

## RESOLUTION 10-02-2012

### DIGEST

#### Corporate Distribution: Preferential Rights

Amends Corporations Code section 402.5, subd. (c) to allow distribution to common shareholders even where corporate assets are insufficient to pay dividends to senior shares or honor liquidation preferences.

### RESOLUTIONS COMMITTEE RECOMMENDATION

#### APPROVE IN PRINCIPLE

#### History:

No similar resolutions found.

#### Reasons:

This resolution amends Corporations Code section 402.5, subd. (c) to allow distribution to common shareholders even where corporate assets are insufficient to pay dividends to senior shares or honor liquidation preferences. This resolution should be approved in principle because it corrects an oversight created in the recent rewriting of the statutory scheme (AB 571), and it does not change existing law.

The resolution seeks to clean up an oversight recently created when Corporations Code sections 500 and 503 were amended and section 502 was repealed. It clarifies that section 402.5(c)'s reference should now be to section 500---not sections 502 and 503---regarding the right of a corporation, secured by Corporations Code section 402.5, to provide in its articles of incorporation the option to make distribution to common shareholders even if the corporate assets are insufficient to pay dividend or liquidation preferences to shares with superior dividend or liquidation rights. It provides a needed change in the reference to make clear that the right secured by Corporation Code section 402.5---to allow the articles of incorporation to waive the restriction on corporate distribution to junior shares where senior shareholder preferential rights are not met in full---alludes to the new Corporations Code section 500, where the restriction now appears, and not to Corporations Code section 502, which was repealed, nor Corporations Code section 503, which now concerns an unrelated subject.

### TEXT OF RESOLUTION

RESOLVED, that the Conference of California Bar Associations recommends that legislation be sponsored to amend Corporations Code section 402.5 to read as follows:

- 1 § 402.5
- 2       The rights, preferences, privileges, and restrictions granted to or imposed upon a class or
- 3 series of preferred shares (Section 176) the designation of which includes either the word
- 4 "preferred" or the word "preference" may:
- 5       (a) Notwithstanding paragraph (9) of subdivision (a) of Section 204, include a provision
- 6 requiring a vote of a specified percentage or proportion of the outstanding shares of the class or
- 7 series that is less than a majority of the class or series to approve any corporate action, except
- 8 where the vote of a majority or greater proportion of the class or series is required by this

9 division, regardless of restrictions or limitations on the voting rights thereof.

10 (b) Notwithstanding paragraph (5) of subdivision (a) of Section 204, provide that in  
11 addition to the requirement of subdivision (a) of Section 1900 the corporation may voluntarily  
12 wind up and dissolve only upon the vote of a specified percentage (which shall not exceed 66 2/3  
13 percent) of such class or series.

14 (c) Provide that a distribution may be made without regard to any preferential dividends  
15 arrears amount and/or any preferential rights amount as described in Section 500 ~~Section 502 or~~  
16 ~~503 not apply in whole or in part with respect to distributions on shares junior to the class or~~  
17 ~~series.~~

(Proposed new language underlined, language to be deleted stricken)

**PROPONENT:** Sacramento County Bar Association

### **STATEMENT OF REASONS**

Existing Law: Prior to January 1, 2012, Corporations Code sections prohibited corporate distributions to junior shares if after the distribution the remaining assets of the corporation are insufficient to pay the dividend preferences or liquidation preferences of shares with superior dividend or liquidation rights. Corporations Code section 402.5, subdivision (c), authorizes the corporation to waive this restriction by including a provision in the articles of incorporation stating that section 502 or 503 not apply in whole or in part. Effective January 1, 2012, section 502 was repealed and section 503 was amended so that it addresses a completely unrelated subject. Also effective January 1, 2012, section 500 was amended to include restrictions similar to former sections 502 and 503 but with new defined terms. Section 402.5, subdivision (c), was not amended to reflect the changes to sections 500, 502 and 503.

This Resolution: This resolution proposes to amend Corporations Code section 402.5 at subdivision (c) so it contains the correct statutory reference to section 500 of the Corporations Code and includes the terms defined in section 500.

The Problem: Corporations Code section 402.5, subdivision (c), was not appropriately amended at the time sections 500, 502 and 503 of the Corporations Code were amended and the subdivision now incorrectly references sections 502 and 503. More importantly, corporate documents submitted to the California Secretary of State for filing that include the incorrect language from section 402.5, subdivision (c), are being rejected because the statutory references are nonexistent or incorrect.

### **IMPACT STATEMENT**

This resolution does not affect any other law, statute or rule.

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