHAPTER FOUR

INTERNAL AFFAIRS

Section 4.01 Registered Agents

Each corporation is required to continuously maintain a registered agent and a registered office within the state of Oregon. ORS 60.111(1). The registered office must be located at a physical street address where process may be personally served on the registered agent. The registered office may not be a commercial mail receiving agency, a mail forwarding business or a virtual office. *Id.*

ORS 60.111(2) states that a registered agent must be:

> (a) An individual who resides in this state and whose business office is identical to the registered office;
>
> (b) A domestic corporation, domestic limited liability company, domestic professional corporation or domestic nonprofit corporation, the business office of which is identical to the registered office; or
>
> (c) A foreign corporation, foreign limited liability company, foreign professional corporation or foreign nonprofit corporation that is authorized to transact business in this state, the business office of which is identical to the registered office.

A registered agent is deemed to have authority to receive any process, notice or demand required or permitted by law to be served upon the corporation. ORS 60.121(1). However, appointment of a registered agent in Oregon does not constitute consent to jurisdiction by the Oregon courts by a foreign corporation. *Figueroa v. BNSF Ry. Co.*, 361 Or 142, 390 P3d 1019 (2017). In addition, "the fact that a corporation is doing business within a state is not sufficient in and of itself to give that state general jurisdiction over the corporation." *Barrett v. Union Pac. R.R. Co.,* 361 Or 115, 132, 390 P3d 1031 (2017).

A registered agent is not a corporation's exclusive agent for all such purposes. For instance, in a lawsuit filed against a corporation, both ORCP 7(D)(3)(b) and Federal Rule of Civil Procedure 4(h) (in somewhat different language) permit service of process to be served on any one of several persons, including its registered agent, an officer, and the corporation's managing agent.

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ORS 60.121(2) and (3) together set forth detailed rules concerning service on the Secretary of State as an alternative to service on a corporation. These rules also apply in situations where a corporation is dissolved, or where a corporation has failed to maintain a registered agent as required by law. Where service is necessary for lawsuits filed in the Oregon courts, special rules are set forth in ORCP 7(D)(3)(b)(ii).

Section 4.02 Dividends & Other Distributions

***A. Definition*.**

ORS 60.001(7) defines the term "distribution" to mean:

> means a direct or indirect transfer of money or other property, except of a corporation's own shares, or an incurrence of indebtedness by a corporation to or for the benefit of the corporation's shareholders in respect of any of the corporation's shares, in the form of a declaration or payment of a dividend, a purchase, redemption or other acquisition of shares, a distribution of indebtedness, or otherwise.

Thus, a distribution includes, but is not limited to, payments commonly referred to as "dividends." In other words, a dividend is a subset of the broader concept of distributions. All dividends are distributions; not all distributions are dividends. For example, funds transferred to shareholders upon the winding up and liquidation of a corporation constitute a "distribution" but were held not to be "dividends" for Oregon tax purposes under the then existing statute. *Cobb v. Galloway,* 167 Or 604, 119 P2d 896 (1941)

Payments to a shareholder/director for attending board meetings may be deemed to be disguised dividends for tax purposes where directors who were not shareholders did not received similar payments. *Elecs. Int'l, Inc. v. Dep't of Revenue* TC-MD 120820C (Or Tax July 31, 2013).

Both distributions and dividends may involve transfers of cash or of other property. ORS 60.001(7); *Grants Pass Hardware Co. v. Calvert*, 71 Or 103, 142 P 569 (1914).

Corporate "profits" and "dividends" are not synonymous. *Brown v. Luce Mfg. Co.,* 231 Mo App 259, 96 SW 2d 1098 (1936); *Boothe v. Summit Coal Mining Co.*, 55 Wash 167, 104 P 207 (1909)(Rudkin concurring). "It is fundamental that corporate earnings, though amounting to corporate assets, are not the equivalent of dividends until declared such by the directors of the corporation." *In re Clark's Trust*, 29 Misc 2d 253, 217 NYS2d 396, 399 (1961).

***B. Power to declare*.**

A corporation has broad power to distribute its assets to its shareholders. *Spokane Concrete Products, Inc. v. U.S. Bank of Washington*, 126 Wash 2d 269,

892 P2d 98 (1995).

Only the board of directors is empowered to authorize the corporation to make distributions to its shareholders. ORS 60.181. The shareholders have no right to vote to make distributions to themselves. *Stipe v. First National Bank of Portland*, 208 Or 251, 301 P2d 175 (1956); *Baillie v. Columbia Gold Mining Co.*, 86 Or 1, 166 P 965, 167 P 1167 (1917); *Matter of Goerler*, 227 AD2d 479, 642 NYS2d 923 (1996); *Southern Pacific Co. v. Lowe*, 247 US 330, 338 (1918).

Under very limited circumstances, a bylaw may confer authority to declare a dividend on an officer. *Blair v. Bishop's Restaurants, Inc.,* 202 Okla 648, 217 P2d 161 (1950).

Case law is split on the legal effect of a unanimous decision of the shareholders to authorize the issuance of a dividend. Some cases indicate that such an action is ineffective. One case goes so far as to state that even a "sole stockholder is not entitled to demand the profits of the corporation until they have been set aside and ordered by the directors to be paid." *Central of Georgia Ry. Co. v. Central Trust Co. of New York*, 135 Ga 472, 491, 69 SE 708, 717 (1910). *See also Cole Real Estate Corp. v. Peoples Bank & Trust Co.*, 160 Ind App 88, 310 NE2d 275 (1974).

> The sole power to declare and pay dividends rests with the board of directors of a corporation. . . . To permit the recovery of an undeclared dividend in an action at law would be the equivalent of allowing the court or jury before whom the case is tried to declare the dividend. "This, of course, is not the law; and, if each stockholder might call in a jury at his pleasure to determine whether a dividend should be declared, corporations would be short-lived affairs and of but little value." *Rubens v. Marion-Washington Realty Corp.*, 116 Ind App 55, 59 NE2d 907, 911 (1945)(quoting from *Knight v. Alamo Mfg. Co.*, 190 Mich 223, 157 NW 24 (1916)).

Other cases hold that a distribution is effective when approved by all of the shareholders, even without board authorization. *In re Wilson's Estate*, 85 Or 604, 167 P 580 (1917); *Metro. Trust Co. v. Becklenberg,* 300 Ill App 453, 21 NE2d 152 (1939); *Steeple v. Max Kuner Co.*, 121 Wash 47, 208 P 44 (1922) (shareholders and directors same).

The leading case on the right of shareholders to force the board of directors to declare dividends is *Dodge v. Ford Motor Co.*, 204 Mich 459, 170 NW 668 (1919).

> **NOTE:** ORS 60.265 provides that certain written agreements by and among the shareholders may govern "the exercise or division of voting powers by or between the shareholders and directors." Arguably, a written agreement which complies with this statute may alter the usual procedures for declaring distributions. This section has not yet been interpreted by the Oregon appellate courts. A discussion of ORS 60.265 is contained in Section 4.07 of this book.

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When declaring a distribution, there are no magic words. A distribution may be declared using any words that express the clear intent of the board to declare a distribution – the use of the specific words "distribution" or "dividend" is not required. *Brown v. Luce Mfg. Co.,* 231 Mo App 259, 96 SW 2d 1098, 1100 (1936).

***C. The right of shareholders to force declaration of a distribution*.**

Although directors generally have the sole power to declare a distribution, under extraordinary circumstances, shareholders may bring a successful action in equity to compel the declaration of a distribution. *Naito v. Naito,* 178 Or App 1, 35 P3d 1068 (2001); *Kelly v. Galloway*, 156 Or 301, 66 P2d 272, 68 P2d 474 (1937); *Baillie v. Columbia Gold Mining Co.*, 86 Or 1, 166 P 965, 167 P 1167 (1917); *United States v. Byrum*, 408 US 125, 142 (1972) (applying Ohio law); *Steele v. Locke Cotton Mills Co.*, 231 NC 636, 58 SE2d 620 (1950).

> As a general rule the officials of a corporation are the sole judges as to the propriety of declaring dividends and the courts will not interfere with the proper exercise of that discretion. Yet when the right to a dividend is clear and there are funds from which it can properly be made, a court of equity will interfere to compel a company to declare it. Directors are not allowed to use their power illegally, wantonly, or oppressively. *W. Q. O'Neall Co. v. O'Neall*, 108 Ind App 116, 25 NE2d 656, 659 (1940).

Even though shareholders have the right to bring such an action, courts are reluctant to substitute the courts' judgment for the business judgment of the board of directors regarding distributions.

> It is settled law in Delaware, and elsewhere, that the declaration of a dividend rests in the discretion of a corporation's board of directors in the exercise of its business judgment. *Mann-Paller Foundation, Inc. v. Econometric Research, Inc.*, 644 F Supp 92, 96 (1986).

The Delaware Supreme Court itself has said:

> It is settled law in this State that the declaration and payment of a dividend rests in the discretion of the corporation's board of directors in the exercise of its business judgment; that, before the courts will interfere with the judgment of the board of directors in such matter, fraud or gross abuse of discretion must be shown. *Gabelli & Co. v. Liggett Group Inc.*, 479 A2d 276, 280 (Del Supr 1984).

See also In re American Int'l Grp. Inc. Derivative Litig., 700 F Supp2d 419, 440-41 (SDNY 2010); *Sec. Police and Fire Professionals of Am. Ret. Fund v. Mack*, 917 NYS2d 527, 30 Misc3d 663, 676-77 (2010).

"The question of whether a dividend shall be declared is ordinarily one of internal management with which the courts will not interfere." *Ostlind v. Ostlind Valve, Inc.*, 178 Or 161, 186, 165 P2d 779, 787 (1946). *See also Stipe v. First Nat. Bank of Portland,* 208 Or 251, 301 P2d 175 (1956); *Baillie v. Columbia Gold Mining Co.*, 86 Or 1, 166 P 965, 167 P 1167 (1917). As the Oregon Supreme Court stated in a later case:

> We have recognized that those in control of corporate affairs have fiduciary duties of good faith and fair dealing toward the minority shareholders. Insofar as dividend policy is concerned, however, that duty is discharged if the decision is made in good faith and reflects legitimate business purpose rather than the private interests of those in control. (citations omitted) *Zidell v. Zidell, Inc.*, 277 Or 413, 418, 560 P2d 1086, 1089 (1977).

Courts have held that there are a great number of reasons for retaining profits, any one of which will likely defeat a shareholder action to compel the declaration of a distribution.

> Even where there are corporate earnings, the legal power to declare dividends is vested solely in the corporate board. In making decisions with respect to dividends, the board must consider a number of factors. It must balance the expectation of stockholders to reasonable dividends when earned against corporate needs for retention of earnings. The first responsibility of the board is to safeguard corporate financial viability for the long term. This means, among other things, the retention of sufficient earnings to assure adequate working capital as well as resources for retirement of debt, for replacement and modernization of plant and equipment, and for growth and expansion. The nature of a corporation's business, as well as the policies and long range plans of management, are also relevant to dividend payment decisions. Directors of a closely held, small corporation must bear in mind the relatively limited access of such an enterprise to capital markets. This may require a more conservative policy with respect to dividends than would be expected of an established corporation with securities listed on national exchanges. (footnote omitted) *U.S. v. Byrum*, 408 US 125, 140 (1972) (applying Ohio law).

The bottom line is: courts usually defer to the business judgment of the board of directors on whether or not a corporation should issue a dividend. Courts intervene and order a dividend only in extraordinary situations, such as when the directors have acted fraudulently, arbitrarily or with some improper motive.

NOTE: The failure to pay dividends, coupled with other bad acts, may constitute grounds for an oppression claim under ORS 60.952. *See* Section 8.04 herein.

***D. Shareholder rights after dividend declared*.**

Once a dividend has been properly authorized by the board, each shareholder has a legal right to receive the dividend and each shareholder may sue individually to enforce that right. ORS 60.181(6).

> When the dividend was declared, the defendant became indebted to each shareholder for his share, and each was in the same position as any other creditor of the corporation and had a right to enforce or assign his demand in like manner. *Steel v. Island Milling Co.*, 47 Or 293, 297, 83 P 783, 785 (1906).

See also In re Wilson's Estate, 85 Or 604, 167 P 580 (1917);*U.S. Industries, Inc. v. Anderson,* 579 F2d 1227 (10th Cir 1978); *Cole Real Estate Corporation v. Peoples Bank and Trust Co.*, 160 Ind App 88, 310 NE2d 275 (1974); *McJannet v. Strehlow Supply Co.*, 25 Wash 2d 468, 171 P2d 684 (1946).

On the other hand, a shareholder has no right to receive a dividend that has been improperly declared – such as when the corporation is insolvent – and a suit

to force payment of an illegal dividend will likely be unsuccessful. *In re WorldCom, Inc*., 323 BR 844 (SDNY 2005).

Once the board of directors declares a dividend, it may not change its mind and rescind the distribution.

> When the dividend was declared, the defendant became indebted to each shareholder for his share, and each was in the same position as any other creditor of the corporation and had a right to enforce or assign his demand in like manner. [A] dividend properly declared by the directors of a corporation cannot subsequently be revoked; and that persons who are shareholders at the time the dividend is declared have a legal claim against the company for the payment of the amount of the dividend; and that, after profits have been set apart and appropriated to the payment of the dividends, they belong to the shareholders, and cannot be recalled, even though the company should suffer losses and become insolvent before the dividend is actually paid. *Albany Fertilizer & Farm Improvement Co. v. Arnold*, 103 Ga 145, 29 SE 695, 696 (1897).

"A board of directors, having once declared the dividend and such declaration having been made public, neither it nor its successors can thereafter rescind or revoke such declaration, although title to the dividend does not actually vest in the stockholders until the date fixed by the directors for determining what stockholders shall be the payees." *Alexander & Alexander v. United States,* 22 F Supp 921, 922-23 (D Md 1938).

In one case, a court held that a board resolution for a periodic dividend was worded such that the board specifically reserved the right to amend the resolution and suspend future dividends. Therefore, these future dividends did not automatically become debts of the corporation until the dividend was actually paid or the corporation took some other affirmative step regarding the specific dividend payment. *U.S. v. Southwestern Portland Cement Co.*, 97 F2d 413 (9th Cir 1938). Another decision indicates the board may rescind a dividend if (i) the declaration is not made known to the shareholders, and (ii) the shareholders have not relied on the declaration. *Carney v. Crocker*, 94 F2d 914 (1st Cir 1938).

One Washington case holds the shareholders may unanimously agree to permit the corporation to revoke the dividend. *McJannet v. Strehlow Supply Co.*, 25 Wash 2d 468, 171 P2d 173 (1946).

When stock sells after a distribution is declared but before the record date, the acquirer will be entitled to the distribution, absent an agreement to the contrary. *See Drexel Burnham Lambert, Inc. v. Chapman,* 174 Ga App 336, 329 SE2d 595 (1985)(owner of shares on distribution date, not record date, entitled to a stock dividend).

> The record date determines to whom the issuer sends the distribution. The ex-date determines which unitholder is legally entitled to the distribution, as well as the date when the price of the security is adjusted downward to reflect loss of the right to the distribution:

> The record date is the date on which one must be registered as a shareholder on the stock book of a company in order to receive a dividend declared by that company. The fact that an individual is the holder of record on the record date, however, does not necessarily mean that such person is entitled to retain the dividend. In terms of entitlement, the ex-dividend date is the dividing line.... When stock is sold prior to the ex-dividend date, the right to a dividend goes with the stock to the purchaser, rather than staying with the seller.... Generally the ex-dividend date precedes the record date, and the stockholder entitled to the dividend is the individual to whom the dividend is sent.

In re THCR/LP Corp., 2006 WL 530148, at *6 (emphasis added) (quoting *Limbaugh v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 732 F.2d 859, 861 (11th Cir.1984)). If the record date precedes the ex-date, and the security is sold during the period between the two, the seller of the security (who held the security on the record date) will receive the full, unadjusted price for the security, as well as the distribution. The purchaser of the security - who is the holder on the ex-date - will be legally entitled to the distribution. Under such circumstances, the seller will be obligated to remit the value of the dividend to the buyer. *See* NASD Notice to Members 00-54 (August 15, 2000); *Silco, Inc. v. United States,* 779 F.2d 282, 284 (5th Cir. 1986) (noting in a taxpayer case involving a cash dividend under New York Stock Exchange rules "[w]hen a stock sales contract is executed after the record date in these circumstances, the seller, who is the holder of record on the record date, receives the dividend from the corporation but must remit the dividend to the purchaser. The seller does this by executing a due-bill to the buyer at the time of sale and then transferring funds to satisfy that due-bill."). *Zardinovsky v. Arctic Glacier Income Fund (In re Arctic Glacier Int'l, Inc.*) (Bankr Del, July 13, 2016)(footnote omitted).

But there can be exceptions, particularly related to trust and tax issues following the death of the shareholder. “[W]here a dividend is declared during the life of the income beneficiary and is payable to shareholders of record on a date prior to the death of the beneficiary, the dividend is included in the estate of the beneficiary, even though it is not payable until after the death of the beneficiary.” *McIlvaine v. AmSouth Bank, NA*, 581 So2d 454 (Ala 1991). *See also In re Wallace's Estate*, 131 Or 597, 282 P 760 (1930); 60 ALR 703.

***E. Dividends on preferred shares*.**

Traditionally, there have been two kinds of corporate stock – common and preferred. *Weaver v. Bowers*, 173 Ohio St 1, 179 NE2d 50 (1962).

Neither the Model Act nor the Oregon Act make any distinction between common and preferred stock. Instead, ORS 60.131(3)(d) provides that the articles of incorporation may authorize one or more classes of shares which have "preference over any other class of shares with respect to distribution, including dividends and distributions upon the dissolution of the corporation." Shares with such preferences are frequently referred to as "preferred shares."

The designation of shares as "preferred" has no special legal meaning, but rather, has the meaning defined for it in the corporation's articles of incorporation. *Waggoner v. Laster*, 581 A2d 1127 (Del Supr 1990); *Collins v. Portland Electric Power Co.*, 7 F2d 221 (D Or 1925), *affirmed*, 12 F2d 671 (9th Cir 1926); *Gaskill v.*

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Gladys Bell Oil Co., 146 A 337 (Del Ch 1929).

> Articulation of the rights of preferred stockholders is fundamentally the function of corporate drafters. Construction of the terms of preferred stock is the function of courts. This Court's function is essentially one of contract interpretation against the background of Delaware precedent. These precedential parameters are simply stated: Any rights, preferences and limitations of preferred stock that distinguish that stock from common stock must be expressly and clearly stated, as provided by statute. Therefore, these rights, preferences and limitations will not be presumed or implied. The other doctrine states that when there is a hopeless ambiguity attributable to the corporate drafter that could mislead a reasonable investor such ambiguity must be construed in favor of the reasonable expectation of the investor and against the drafter. This latter doctrine is not applicable here because there is no ambiguity. (footnotes omitted) *Elliott Associates, L.P. v. Avatex Corp.,* 715 A2d 843, 852-3 (Del Supr 1998).

A preferred share's right to a dividend may be "cumulative, noncumulative or partially cumulative." ORS 60.131(3)(c).

A "cumulative" dividend means that the preferred shares' dividends for that year and all preceding years must be paid before any dividends can be paid to inferior classes for that year. *Arizona Power Co.v. Stuart*, 212 F2d 535, 539 (9th Cir 1954).

The owner of preferred shares has the status of a shareholder – not the status of a creditor. *Arizona Power Co.v. Stuart*, 212 F2d 535, 539 (9th Cir 1954). An agreement to give preferred shareholders a higher claim to corporate assets than is possessed by general creditors is against public policy and unenforceable. *Hewitt v. Linnhaven Orchard Co.*, 90 Or 1, 174 P 616 (1918); *O'Neal v. Automotive Piston & Parts Co.*, 188 Ga 380, 4 SE2d 40 (1939). As such, dividends are not due the preferred shareholders until declared by the board of directors in their honest discretion. *Treves v. Menzies*, 37 Del Ch 330, 142 A2d 520 (1958); *W. Q. O'Neall Co. v. O'Neall*, 108 Ind App 116, 25 NE2d 656 (1940).

Although some courts are more inclined to intervene to protect the rights of preferred shareholders to dividends, *W. Q. O'Neall Co. v. O'Neall*, 188 Ga 380, 4 SE2d 40 (1939) – other courts are not so inclined. *Welch v. Atlantic Gulf & West Indies S.S. Lines*, 101 F Supp 257 (ED NY 1951).

> **NOTE:** If one class of stock is given a preference over another class of stock, the articles should specify the nature of the preference (*e.g.*, "$1.00 per share per calendar year before any distributions may be paid on the common shares") and state whether the preference is cumulative or non-cumulative (*i.e.*, whether or not the right to the distribution carries over to subsequent years and is or is not aggregated with the preference for such years). *See Collins v. Portland Electric Power Co.*, 7 F2d 221 (D Or 1925), *affirmed*, 12 F2d 671 (9th Cir 1926); *Allied Magnet Wire Corp. v. Tuttle*, 199 Ind 166, 154 NE 480, 156 NE 558 (1926). The articles should also state whether or not the

preferred shares have the right to additional distributions after receiving the preference distribution (*i.e.*, whether a preferred share is entitled to any additional sum after it has received its preferred sum for that year and once a distribution is declared for the common shares for that year).

The articles should also specify the relative rights of the shares upon liquidation. ORS 60.131(3)(d) & 60.134. *See Haworth v. Hubbard*, 220 Ind 611, 44 NE2d 967 (1942). Keep in mind that the Act's use of the term "distribution" encompasses dividends – as well as the purchase or redemption of shares – as well as many other types of transfer from the corporation to the shareholders. ORS 60.001(7).

***F. When can the board declare a distribution: early tests*.**

In the early evolution of corporate law, the shareholders' original capital contributions (*i.e.*, the total amount that all shareholders paid the corporation for their stock) were considered sacred and untouchable. These original contributions could only be redistributed to the shareholders upon liquidation and after payment of all creditors. Some courts went so far as to describe these original capital contributions as a "trust fund" for the creditors. *McDonald v. Williams*, 174 US 397 (1899); *Lantz v. Moeller*, 76 Wash 429, 136 P 687 (1913).

The "stated capital" of a corporation was the aggregate of all issued shares multiplied by the par value of those shares. The "capital surplus" was the aggregate of all the sums originally paid for all issued shares, less the stated capital. Originally, it was the "stated capital" which was considered the trust fund and out of which dividends could not be paid. Restrictions were usually imposed on the payment of dividends out of capital surplus as well.

The corporation’s net worth in excess of the capital contributions exchanged for its stock (*i.e.,* in excess of its stated capital plus its capital surplus) was referred to by a number of terms including: "earned surplus," "unreserved and unrestricted earned surplus," "profits," "capital surplus," or "net earnings." Until modern times, most corporations could only pay dividends out of this earned surplus. *Collins v. Portland Electric Power Co.*, 7 F2d 221 (D Or 1925), *affirmed*, 12 F2d 671 (9th Cir 1926); Basye, *Recent Amendments to Certain Financial Provisions of the Oregon Business Corporation Act*, 472 OR L REV 320, 325 (1968).

Over time, this strict limitation on the payment of distributions weakened. One by one, states adopted statutes which permitted some portion of the shareholders' original capital contributions to be redistributed to them – even though the corporation continued to be a going concern (but so long as the corporation remained solvent).

***G. Solvency test*.**

Most recently, some states have adopted a "solvency" test. Under this test, distributions may be declared as long as the payment does not render the corporation unable to pay its bills as they come due and as long as the payment does not reduce the corporation's total assets below its total liabilities.

The "solvency" test is the least restrictive test permitted. A distribution which violates the solvency test would likely constitute a fraudulent conveyance. Since the directors of an insolvent corporation owe a duty to corporate creditors to prevent the dissipation of corporate assets, a distribution which violates the solvency test would also likely constitute a breach of the directors' common law duty to creditors. *See* Sections 9.08 and 12.07.

***H. Oregon has adopted the solvency test*.**

Oregon has adopted the solvency test for distributions. ORS 60.181. With limited exceptions, distributions may now be made out of all of the original capital contributions of the shareholders.

Pursuant to ORS 60.181(3) – which is based upon Revised Model Act § 6.40 – a distribution may be made only if the corporation is solvent, after giving effect to the distribution:

> (a) The corporation would be able to pay its debts as they become due in the usual course of business; or
>
> (b) The corporation's total assets would be at least equal the sum of its total liabilities plus, unless the articles of incorporation permit otherwise, the amount that would be needed if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of the shareholders whose preferential rights are superior to those receiving the distribution.

Under the Oregon Act, a distribution made while the corporation is insolvent is illegal and void. *In re Enron Corp.*, 323 BR 857 (Bankr SDNY 2005). Thus, if a corporation enters into a contract to repurchase some of its shares during a period of insolvency, the contract is illegal and unenforceable against the corporation. *Field v. Haupert*, 58 Or App 117, 647 P2d 952 (1982); *McGinley v. Massey,* 71 Md App 352, 525 A2d 1076 (1987). *But see Minnelusa Co. v. Andrikopoulos,* 929 P2d 1321 (Colo 1996).

In determining solvency, the market value of corporate assets (not necessarily their book value) – including intangible assets – should be taken into account. *Hansen v. Singmaster Insurance Agency, Inc.*, 80 Or App 329, 722 P2d 1254, *opinion adhered to*, 82 Or App 219, 728 P2d 69 (1986). “Under Oregon law, however, the determination that the company is solvent enough to make a distribution may be made on the basis of any method that is reasonable under the circumstances.” *Meeks v. PRN, Inc.,* 1994 US App LEXIS 23768 (9th Cir 1994).

In the context of a leveraged buyout, the going concern value – rather than the book value – of corporate assets may be the appropriate value for determining solvency. *Spokane Concrete Products, Inc. v. U. S. Bank of Washington*, 126 Wash 2d 269, 892 P2d 98 (1995); *Moody v. Security Pac. Business Credit, Inc.*, 971 F2d 1056 (3rd Cir 1992).

A discussion of the development of Oregon law on the issue of distributions while insolvent is set forth in *In re Enron Corp.*, 323 BR 857 (Bankr SDNY 2005). (Enron was an Oregon corporation at the time it filed for bankruptcy).

***I. Delayed distributions*.**

Not all distributions occur immediately. Under prior law, a corporation not only had to be solvent on the date the distribution obligation was incurred, it was required to remain solvent throughout the period during which payments occurred. *In the Matter of Poole, McGonigle & Dick, Inc.*, 796 F2d 318 (9th Cir 1986). This test posed particular difficulties in a partial liquidation through which a former shareholder was to receive payments over several years.

With respect to stock repurchase contracts which call for one or more payments at a later date, ORS 60.181(5) now provides that the effect of the distribution is measured as follows:

> (a) In the case of distribution by purchase, redemption or other acquisition of the corporation's shares, as of the earlier of the date the money or other property is transferred or debt incurred by the corporation or the date the shareholder ceases to be a shareholder with respect to the acquired shares;
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> (b) In the case of any other distribution of indebtedness, as of the date the indebtedness is distributed; and
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> (c) In all other cases, as of the date a distribution is authorized if the payment occurs within 120 days after the date of authorization or the date the payment is made if it occurs more than 120 days after the date of authorization.

As long as a corporation complies with the above provisions, a corporation's indebtedness to a former shareholder is at parity with its indebtedness to its general unsecured creditors, absent an agreement to the contrary. ORS 60.181(6). However, the U.S. Bankruptcy Code provisions regarding insider preferences may supersede this provision. 11 USC § 547. *See also In re Enron Corp.*, 323 BR 857 (Bankr SDNY 2005).

A more detailed discussion of distributions appears in Peterson & Hawker, *Does Corporate Law Matter? Legal Capital Restrictions on Stock Distributions*, 31 AKRON L REV 17 (1997); Art, *Corporate Shares and Distributions in a System Beyond Par Value: Financial Provisions of Oregon's New Corporation Act*, 24 WILL L REV 203 (1988); McGough, *Statutory Limits on a Corporation's Right to Make Distributions to Shareholders: The Law of Distribution in the 1984 Revised Model*

Business Corporation Act, 21 AKRON L REV 27 (1987).

***J. Liability for illegal distributions*.**

Directors who negligently approve an illegal distribution and shareholders who knowingly accept an illegal distribution are liable to the corporation.

ORS 60.367(1) provides that directors may be liable to the corporation for unlawful distribution, unless the directors comply with the standards of conduct described in ORS 60.357; *In re Enron Corp.*, 323 BR 857 (Bankr SDNY 2005). This topic is discussed in more detail in Section 9.07 of this book.

A shareholder may be liable to the corporation for an unlawful distribution to the extent "the shareholder accepted knowing the distribution was made in violation of this chapter or the articles of incorporation." ORS 60.367(2)(b).

ORS 60.367 creates a cause of action in the corporation for illegal distributions, but not a cause of action at law by creditors. *Wakeman v. Paulson*, 264 Or 524, 506 P2d 683 (1973). However, creditors may be able to impose liability upon "bad faith" shareholders and negligent directors through an equitable proceeding, a bankruptcy trustee, a receiver, or some other proceeding in equity. *Id*. *See also In re Sheffield Steel Corp*., 320 BR 405 (NE OK 2004); *Rosebud Corporation v. Boggio*, 39 Colo App 84, 561 P2d 367 (1977).

This topic is discussed in more detail in Section 10.12 of this book.

Section 4.03 Share/Stock Dividends

A. Current rule.

A "share dividend" or "stock dividend" is a pro rata dividend which consists of new shares created and issued by a corporation. *Joyce v. Congdon*, 114 Wash 239, 195 P 29 (1921).A share dividend is expressly excluded from the definition of "distribution" in ORS 60.001(7).

Prior to the effective date of the Act, distributions could not be paid out of the stated capital, that is, out of the aggregate of the par values of all issued shares. *See* Section 4.02 of this book. Thus, the issuance of a stock dividend increased stated capital and was permitted only where there was sufficient surplus earnings available to increase stated capital to include the newly issued shares. *Northern Bank & Trust Co. v. Day*, 83 Wash 296, 145 P 182 (1915).

The Oregon Business Corporation Act no longer uses "stated capital" terminology and no longer requires that distributions be paid only out of net earnings or profits. Distributions may now generally be paid as long as a corporation is solvent. *See* Section 4.02 of this book. Thus unless the articles provide otherwise, the board may issue pro rata share dividends at any time. ORS 60.154 provides:

> (1) Unless the articles of incorporation provide otherwise, shares may be issued pro

> rata and without consideration to the corporation's shareholders or to the shareholders of one or more classes or series. An issuance of shares under this subsection is a share dividend.
>
> (2) Shares of one class or series may not be issued as a share dividend in respect to shares of another class or series unless the articles of incorporation so authorize, a majority of the votes entitled to be cast by the class or series to be issued approve the issue or there are no outstanding shares of the class or series to be issued.
>
> (3) If the board of directors does not fix the record date for determining shareholders entitled to a share dividend, the record date is the date the board of directors authorizes the share dividend.
>
> (4) For purposes of this section, a share dividend shall include a share split, other than a reverse share split.

This is not a significant departure from the law in effect in Oregon immediately before adoption of the current Act.

Except under specified circumstances, shareholders of one class or series of shares may not be issued shares of another class or series of shares. ORS 60.154(2).

B. Old rule.

Even under earlier Oregon law, a corporation could issue a share dividend without regard to the “stated capital” requirement.

> A stock dividend takes nothing from the property of the corporation and adds nothing to the interests of the shareholders. The property of the corporation is not diminished. The stockholders' interests are not increased. Their proportional interests remain the same. The only change is in the evidence which represents a given stockholder's interest, that is, the new shares representing the same proportional interest that the original shares represented before the issue of the stock dividend. In short, the corporation is no poorer and the stockholder is no richer than they were before. A stock dividend is, therefore, not in any true sense a dividend at all. Its issuance is, in the last analysis nothing more than an incident or process in corporation bookkeeping. *Stipe v. First National Bank of Portland*, 208 Or 251, 274, 301 P2d 175, 186 (1956).

A share dividend "does not add anything to or take anything away from a shareholder's proportionate interest in the corporation." *English v. United States*, 270 F2d 876 (7th Cir 1959).

> It is somewhat of a misnomer to call it a "dividend" because it is really just a further division of shares in the company's ownership. Nothing concrete is *gained* thereby except that smaller shares, being less costly per share, have a wider market and therefore attract more trading. But when it is issued, the stockholder has the same percentage ownership in the company he had before, relative to all other stockholders. *Drexel Burnham Lambert, Inc. v. Chapman*, 174 Ga App 336, 338, 329 SE2d 595, 598 (1985).

In those states whose statutes continue to prohibit distributions from stated capital, the issuance of a share dividend likely has the effect of increasing stated capital (since stated capital is determined by multiplying the number of issued shares by their par value). Thus, in such jurisdictions, the issuance of a share dividend is

only permitted if there is sufficient net earnings available to increase stated capital to include the newly issued shares. *Anacomp, Inc. v. Wright*, 449 NE2d 610 (Ind App 1983); *Northern Bank & Trust Co. v. Day*, 83 Wash 296, 145 P 182 (1915); *Lantz v. Moeller*, 76 Wash 429, 136 P 687 (1913).

C. Share splits.

At one time, some courts made a distinction between share dividends and share splits. A share split is a pro rata division of all issued shares into a greater or lesser number of shares. *Anacomp, Inc. v. Wright*, 449 NE2d 610 (Ind App 1983).

> The effect of a stock split is merely to change the form of the stockholder's interest in the company, but not the substance of his property. It simply involves a division of the outstanding shares into more units, each with less value. Each stockholder's proportionate share of ownership, his rights on dissolution, and the total value of his investment in the corporation are maintained intact. The only significant changes are the issuance of a new certificate and a reduction in the market value of each share unit, which usually increase marketability of the shares. *Rogers Walla Walla, Inc. v. Ballard*, 16 Wash App 81, 87, 553 P2d 1372, 1376 (1976).

ORS 60.154(4) now provides that "a share dividend shall include a share split, other than a reverse share split." *See also in re Rees' Estate,* 210 Or 429, 311 P2d 438 (1957); *Allen v. National Bank of Austin,* 19 Ill App2d 149, 153 NE2d 260 (1958).

Like a share dividend, a stock split does not effect the relative ownership of the shareholders since the new shares are issued pro rata. A share split has the same effect as a share dividend.

A reverse stock split which calls for the cash out fractional shares gives rise to dissenter's rights under the Oregon Act. ORS 60.554(1)(a)(B).

Section 4.04 Indemnity of Directors & Officers; Limited Liability

The Act creates both permissive and mandatory rights to indemnification by directors and officers. The Act also permit the corporation to advance litigation expenses during the course of the lawsuit.

Officers and directors are entitled to indemnity only for claims against them arising out of their corporate roles, not claims against them in their personal capacity. *See for example Bensen v. American Ultramar Ltd.*, 1996 WL 435039 (SDNY 1996); *Tilden of New Jersey, Inc. v. Regency Leasing Systems, Inc*., 237 A.D.2d 431, 655 N.Y.S.2d 962 (1997)(director not entitled to litigation expenses when sued on a guaranty); *Petty v. Bank of New Mexico Holding Co.* 109 NM 524, 787 P2d 443 (1990). Some courts have held that litigation advances should be apportioned between personal (as an ordinary creditor) and corporate claims. See for example: *Booth Oil Site Administrative Group v. Safety-Kleen Corp*., 137 F Supp

2d 228 (WDNY 2000).

Indemnifying a director for an act unrelated to the company might be an *ultra vires* act. *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Emhart Corp.,* 11 F3d 1524, n 7 (10th Cir 1993).

If a director or officer is entitled to indemnity, the amount due is on par with the debts due other creditors. Upon dissolution, any such indemnity must be paid before distribution of assets to the shareholders. *Crocker v. Stevens*, 210 Ga App 231, 435 SE2d 690 (1993).

A more detailed discussion of the indemnity of directors and officers is contained in Roy & Frassetto, *Exculpation and Indemnification of Corporate Directors under Oregon's New Corporation Code*, 24 WILL L REV 257 (1988); Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L J 1155 (1990); *Note*, 17 Val U L Rev 230 (1983).

***A. Permissive indemnity of directors & officers*.**

ORS 60.391 permits a corporation to indemnify past and present directors for their good faith acts. But it does not permit indemnity in cases where the director is adjudicated liable to anyone – including the corporation – on the basis of improper personal benefit.

ORS 60.407(2) authorizes a corporation to indemnify officers, agents and employees in the same manner.

Except as limited by ORS 60.047(2)(d), a director or officer's right to mandatory indemnity may be expanded by the corporation's articles, bylaws, contract, director resolution or shareholder vote.“It is common for corporations to adopt through their by-laws a requirement that they must (as opposed to may) reimburse directors for their costs.” *Owens Corning v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA,* 257 F3d 484, 494 (6th Cir 2001).

A bylaw provision concerning the extent of indemnity which conflicts with the terms of the articles of incorporation is void. *Sabre Farms, Inc. v. Jordan*, 78 Or App 323, 717 P2d 156 (1994).

ORS 60.397 permits a corporation to advance litigation expenses to directors pending final disposition of the litigation. ORS 60.407(2) permits a corporation to advance litigation expenses to an officer, agent and employee to the same extent as to a director.

***B. Mandatory indemnity of directors & officers*.**

Unless limited by its articles of incorporation, a corporation is required to indemnify directors who is “wholly successful” in any litigation in which the director was a party because he/she was a director. ORS 60.394; *Damerow Ford Co. v. Bradshaw*, 128 Or App 606, 876 P2d 788 (1994). “[A] litigant is wholly successful as

long as that individual did not incur any personal liability." *In re Internet Navigator, Inc.,* 301 BR 1 (BAP 8th Cir 2003).

> The purpose of the indemnification legislation is to encourage qualified individuals to accept the responsibilities of corporate management without fear that expenses incurred by them in performing their duties as directors will not be borne by the corporation.... To expand the list of persons entitled to claim the benefit of indemnification to include persons who are litigating questions relating to their private interests for their own private benefit, would go far beyond the purpose of the statute.
>
> The remaining prerequisites to indemnification, that the agent acted in good faith and with a reasonable belief that the activity was in the best interests of the corporation, allow for indemnification even where the agent was negligent or committed some error.
>
> The statute, however, prohibits indemnification in cases of bad faith or intentional wrongdoing, because: "Indemnification, if permitted too broadly, may violate ... basic tenets of public policy. It is inappropriate to permit management to use corporate funds to avoid the consequences of wrongful conduct or conduct involving bad faith. A director, officer, or employee who acted wrongfully or in bad faith should not expect to receive assistance from the corporation for legal or other expenses and should be required to satisfy not only any judgment entered against him but also expenses incurred in connection with the proceeding from his personal assets. Any other rule would tend to encourage socially undesirable conduct."
>
> Of course, if the corporate agent is acquitted of any wrongdoing, he or she has a right to indemnification for legal expenses incurred for his or her defense, even though he or she was initially charged with bad faith or intentional misconduct.
>
> *Plate v. Sun-Diamond Growers,* 225 Cal App3d 1115, 275 Cal Rptr 667, 672-72 (1990)(citations & internal quotations omitted).

The right to mandatory indenmity is extended to officers by ORS 60.407(1). *Damerow Ford Co. v. Bradshaw*, 128 Or App 606, 876 P2d 788 (1994).

ORS 60.401 authorizes a court to order indemnify of a director under two circumstances.

First, a court may order a corporation to indemnify a director if it determines the director is entitled to mandatory indemnification under ORS 60.394.

Second, a court may order indemnity if it determines the director "is fairly entitled to indemnification in view of all the relevant circumstances, whether or not the director met the standard of conduct set forth in ORS 60.391 or was adjudicated liable as described in ORS 60.391(4)."

An officer is entitled to court ordered indemnification to the same extent as a director. ORS 60.407(1).

One court held that Oregon's mandatory indemnification did not apply to punitive damages since the jury had to have found that defendant breached his fiduciary duty and acted with malice and reckless disregard. *In re Stein,* 210 BR 177 (D Ariz 1997).

C. Advance of expenses.

ORS 60.397 permits (but does not require) the corporation to pay the reasonable expenses of a director who is a party to a proceeding in advance of final disposition of the proceeding:

> (1) A corporation may pay for or reimburse the reasonable expenses incurred by a director who is a party to a proceeding in advance of final disposition of the proceeding if:
>
> (a) The director furnishes the corporation a with a signed written affirmation of the director's good faith belief that the director has met the standard of conduct described in ORS 60.391; and
>
> (b) The director furnishes the corporation with a written undertaking, executed signed personally or on the director's behalf, to repay the advance if the director is ultimately determined not to have met the standard of conduct.
>
> (2) The undertaking required by subsection (1)(b) of this section must be an unlimited general obligation of the director but need not be secured and may be accepted without reference to financial ability to make repayment.

The board of directors is bound by its fiduciary duty and by conflict of interest rules in deciding whether to advance expenses or agree to permissive indemnity. ORS 60.404 provides:

> (1) A corporation may not indemnify a director under ORS 60.391 unless authorized in the specific case after a determination has been made that indemnification of the director is permissible in the circumstances because the director has met the standard of conduct set forth in ORS 60.391.
>
> (2) A determination that indemnification of a director is permissible shall be made:
>
> (a) By the board of directors by majority vote of a quorum consisting of directors not at the time parties to the proceeding;
>
> (b) If a quorum cannot be obtained under paragraph (a) of this subsection, by a majority vote of a committee duly designated by the board of directors consisting solely of two or more directors not at the time parties to the proceeding. However, directors who are parties to the proceeding may participate in designation of the committee;
>
> (c) By special legal counsel selected by the board of directors or its committee in the manner prescribed in paragraph (a) or (b) of this subsection or, if a quorum of the board of directors cannot be obtained under paragraph (a) of this subsection and a committee cannot be designated under paragraph (b) of this subsection, the special legal counsel shall be selected by majority vote of the full board of directors, including directors who are parties to the proceeding; or
>
> (d) By the shareholders.
>
> (3) Authorization of indemnification and evaluation as to reasonableness of expenses shall be made in the same manner as the determination that indemnification is permissible, except that if the determination is made by special legal counsel, authorization of indemnification and evaluation as to reasonableness of expenses shall be made by those entitled under subsection (2)(c) of this section to select counsel.

This determination is an on-going one which should take into account facts as they are uncovered in the course of the litigation. ORS 60.397 is taken directly from Section 8.53 of the 1984 version of the Model Business Corporation Act, the Comments to which state:

> Section 8.53 established a workable standard: indemnification is permitted if the facts then known to those making the determination do not establish that indemnification would be precluded under section 8.51. The directors (or special legal counsel) making the determination under section 8.53(c) would normally communicate with counsel and the person or persons monitoring the matter for the corporation in order to gain familiarity with the status of the proceeding and the relevant facts that have emerged, but it is not required (or expected) that any form of independent investigation be undertaken for purposes of the determination. Thus, an advance may be made under section 8.53 **unless it becomes clear, from the facts at hand, that indemnification under section 8.51 cannot be provided. As additional facts become known, a different determination may be required.** (emphasis added) Official Comment to Revised Model Business Corporation Act section 8.53.

The board's determination whether or not to advance expenses is subject to the same fiduciary obligations against conflicts of interest as are other self-dealing decisions. Courts have the power to determine whether the board has breach its fiduciary obligations in approving the advance of litigation expenses. *Petty v. Bank of New Mexico Holding Co.* 109 NM 524, 787 P2d 443 (1990). But this view is not universal. Another court held the board need not comply with the usual conflict of interest procedures in order to make a good faith advancement of litigation expenses. *Service Corporation International v. H.M. Patterson & Sons, Inc.*, 263 Ga 412, 434 SE2d 455 (1993).

***D. Limited liability*.**

ORS 60.047(2)(d) permits a corporation to include in its articles of incorporation a provision eliminating or limiting the personal liability of directors to the corporation or to the shareholders.

A corporation may not so eliminate or limit directors' liability for their breach of loyalty, acts performed not in good faith, intentional misconduct, knowing violation of law, unlawful distributions or transactions involving improper personal benefit. Retroactive provisions eliminating or limiting liability are prohibited, unless the articles or bylaws explicitly authorize retroactivity. ORS 60.047.

Section 4.05 Corporate Records

ORS 60.771 requires a corporation to maintain certain records. For instance, it must maintain minutes of corporate meetings, appropriate accounting records and a list of shareholders in alphabetical order by class.

ORS 60.771(5) requires that a corporation physically keep a copy of the following records at its principal office or registered office:

> (a) The articles or restated articles of incorporation and all amendments to the articles of incorporation or restated articles of incorporation that are currently in effect;
>
> (b) The corporation's bylaws or restated bylaws and all amendments to the bylaws or restated bylaws that are currently in effect;
>
> (c) Resolutions that the corporation's board of directors adopts to create one or more classes or series of shares and fixing the relative rights, preferences and limitations for each class or series, if shares issued pursuant to those resolutions are outstanding;
>
> (d) The minutes of all shareholders' meetings and records of all action that shareholders take without a meeting, for the past three years;
>
> (e) All written communications to shareholders generally within the past three years;
>
> (f) A list of the names and business addresses of the corporation's current directors and officers; and
>
> (g) The corporation's most recent annual report delivered to the Secretary of State under ORS 60.787.

A corporation's records must be maintained either in written form or in a form capable of conversion to written form. ORS 60.771(4).

A discussion of the right of shareholders to inspect corporate records is contained in Section 4.06 of this book. A discussion of corporate minutes is contained in Section 5.06 of this book.

Section 4.06 Shareholder Right to Inspect Records

A. Statutory right to inspect.

Pursuant to ORS 60.224 and 60.774, shareholders have the right to inspect specified corporate records.

“There can be no question that the decisive weight of American authority recognizes the common-law right of the shareholder, for proper purposes and under reasonable regulations as to place and time, to inspect the books of the corporation of which he is a member. . . . The right of inspection rests upon the proposition that those in charge of the corporation are merely the agents of the stockholders who are the real owners of the property.” *Guthrie v. Harkness,* 199 US 148, 153, 155 (1905).

ORS 60.224 grants the right to inspect shareholder lists. ORS 60.774 grants the right to inspect certain other records – records which include meeting minutes and accounting records.

A shareholder may specify the inspection date; the corporation the location. ORS 60.774(2). A shareholder's demand must be made in good faith and for a proper purpose and the purpose must be set out in the shareholder's demand. ORS 60.774(3).

Section 4.06

Since 1862, a shareholder's right to inspect records has been a statutory right in Oregon. *Rosentool v. Bonanza Oil and Mine Corp.*, 221 Or 520, 352 P2d 138 (1960) (which contains a good discussion of the history of shareholder inspection rights). But a shareholder's right to inspect corporate records exists independent of statute and a shareholder's common law right to inspect records may be greater than the right granted by statute. *Bernert v. Multnomah Lumber & Box Co.*, 119 Or 44, 247 P 155, 248 P 156 (1926); *Guthrie v. Harkness,* 199 US 148, 153 (1905).

> But even if the statute has been repealed, the common law right of a stockholder to examine the books and records of the corporation at proper times and for proper purposes remains. And, under the common law rule, as it prevails in most states, . . . the burden of showing improper motives on the part of the shareholder in demanding an inspection of the books and records of the corporation is upon the defendant. It is presumed, until the contary (sic) is shown, that the shareholder seeks the information for a proper purpose. This is the rule that prevails in this state. (citations omitted) *State ex rel Grismer v. Merger Mines Corporation*, 3 Wash 2d 417, 420-21, 101 P2d 308, 310 (1940).

But see Southern Acceptance Corporation v. Nally, 222 Ga 534, 150 SE2d 653 (1966).

A shareholder's common law right to inspect corporate books flows from the shareholder's proprietary interest in the corporation.

> Although there may be reasons of public policy why the stockholders of a corporation should have the right to examine its books and records, the primary basis for that right is not one of public policy, but the private and proprietary interest of stockholders, as owners of the corporation. (footnotes omitted) *Campbell v. Ford Industries, Inc.*, 274 Or 243, 249-50, 546 P2d 141, 145 (1976).

"Statutes providing for a shareholder's right of inspection have been construed as enlarging or extending the common law right rather than as a restriction or abrogation of the right of inspection." *Tucson Gas & Electric Co. v. Schantz,* 5 Ariz App 511, 428 P2d 686, 688-9 (1967). Cases hold that the shareholder's common law right to inspect records can only be taken away by a specific statutory enactment. *Rainbow Navigation, Inc. v. Pan Ocean Navigation, Inc.,* 535 A2d 1357, 1359 (Del Super 1987).

Courts have held that the right to inspection goes beyond the documents set out in the statute.

> the term 'records and books of account,' as in the earlier Illinois Act, and the term 'books and records of account,' as in the subsequent Illinois Business Corporation Act (upon which the Model Business Corporation Act was based), were both held by the Illinois courts not to be limited to 'books and records of account' in any 'ordinary,' literal or otherwise limited sense, but to be the subject of a broad and liberal construction so as to extend to all records, contracts, papers and correspondence to which the common law right of inspection of a stockholder may properly apply.
>
> We believe that the same broad and liberal interpretation of this provision of the Model Business Corporation Act was intended by the members of the committee which drafted that provision and which included three of the four persons who drafted

> the Illinois Act. We also believe it is proper to assume that upon the adoption of that Model Act the Oregon legislature intended that this provision of that Act should be interpreted and applied in the same manner as intended by the drafters of that Model Act. (footnote omitted) *Meyer v. Ford Industries, Inc.*, 272 Or 531, 541, 538 P2d 353 (1975)

More recently, the Alaska Supreme Court has said:

> The statutory phrase "books and records of account" encompasses monthly financial statements, records of receipts, disbursements and payments, accounting ledgers, and other financial accounting documents, including records of individual executive compensation and transfers of corporate assets or interests to executives. Such information is crucial to the shareholders' ability to monitor the performance of their corporate agents and protect their interests as shareholders. (footnote omitted) *Pederson v. Arctic Slope Reg'l Corp*., 331 P3d 384 (Ak 2014).

The right to inspection applies to current shareholders, but not former shareholders. *Biberstine v. New York Blower Co.*, 625 NE2d 1308 (Ind App 1993); *Application of Nash,* 11 Misc2d 768, 175 NYS2d 938 (1958). It applies whether or not the shareholder has paid for the shares or the certificates have been issued. *Babbitt v. Pacco Investors Corp.*, 246 Or 261, 425 P2d 489 (1967).

Courts previously differed on whether an equitable owner of shares had inspection rights. *Shaw v. Agri-Mark, Inc.,* 663 A2d 464 (Del Supr 1995) (no right to inspect); *Texas Infra-Red Radiant Co. v. Erwin,* 397 SW2d 491 (Tex Civ App 1965) (right to inspect). But many statutory inspection statutes now specifically provide that some beneficial owners have inspection rights. *See* ORS 60.774(6); *Cent. Laborers Pension Fund v. News Corp.,* 45 A3d 139, 143-4 (Del 2012).

A subscriber who is never issued a stock certificate and whose shares are not registered in the records of the corporation does not has a statutory inspection right, but may seek injunctive relief such that the corporation records reflect that share ownership. *Yeoman v. Public Safety Center, Inc.,* 241 Or App 255, 267, 250 P3d 411 (2011).

***B. Proper purpose*.**

At common law, there was no requirement that there be any particular dispute before a shareholder became entitled to inspect corporate records. *Lake v. Buckeye Steel Casting Co.,* 2 Ohio St2d 101, 206, NE2d 566 (1965); *Homestead Mining Co. v. Superior Court of San Francisco,* 11 Cal App2d 488, 54 P2d 535, 539 (1936) (shareholder may even be on only a fishing expedition).

ORS 60.774(1) grants shareholders an unconditional right to inspect those records required to be kept by ORS 60.771(5):

> (a) The articles or restated articles of incorporation and all amendments to the articles of incorporation or restated articles of incorporation that are currently in effect;
>
> (b) The corporation's bylaws or restated bylaws and all amendments to the bylaws or restated bylaws that are currently in effect;

> (c) Resolutions that the corporation's board of directors adopts to create one or more classes or series of shares and fixing the relative rights, preferences and limitations for each class or series, if shares issued pursuant to those resolutions are outstanding;
>
> (d) The minutes of all shareholders' meetings and records of all action that shareholders take without a meeting, for the past three years;
>
> (e) All written communications to shareholders generally within the past three years;
>
> (f) A list of the names and business addresses of the corporation's current directors and officers; and
>
> (g) The corporation's most recent annual report delivered to the Secretary of State under ORS 60.787.

Other corporate records may be inspected only if the "shareholder's demand is made in good faith and for a proper purpose." ORS 60.774(3)(a). These records are set out in ORS 60.774(2):

> (a) Excerpts from minutes of any meeting of the board of directors or a meeting that a committee of the board of directors conducts while acting in place of the board of directors on behalf of the corporation, minutes of any meeting of the shareholders and records of action the shareholders, the board of directors or a committee of the board of directors takes without a meeting, to the extent not subject to inspection under subsection (1) of this section;
>
> (b) Accounting records of the corporation, including tax returns; and
>
> (c) The record of shareholders.

In addition to the records which may be inspected pursuant to ORS 60.774, common law gives a shareholder the right to inspect corporate records – the scope of which may be greater or less than the scope of records set out in the statute. As discussed above, such inspections may not require the existence of any specific dispute, but may not be initiated for an improper purpose.

If the shareholder has more than one purpose, the primary purpose must be proper.

> [W]hen seeking inspection of books and records other than the corporate stock ledger or stock list, a shareholder has the burden of proving that his purpose is proper. Since such a shareholder will often have more than one purpose, that requirement has been construed to mean that the shareholder's primary purpose must be proper; any secondary purpose, whether proper or not, is irrelevant. *Thomas & Betts Corp. v. Leviton Mfg. Co., Inc.*, 681 A2d 1026, 1030 (Del Supr1996).

The investigation of waste and mismanagement has been held to be a proper purpose. *Id; Amalgamated Bank v. Yahoo! Inc.,* 132 A3d 752 (Del Ch 2016). The valuation of shares may also be a proper purpose. *Towle v. Robinson Springs Corp.*,168 Vt 226, 719 A2d 880 (1998); *Computer Solutions, Inc. v. Gnaizda,* 633 So2d 1100 (Fla App 1994).

One court held that "improper purpose" includes inspection for nonderivative litigation and for competitive purposes. *Dynamics Corp. of America v. CTS Corporation*, 479 NE2d 1352, 1355 (Ind App 1985). Another court held that inspection should be denied where the shareholder is motivated by “disinterested malevolence.” *Tate v. Sanotone Corp.,* 272 App Div 103, 69 NYS2d 535 (1947). An inspection request is not “an invitation to an indiscriminate fishing expedition. *Security First Corp. v. U.S. Die Casting and Development Co.*, 687 A2d 563, 565 (Del Supr 1996).

But a different court held that the fact the demanding shareholder is also a shareholder in a competing corporation was not enough to deny him of his right to inspect. *Mayer v. Cincinnati Economy Drug Co.*, 89 Ohio App 512, 103 NE2d 1 (1951).

C. Burden of Proof.

Under prior versions of the inspection statute, a corporation had the burden of proof on the issue of whether the shareholder's purpose was improper. *Babbitt v. Pacco Investors Corp.*, 246 Or 261, 425 P2d 489 (1967); *Rosentool v. Bonanza Oil and Mine Corp.*, 221 Or 520, 352 P2d 138 (1960); *Bernert v. Multnomah Lumber & Box Co.*, 119 Or 44, 247 P 155, 248 P 156 (1926).

The current Act does not specifically address the burden of proof issue, but the language of ORS 60.774(3) implies that the burden of proving good faith is on the shareholder for inspection of the records set out in ORS 60.774(2) (but not necessarily other corporate records). Similar language has been so interpreted. *Amalgamated Bank v. Yahoo! Inc.,* 132 A3d 752 (Del Ch 2016); *Thomas & Betts Corp. v. Leviton Mfg. Co., Inc.*, 681 A2d 1026, 1030 (Del Supr 1996); *Riser v. Genuine Parts Co.*, 150 Ga App 502, 258 SE2d 184 (1979). *But see State ex rel Paschall v. Scott*, 41 Wash 2d 71, 74, 247 P2d 543, 545 (1952). The more widely held view appears to be:

> Once a shareholder asserts a proper purpose, the burden then shifts to the corporation to prove that an improper purpose is the primary purpose for inspection or that the shareholder's request is made in bad faith. *Towle v. Robinson Springs Corp.,*168 Vt. 226, 719 A.2d 880 (1998)(citing *Compaq Computer Corp. v. Horton*, 631 A2d 1, 3 (Del 1993)).

NOTE: Where the burden of proof falls may rest on whether the records sought are those specified in ORS 60.771(5), those specified in ORS 60.774(2), or other records for which inspection is permitted or required by common law.

***D. Court ordered inspection*.**

If a corporation denies a shareholder's request to inspect, the shareholder may seek a court order requiring inspection. ORS 60.781. If the court orders

inspection, it may impose reasonable restrictions on the use or distribution of the records. ORS 60.781(4).

If the court orders inspection, it must award the shareholder his/her costs – including reasonable attorney fees – unless the corporation proves it acted in good faith. ORS 60.781(3).

Earlier versions of this statute also awarded the shareholder a penalty payment against the corporation and those who improperly prevented access. *Meyer v. Ford Industries, Inc.*, 50 Or App 249, 622 P2d 1139 (1981); *Babbitt v. Pacco Investors Corp.*, 246 Or 261, 425 P2d 489 (1967). The present Act does not give the court specific authority to award such penalties.

A court may order inspection outside the scope of the current Act. For instance, a court may order inspection under the common law or as part of discovery under the Oregon Rules of Civil Procedure. ORS 60.774(5).

E. Inspection Rights of LLC Members.

In Oregon, a limited liability company is required to keep in its business or registered office copies of the following documents, specified in ORS 63.771(1):

> (1) Each limited liability company shall keep at an office specified in the manner provided in any operating agreement or, if none, at the registered office, the following:
>
> (a) A current list of the full name and last-known business, residence or mailing address of each member and manager, both past and present.
>
> (b) A copy of the articles of organization and all amendments thereto, together with executed copies of any powers of attorney pursuant to which any amendment has been executed.
>
> (c) Copies of the limited liability company's federal, state and local income tax returns and reports, if any, for the three most recent years.
>
> (d) Copies of any currently effective written operating agreements and all amendments thereto, copies of any writings permitted or required under this chapter, and copies of any financial statements of the limited liability company for the three most recent years.
>
> (e) Unless contained in a written operating agreement or in a writing permitted or required under this chapter, a statement prepared and certified as accurate by a manager of the limited liability company which describes:
>
> (A) The amount of cash and a description and statement of the agreed value of other property or services contributed by each member and which each member has agreed to contribute in the future;
>
> (B) The times at which or events on the occurrence of which any additional contributions agreed to be made by each member are to be made; and
>
> (C) If agreed upon, the time at which or the events on the occurrence of which the limited liability company is dissolved and its affairs wound up.

A member can inspect and copy these records, as well as "any limited liability company records" upon the member's "reasonable request." ORS 63.771(2). A member may have an agent or attorney inspect and copy these records on the member's behalf. ORS 63.777.

If the LLC does not comply with the member's request to inspect and copy, the member can apply to the circuit court for an order permitting inspection. ORS 63.781. If the court orders such inspection, it is required to order the LLC to pay the member's reasonable attorney fees incurred in bringing the action. *Id.* The court may impose reasonable restrictions on the use or distribution of the records by the demanding member. *Id.*

A shareholder's right to inspect corporate records exists independent of statute and a shareholder's common law right to inspect records may be greater than the right granted by statute. *Bernert v. Multnomah Lumber & Box Co.*, 119 Or 44, 247 P 155, 248 P 156 (1926). Presumably, a member of an LLC also has a common law right to inspection, but given the broadness of the LLC inspection statute, it is hard to imaging records inspectible under common law, but not under the statute.

Under the Oregon corporate statute, shareholder access to a corporate records can be denied where the shareholder's purpose for inspection is improper. *Babbitt v. Pacco Investors Corp.*, 246 Or 261, 425 P2d 489 (1967). The LLC's inspection provisions make no mention of proper purpose as grounds for denying inspection, but does include a "reasonable request" requirement. ORS 63.771(2).

In *Kasten v. Doral Dental USA, LLC,* 2007 WI 76, 733 NW2d 300 (2007), the Wisconsin Supreme Court analyzes in depth its state's LLC inspection statute (which is similar to Oregon's inspection statute) and concludes that members are granted broader inspection rights than are corporate shareholders. Wisconsin, like Oregon, omits a "proper purpose" requirement but includes a "reasonable request" requirement. On this requirement, the court stated:

> We read the absence of "proper purpose" language in Wis. Stat. § 183.0405(2) to indicate the drafters of the WLLCL chose not to require LLC members to demonstrate, as a threshold matter, that their inspection request is not made for an improper motive. Moreover, this interpretation is in harmony with the intent of the WLLCL drafters to favor simple default rules suitable for "mom and pop" operations. However, this does not mean that the statute is blind to a member's motive for making an inspection request.
>
> We conclude that a number of factors may be relevant to whether a request to inspect LLC records (or, here, "Company documents") was submitted "upon reasonable request." The scope of items subject to inspection under Wis. Stat. § 183.0405(2) "any ... record[s]," unless the operating agreement provides otherwise-is so broad that to permit any inspection request, no matter its breadth, could impose unreasonable burdens upon the operation of the company. Because we do not believe that the drafters intended the inspection statute to threaten the financial well being of the company, we read "upon reasonable request" to pertain to the breadth of an inspection request, as well as the timing and form of the inspection.

> We therefore conclude that one purpose of the language "upon reasonable request" is to protect the company from member inspection requests that impose undue financial burdens on the company. Whether an inspection request is so burdensome as to be unreasonable requires balancing the statute's bias in favor of member access to records against the costs of the inspection to the company. When applying this balancing test, a number of factors may be relevant, including, but not limited to: (1) whether the request is restricted by date or subject matter; (2) the reason given (if any) for the request, and whether the request is related to that reason; (3) the importance of the information to the member's interest in the company; and (4) whether the information may be obtained from another source. *Id* at 319-320.

If at least 25% of an LLC's owners live in California, those members have the inspection rights afforded by California law, even though the LLC was formed under the laws of another state. *Burkle v. Burkle*, 141 Cal App 4th 1029, 46 Cal Rptr 3d 562 (2006).

Interpreting the Operating Agreement and Delaware LLC statute which both gave members a right to inspect the "books and records" of the LLC, the Court granted a member the right to inspect the tax records, member list, and other records pertaining to the monthly valuation of the LLC's asset (an investment in a investment Fund), while denying the LLC member the right to inspect the Fund's records. *Arbor LP v. Encore Opportunity Fund, LLC,* 2002 WL 205681 (Del Ch). The Fund was a separate entity with its own board and with owners other than the LLC.

In *Kinkle v. RDC, LLC,* 889 So2d 405 (La App 2004), the court held that the Estate of a deceased member is entitled to a proportionate share of profits, losses and distributions associated with that membership interest, but is not entitled to other rights of membership unless admitted as a substitute member. Thus, the Estate had no right to inspect the LLC's books and records nor did the Estate have a right to an accounting.

Merovich v. Huzenman, 911 So 2d 125 (Fl Ct App 2005) holds to the contrary, but that holding is based upon a statute that specifically includes an estate of a deceased member (Oregon's statute does not).

The closest LLC case law in Oregon on inspection rights of an assignee is *Law ex rel. Robert M. Law Profit Sharing Plan v. Zemp*, 276 Or App 652, 368 P3d 821 (2016), which held that the trial court exceeded its authority in issuing a charging order on behalf of an assignee (judgment creditor) ordering inspection. The LLC inspection statute itself was not discussed.

One case held that a former LLC member has the right to inspect records related to tax matters for the period in which the former member was liable for a proportionate share of the tax associated with LLC's profits. *Abdalla v. Qadorh-Zidan,* 913 NE2d 280 (Ind App 2009).

Section 4.07 Shareholder Agreements in Close Corporations

***A. Statutory requirements*.**

Since 1993, a close corporation has been able to adopt procedures otherwise inconsistent with the Oregon Business Corporation Act by means of a shareholder agreement complying with the requirements of ORS 60.265. ORS 60.265(1) provides that such an agreement:

> is effective among the shareholders and the corporation, and binding on the board of directors, if the agreement complies with this section and it:
>
> (a) Restricts the discretion or powers of the board of directors;
>
> (b) Establishes who shall be directors or officers of the corporation or establishes their terms of office or manner of selection or removal;
>
> (c) Governs, in general or in regard to specific matters, the exercise or division of voting power by or between the shareholders and directors or by or among any of them, including use of weighted voting rights or director proxies;
>
> (d) Establishes the terms and conditions of any agreement for the transfer or use of property or the provision of services between the corporation and any shareholder, director, officer or employee of the corporation or among any or them; or
>
> (e) Requires dissolution of the corporation at the request of one or more of the shareholders or upon the occurrence of a specified event or contingency.

For such an agreement to be effective, either: (i) it must be approved by all persons who are shareholders at the time and be set out in the articles or the bylaws; or (ii) it must be a written agreement signed by all persons who are shareholders at the time of the agreement and the agreement must be made known to the corporation. ORS 60.265(2)(a).

Amendment of such a shareholder agreement requires unanimous consent of all shareholders, unless the agreement provides otherwise. ORS 60.265(2)(b). The agreement is valid for ten years, unless the agreement provides otherwise. ORS 60.265(2)(c).

Such a shareholder agreement ceases to be effective if the shares of a corporation's stock become publicly traded on a national exchange or NASDAQ. ORS 60.265(4).

If such an agreement is adopted, share certificates must conspicuously note the existence of the agreement. ORS 60.265(3). The existence of such an agreement may shift liability for certain discretionary acts from the directors to the shareholders. ORS 60.265(5). ORS 60.265(6) reaffirms the limited liability of shareholders, even though such an agreement has been adopted and/or the shareholders fail to observe usual corporate formalities.

***B. History*.**

In 1983, a Supplement to the Revised Model Business Corporation Act was

adopted related to close corporations. If adopted by a state, the "Close Corporation Supplement" would allow that state's close corporations to radically change their own rules of corporate governance. For instance, the Supplement would permit close corporations to dispense with a board of directors and would permit the shareholders to directly manage the corporation.

The Close Corporation Supplement is discussed in Kessler, *The ABA Close Corporation Statute*, 36 MERCER L REV 661 (1985); *Statutory Needs of Close Corporations - An Empirical Study: Special Close Corporation Legislation or Flexible General Corporation Law*, 10 J CORP L 849 (1985).

In 1993, the Business Corporation Act Task Force of the Oregon State Bar Business Section ("1993 Task Force") submitted a bill to the Oregon legislature proposing special provisions for close corporations. This bill was much narrower than the Supplement and became even narrower when the 1993 Task Force withdrew its support from previously submitted sections which permitted a close corporation to completely eliminate its board of directors, to allow disproportionate distributions, or to modify its management authority.

In legislative committee testimony submitted by Andrew J. Morrow, Jr. on behalf of the 1993 Task Force, he noted:

> At one time, the Business Corporation Act Task Force of our Section considered adoption of the Close Corporation Supplement to the Model Business Corporation Act. This was a series of statutory sections which would have modified provisions applicable to business corporations to accommodate the needs of closely held corporations. The supplement was not widely adopted elsewhere, and we did not consider it appropriate for adoption in Oregon, although there are several other states which have special statutes applicable to closely held corporations.
>
> More recently, the ABA Business Law Section Committee on Corporate Laws recommended changes in two areas to accommodate the needs of closely held corporations. These changes were included as Sections 4, 10, 14 and 15 of this Bill as introduced. The Model Act changes basically fall into two areas. Section 14 of the Bill, and the cross-references added by Section 4, allow for shareholder agreements that modify the usual corporate procedures and allocation of power among shareholders and directors. Section 15, and the accompanying notice requirements in Section 10, would have provided a procedure for resolution of judicial action to dissolve a corporation by allowing the corporation pr its shareholders to buy out the interests of the shareholder petitioning for dissolution, either at an agreed price or, if the parties are unable to agree, at a fair value determined under the supervision of the court. After further consideration, we recommend that the Committee amend the Bill to eliminate Sections 10 and 15.
>
> These procedures deserve further consideration before being adopted in Oregon.
>
> The list of corporate procedures which may be modified by a shareholders' agreement under Section 14 of the Bill was relatively extensive, and the Task Force received comments suggesting modifications to the list. The proposed amendments would delete the provisions permitting shareholders to eliminate a board of directors; to allow disproportionate distributions, or to modify generally management authority for the corporation. The provisions which remain would allow weighted voting rights, director's proxies (which are presently prohibited), and establishment of procedures

> for selecting directors or officers which differ from shareholder voting at a meeting. The provisions would allow closely held businesses more flexibility in allocating management responsibility and control than is allowed under the usual structure, but the amendments would be less expansive in this regard than the original proposals. While many of these objectives can generally be accomplished using existing corporate procedures, the process is often complex, involving special classes of shares with broader voting rights, voting agreements or other mechanisms. The amendments contained in the section would allow those corporations to accomplish their desired business management and control objectives more simply and efficiently. (May 10, 1993 testimony of Andrew J. Morrow, Jr. before the Oregon Senate Judiciary Committee, Exhibit H to SB 230).

The bill passed the legislature and was signed by the Governor. It went into effect at the end of 1993 as ORS 60.265.

ORS 60.265(1) contains fairly broad language which permits such a shareholder agreement to include language regarding "the exercise or division of voting power by or between the shareholders and directors or by or among any of them." This language should be read in light of the fact the legislature considered – but did not adopt – provisions permitting a close corporation to eliminate its board of directors. There are no reported Oregon cases which decide how much reallocation of power from directors to shareholders would constitute effective elimination of the board of directors.