

GRADER'S GUIDE

*** QUESTION NO. 5 ***

SUBJECT: BUSINESS LAW

1. Right to Information (40 points)

This question asks the examinee to discuss the respective rights of a shareholder and director to review corporate records and to inspect a corporation's business premises.

Bob is both a shareholder and director of the corporation. The right of a director to inspect corporate records is absolute so Bob would rely on his status as a director to demand inspection of corporate records. Pursuant to AS 10.06.450(d), "A director has the absolute right at a reasonable time to inspect and copy all books, records, and documents of every kind and to inspect the physical properties of the corporation. . . ." Consequently, Bob has an absolute right to inspect all of the information requested and has a right to visit and inspect the business premises. Alaska law does not include any specific requirements for a director to make demand for inspection and requires only that inspection be at a reasonable time. Bob called Art, the president of AAI and the person in control of the business records, in an effort to make arrangements to inspect the corporation's records. The facts indicate that Bob was agreeable to Art providing copies of AAI's records for Bob's review. Thus, Bob did not demand inspection at an unreasonable time. Whether Bob's later appearance at the shop to demand inspection of the premises was at a reasonable time is a closer call. The facts explain that Bob arrived after business hours. On the one hand, inspection at this time would avoid any interference with the corporation's business. On the other hand, it may require Art or other employees to remain at the business after hours.

Cindy is a shareholder only of the corporation. Pursuant to AS 10.06.430(b), a corporation has an obligation to make its books and records of account "reasonably available for inspection and copying at the registered office or principal place of business in the state by a shareholder of the corporation." The statute provides that, "Shareholder inspection shall be upon written demand stating with reasonable particularity the purpose of the inspection. . . Only books and records of account, minutes, and the record of shareholders directly connected to the stated purpose of the inspection may be inspected or copied." AS 10.06.430(b). While Cindy has a right to inspect the financial statements of the corporation, she does not necessarily have a right to inspect "all other documents relating in any way to the business of the corporation." The statute limits a shareholder's inspection right to the inspection of

books and records of account. Also, Cindy has not made a proper demand to inspect the records because: (1) she has not made a written demand, and (2) she has not stated with reasonable particularity her purpose for wanting to inspect the records. Cindy's status as an owner of the corporation does not provide the corporation with any meaningful information to determine whether Cindy's purpose for inspection is proper or for determining the scope of the information that would be directly connected to the purpose. Thus, Cindy has not made a proper demand to inspect the financial statements of the corporation. Finally, while directors have an absolute right to inspect a corporation's business premises, Alaska statute does not provide this right to shareholders. Thus, Cindy did not have a right to inspect the business premises.

2. New Business; Enforcement of the BCI Contract. (60 points)

This question raises the issue of ultra vires acts. Under Alaska law, a corporation may be organized for any lawful purpose. AS 10.06.005. A corporation's articles of incorporation may contain a provision restricting the business in which the corporation may engage, however. AS 10.06.210(g). AAI's articles of incorporation contained such a restriction. The facts state that the purpose of corporation was to engage in the business of repairing cars. Under state law, a corporation is authorized to exercise all powers necessary or convenient to carry out the purposes for which the corporation is organized. AS 10.06.010. Thus, AAI was not authorized to conduct the computer repair business. Consequently, while the board of directors authorized Art to conduct the day-to-day business of the corporation, Art was not authorized to expand the business of the corporation beyond the purposes stated in the articles of incorporation. Art was limited to exercising powers necessary or convenient to carry out the car repair business only.

Ultra vires acts are "acts beyond the scope of power allowed or granted by a corporate charter or by law." Black's Law Dictionary (7th ed. 1999); *see also Stevens By and For Benefit of Park View Corp. v. Richardson*, 755 P.2d 389, 392 (Alaska 1988) (noting in dicta that an act that does not benefit the corporation is ultra vires as a waste of corporate assets). AAI's articles of incorporation clearly limit AAI's business to that of repairing cars. Art's execution of the BCI contract was beyond the scope of power granted AAI by its articles of incorporation.

Nonetheless, the BCI contract is not invalid and unenforceable merely because Art exceeded the corporation's business purpose in entering into the agreement, purportedly as the president of the corporation. Rather, it is subject to being set aside and its performance enjoined by a court. AS 10.06.015 provides, in relevant part:

(a) An act of a corporation . . . otherwise lawful, is not invalid because the corporation was without capacity or power to do the act . . . , but the lack of capacity or power may be asserted

(1) in an action by a shareholder against the corporation to enjoin the doing of an act . . . ; if the unauthorized act or transfer sought to be enjoined is being, or is to be, performed or made under a contract to which the corporation is a party, the court may, if all of the parties to the contract are parties to the action, set aside and enjoin the performance of the contract, and in so doing may allow to the corporation or to the other parties to the contract, compensation as may be equitable for the loss or damage sustained by any of them from the action of the court in setting aside and enjoining the performance of the contract; however, anticipated profits to be derived from the contract may not be awarded by the court as a loss or damage sustained;

. . . .

Thus, Cindy's remedy would be to pursue an action against the corporation and BCI to enjoin enforcement of the contract. However, Cindy may assert the lack of AAI's authority to enter into the contract only if the third-party (BCI) has not acquired rights under the contract for the reason that the contract was authorized or ratified by AAI's board of directors, or was done within the scope of Art's authority, actual or apparent, conferred by AAI's board, or was within the agency power of Art, as the president of AAI. AS 10.06.020;¹ AS 10.06.025(a).²

¹ AS § 10.06.020, states: A limitation upon the powers of the shareholders, officers, or directors, or the manner or exercise of their powers, contained in or implied by the articles of incorporation, bylaws, or action of the board . . . may not be asserted as between the corporation or a shareholder and a third person, except in a proceeding (1) by a shareholder or the state to enjoin the doing or continuance of unauthorized business by the corporation or its officers, or both, in a case where a third party has not acquired rights under AS 10.06.025(a). . . ."

² AS 10.06.020, states: (a) A contract or conveyance made in the name of the corporation that is authorized or ratified by the board, or is done within the scope of the authority, actual or apparent, conferred by the board or within the agency power of the officers executing it, except as the board's authority is limited by law, binds the corporation, and the corporation acquires rights under the contract, whether the contract is executed or is wholly or in part executory.

The facts indicate that the board of directors had not authorized the contract with BCI and do not include any facts supporting a finding that the board ratified the contract.

Execution of the contract was not done within Art's authority, actual or apparent. Actual authority is created by "written or spoken words or other conduct of the principal which, reasonably interpreted, causes the agent to believe that the principal desires him to so act on the principal's account. *Sea Lion Corp. v. Air Logistics of Alaska, Inc.*, 787 P.2d 109, 117, n.3 (Alaska 1990). Art did not obtain authorization from the board of directors to conduct the new business or to enter into the BCI contract and the facts do not indicate any other action by the board that would permit a finding of actual authority. Apparent authority is "the power to affect the legal relations of another person by transactions with third persons, professedly as agent for the other, arising from and in accordance with the other's manifestations to such third persons." Restatement (Second) of Agency §8. Apparent authority is created "as to third persons by written or spoken words or other conduct of the principal which, reasonable 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." *Sea Lion*, 787 P.2d at 117, n.3. The facts state that Art provided BCI with a copy of AAI's minutes evidencing that Art was the president of AAI. However, Art also provided a copy of AAI's articles of incorporation to BCI. The facts do not state that there were any other expressions of Art's authority to execute the contract. The restriction in the articles, reasonably interpreted, should have led BCI to question whether Art had authority to execute contract to provide computer repair services.

Consequently, Cindy would have a strong argument that the court should set aside or enjoin enforcement of the contract. If the court set aside or enjoined enforcement of the contract, BCI would have a right to damages resulting from the consequent breach of the contract by the corporation, however. Cindy would then want to proceed against Art for the loss suffered by the corporation.