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Report of the Corporation, Banking and Business Law Committee to the Colorado Bar Association Board of Governors

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REPORT OF THE CORPORATION, BANKING AND BUSINESS LAW COMMITTEE TO THE COLORADO BAR ASSOCIATION BOARD OF GOVERNORS

at Aspen, Colorado — September 7, 1956



Robert S. Gast, Chairman

The Committee hereby submits to the Board of Governors, with unqualified recommendation for its approval, the Colorado Business Corporation Act as studied and drafted by your Committee during the past eight months.

In general, the proposed new corporate statute is based upon the 1953 revision of the Model Business Corporation Act adopted by the American Bar Association and supplemented by further revisions, alternative provisions, and optional sections adopted by the Committee of Corporate Laws of the American Bar Association in 1955.

The corporation law of the State of Colorado has been amended from time to time in a piecemeal fashion in an effort to modernize the law and bring our corporate statutes to date. A good example of this is the various amendments to the corporate law found in the 1955 Session Laws of Colorado. Although such amendments have served in part to broaden and liberalize Colorado corporate law, they have done little to clarify the meaning of our statutes on such important problems as dividends, the ultra vires doctrine, and the protection of corporate names. Much of the present Colorado law on corporations is vague and confusing. Some provisions serve no legitimate purpose in modern corporate practice. Some law which should be clearly defined by statute is omitted.

In your Committee's opinion the proposed Colorado Business Corporation Act is far superior to the present Colorado Statutes. It retains much of the concise, clear wording of the Model Business Corporation Act of the A.B.A., which has now been adopted with amendments as the statutory law of Wisconsin (1951), Oregon (1952), District of Columbia (1954), Texas (1955), and Virginia (1956). Where Colorado law or practice appeared preferable to those policies set forth in the Model Code, we have retained such sections in the proposed statute submitted to you. Where the Model Code overlapped into other fields of law, such as taxation and titles to real estate, your Committee has consulted with the

Colorado Bar Association Committee on Taxation and Real Estate Standards to obtain recommendation on franchise taxes, license fees, filing fees, and recording data for title examination. We have incorporated the best of such recommendations into the final draft.

It would be impossible in this report to discuss in detail each provision of the proposed Act and analyze it as to existing Colorado law. However, we should like to highlight certain portions of the Act as it modifies and clarifies existing Colorado law, and then explain in general certain features of the Model Act which the Committee has deleted as being contrary to modern corporate practice in Colorado.

Under the proposed Act, Corporations may be organized for any lawful purpose excepting banks, insurance companies, savings and loan associations, non-profit and religious corporations, and those special corporations such as mining, ditch and reservoirs, and title and guaranty companies which are governed by specific statutes applying to particular corporations. However, it is made clear that the proposed Act shall apply to corporations of every class and character to the extent the Act is not inconsistent with the special corporate statutes.

Under the proposed Act, corporations have broad general powers, including the power to operate and own property outside the State of Colorado, and the Act specifically provides that such powers granted by statute need not be set forth in the Articles of Incorporation. This, of course, changes existing Colorado law in that a corporation cannot operate out of the State unless the

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Sincerely,

ROBERT T. HAINES, President

Articles of Incorporation so provide, and then it is necessary to state where the books and stock records will be kept. In connection with corporate powers, your Committee broadened the Model Act by incorporating in the proposed Act the power of the corporate entity to enter into partnerships, joint ventures, syndicates, and the like.

The proposed Act provides that ultra vires acts by officers and directors of a corporation shall not invalidate contracts or conveyances. For such ultra vires acts, the statute provides three remedies: (a) a cause of action by the corporation against the officers and directors; (b) the Attorney General may dissolve the corporation; (c) the injured party may get damages in an action for injunction before performance of the contract. This modification of the common law doctrine prohibits a corporation from voiding its own contracts with innocent third parties.

Under the proposed Act each domestic and foreign corporation must maintain a registered office and registered agent in the State of Colorado and process may be served on the registered agent or, if he cannot be found, upon the Secretary of State. However, this is not exclusive and process may also be served in the manner provided by the Colorado Rules of Civil Procedure.

In the proposed Act, promissory notes and future services are excluded as consideration for the issuance of stock either as payment or part payment for such stock. The preemptive right to subscribe for additional stock is made specifically applicable to treasury shares as well as unissued shares and may be limited or denied to the extent provided in the articles of incorporation and a corporation may issue or sell shares of stock to officers and employees without like offering to the other shareholders on terms approved by two-thirds of the shareholders entitled to vote.

The proposed Act abolishes the necessity for the publication in a newspaper of a notice of special or annual stockholders' meetings and provides merely for the mailing of a written notice of such meetings not less than ten and not more than fifty days before said meetings.

Although the Model Act as originally adopted made cumulative voting mandatory, your Committee in the proposed Act has made this permissive only to the extent set forth in the articles of incor-

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poration, and has made appropriate amendments to the Model Act so that cumulative voting is denied when the articles of incorporation are silent as to this right.

The proposed Act leaves the number and election of directors up to the bylaws of the corporation unless otherwise provided in the Articles of Incorporation with the proviso that vacancies created by amending the bylaws to increase the number of directors must be filled by the stockholders rather than the directors as under present Colorado law.

Under the Model Act, dividends may be declared and paid only out of the unreserved and unrestricted earned surplus of the corporation. Your Committee decided to liberalize this provision in accordance with other state statutes, such as Illinois, and incorporate a provision whereby dividends may be paid out of paid-in surplus or surplus arising from the surrender to the corporation of any of its shares, or surplus arising from the reduction of par value of any outstanding stock. Although under the proposed Act and present Colorado law it is illegal for the board of directors to declare a dividend when the corporation is insolvent, the Committee removed from the present Colorado law the joint and several personal liability of directors for all debts of the corporation arising from the declaration of such illegal dividend.

The Model Act prohibits loans by the corporation to its officers and directors and makes the directors individually liable for the amount of any such loan to an officer or director. Your Committee believed that as a practical matter, many small closely-held corporations often make loans to the officers and directors, and such practice was unobjectionable. The Committee thus deleted this restrictive provision from the proposed Act.

The proposed Act provides that only a person who has been a shareholder of record for six months and who shall be the holder of at least 5% of all outstanding shares of the corporation shall have the unlimited right to inspect the books and records of the corporation. However, any shareholder may apply to any court for permission to inspect the books and records of a corporation for a legitimate purpose. This appears more desirable than present Colorado laws which permit any stockholder to demand access to the books and records of a corporation. Also, the proposed Act

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permits any stockholder to request the most recent financial statement of a corporation whereas present Colorado law grants this right only to a shareholder owning 15% or more of the capital stock of the corporation.

Your Committee has also deemed it wise to delete from the proposed Act those provisions of the Model Act which require \$1000 paid-in capital before the corporation can begin its business.

Broad powers of amendment are included within the proposed Act and it is possible to amend the articles of incorporation to change the objects and purposes of the corporate entity. We have changed the Model Act to permit stockholders as well as directors to instigate action on amendments to the articles by calling the necessary stockholders' meeting.

The proposed Act separates the merger or consolidation of inter-domestic corporations from domestic with foreign corporations. The result is that both situations are much clearer than under present Colorado law, and existing conflicts are eliminated as to the number of shareholders required to approve the merger or consolidation. Under the proposed Act, the dissenting shareholder must make his written demand for payment within 10 days after the vote is taken on the merger or consolidation. Value of his stock is determined as of a day prior to the vote upon the merger or consolidation, and if value cannot be agreed upon, Courts are resorted to rather than three appraisers as under present Colorado law. This serves to shorten the time for the dissenting stockholder to make his demands known and alleviates the unfair benefit of the "wait and see" period now existing under Colorado law.

The proposed Act arms the State of Colorado with the weapon of involuntary dissolution in the event the corporation exceeds its authority, fails to appoint a registered agent, or fails to pay its franchise tax or make annual reports. The Committee has deleted from the proposed Act provisions of present Colorado law relating to \$1000 liability of officers and directors at the suit of any creditor and relating to stay of proceedings on motion of an adversary being sued by the corporation where the corporation has failed to file annual reports. The Committee has retained the provision for the Secretary of State to declare a corporation defunct and inoperative upon failure to pay franchise taxes or make annual reports for a period of two years.

With the approval of the Secretary of State of Colorado, your Committee has drastically changed the franchise tax, license fees, and filing fees for domestic and foreign corporations. The proposed Act abolishes the present Colorado license fees and the license fees proposed by the Model Code. It was felt that license fees duplicated the proposed annual franchise tax. The filing fees for articles of incorporation were established at \$25 for all corporations regardless of size of the corporation or authorized capitalization. The annual franchise tax for all corporations was established at \$20,

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regardless of the size of the corporation or its authorized capital. Your Committee has been assured that these uniform fees and taxes will not result in any decreased revenue to the State of Colorado. Collection of the franchise tax by the Colorado Department of Revenue by applying the first \$20 paid by a corporation on its Colorado State Income Tax to the Secretary of State for franchise taxes and incorporating the annual report into the State Income Tax Return was seriously considered, and although this met with the approval of the Director of Revenue, your Committee believed such a drastic innovation at this time should not be incorporated in the proposed Act.

We have attempted here to cover only certain highlights of the proposed Act. Space limitations prohibit outlining the treatment of foreign corporations, liquidations, dissolution, sale of assets and other matters therein set forth. Suffice it to say that all such subjects are covered with extreme clarity by the proposed Act without basic fundamental changes of existing Colorado law.

I should like to express my deep appreciation to Charles A. Baer, who acted as Secretary of the Committee; to the three subchairmen, Keith Anderson, Harl G. Douglass and Martin Harrington, each of whom had the responsibility of analyzing in written reports various portions of the Model Code; and to Claude Maer, Richard M. Davis, Robert Charlton and other Denver members of the Committee, who gave liberally of their time and experience in drafting the proposed Act and proofreading the final product. I am grateful for their assistance in making this report possible.

Respectfully submitted,

ROBERT S. GAST
Chairman of Corporation,
Banking, and Business Law
Committee

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