

STOCKHOLDER'S LIABILITY WHEN A CORPORATION ILLEGALLY REDUCES ITS STATED CAPITAL IN ORDER TO REPURCHASE HIS SHARES

I. INTRODUCTION

When a corporation illegally reduces its stated capital in order to repurchase the shares of a stockholder,¹ substantial unrest results. The remaining shareholders are disturbed since a part of their investment has been diverted to a particular shareholder. Creditors are disturbed since stated capital, which in theory represents a "cushion" to secure their debts and on which they had a right to rely,² has been "raided." The imposition of liability on the selling shareholder is an attempt to remove the unrest by restoring the stated capital to its originally intact status. A liability statute, however, must do much more than determine who is entitled to the illegally withdrawn assets. It should provide a method of deterring individuals from that activity which may lead to the unrest which the legislature is seeking to avoid.

Even when stated capital is not reduced, the repurchase procedure in itself can lead to specific dangers.

[M]any abuses are made possible by permitting a corporation to deal in its own shares. There is no doubt that such power "is a fruitful source of unfairness, mismanagement and corruption." The purchase of its own shares may be a method of secret withdrawal and reduction of current assets to the prejudice of creditors and holders of prior securities, a method of favoritism to insiders, or of speculation with corporate funds and the creation of artificial market prices.³

To minimize these dangers, legislatures often impose very tight controls on the corporation's dealings in its own securities.⁴ The statute may require shareholder consent to reduce capital,⁵ or may demand public notification of the capital reduction.⁶ Many statutes insist that the corporation refrain from any purchase that might lead to a capital impairment.⁷ Another way in which the legislature can discourage these dangers is through the imposition of sanctions on violators of the statutory requirements for repurchase of shares and reduction of capital. Standards of liability are set out for the director who consents to the transaction and for the shareholder who

¹ This will normally be done by releasing funds from stated capital and thereby creating a "surplus" with which the corporation makes the repurchase.

² *Kimbrough v. Davies*, 104 Miss. 723, 735, 61 So. 697, 698 (1913); *Whittaker v. Weller*, 8 Wash. 2d 18, 111 P.2d 218 (1941). But see *Latty*, Some Miscellaneous Novelties in the New Corporation Statutes, 23 Law & Contemp. Prob. 363, 364 (1958).

³ 1 *Ballantine & Sterling*, California Corporation Laws 298 (4th ed. 1962), as cited in *England v. Christensen*, 243 Cal. App. 2d 478, 488 n.17, 52 Cal. Rptr. 402, 408 n.17 (1966).

⁴ See, e.g., Cal. Corp. Code § 25507 (West 1955).

⁵ Del. Code Ann. tit. 8, § 244(a) (1953).

⁶ N.J. Stat. Ann. § 14:11-5 (1939).

⁷ See, e.g., Del. Code Ann. tit. 8, § 160 (1953); Wash. Rev. Code Ann. § 23.01.120(2) (1961); W. Va. Code Ann. § 3051 (1961).

is the recipient of the illegal withdrawal of assets.⁸ It is upon the latter liability that this comment will focus.

II. STRICT LIABILITY

The strictest standard of liability under present day corporate codes is that which requires the shareholder to return what he received regardless of his knowledge of the illegal processes that led to the distribution to him. Suppose the shareholder sells his shares on the open market without knowing the identity of the purchaser or without knowing that his sale was part of a series of events which led to a capital impairment. Should he be held liable? An argument in favor of imposing liability in this situation is that it provides the easiest way to restore all parties to the status quo. When the shareholder simply returns the proceeds he received in exchange for his shares, the stated capital is, in effect, restored intact, so that the investment of the creditors and other shareholders is no longer subject to any greater risk than they bargained for. It might also be argued that there is a direct relation between the strictness of the standard of liability and the deterrence of the evils which the legislature is seeking to avoid; the heavier the standard of liability imposed, the more likely will the parties be discouraged from entering the illegal transaction. Before evaluating the soundness of these arguments, an examination will be made of the strict liability statutes as they exist today.

In Minnesota, if the corporation uses nonsurplus funds to purchase a shareholder's shares,⁹ the latter receives an "unlawful distribution" for which he is individually liable under all circumstances.¹⁰ Several other states impose the same absolute standard.¹¹ Some legislatures, on the other hand, while still imposing liability on the shareholder independent of his state of mind, subject this liability to one or more of the following conditions: (1) insolvency of the corporation, (2) publication of capital reduction, (3) director's primary liability, and (4) director's contribution.

Massachusetts, for example, provides that when a corporation makes any distribution to a shareholder, whether by way of "purchase of its own stock or otherwise," the shareholder shall be liable "if the corporation is, or is thereby rendered, bankrupt or insolvent and if the corporation is thereafter duly adjudicated bankrupt . . ."¹² Vermont imposes liability when the corporation's "capital stock is reduced before the full payment of its debts."¹³ Vermont seems to impose a heavier burden on the shareholder, since he is liable whenever the corporation becomes insolvent in the equity sense, *i.e.*, when the corporation is unable to pay its debts as they become due in the

⁸ N.Y. Bus. Corp. Law § 719 (McKinney 1963); Va. Code Ann. § 13.1-44 (1950).

⁹ Minn. Stat. Ann. § 301.22(6) (1947) provides for repurchase only out of earned surplus or paid-in surplus.

¹⁰ Minn. Stat. Ann. § 301.23(1) (1947).

¹¹ E.g., Md. Ann. Code art. 23, § 36(c) (1957); Mich. Comp. Laws § 450.48 (1948); R.I. Gen. Laws Ann. § 7-3-29 (1956).

¹² Mass. Gen. Laws Ann. ch. 156B, § 45 (Supp. 1965). Cf. Fla. Stat. Ann. § 608.55 (1956).

¹³ Vt. Stat. Ann. tit. 11, § 362 (1958). Cf. N.C. Gen. Stat. § 55-54 (1965).

usual course of business. The shareholder in Massachusetts, on the other hand, is not liable until the corporation has been declared insolvent in the bankruptcy sense.¹⁴

Adopting the second condition, Delaware,¹⁵ Kansas,¹⁶ New Jersey,¹⁷ New Mexico,¹⁸ and West Virginia¹⁹ impose strict liability on the shareholder when no public notification is made by the corporation of the reduction of capital. Until such notice is given, the creditors are led to believe "that the capital has not been impaired by payments to stockholders for their shares."²⁰ The shareholder's ignorance of the source of the payment or of the corporation's failure to notify will be no defense.²¹

The third way in which the shareholder avoids liability is through the imposition of liability on the director. In Idaho,²² Kentucky,²³ and Washington,²⁴ the director who makes an unlawful distribution to shareholders "knowingly or without making reasonable inquiry" is liable to the corporation. Under these statutes, the shareholder will be liable to the corporation only: first, when no director is liable to the corporation, or second, to the extent that the corporation is unable to obtain satisfaction after judgments against directors. Although the same language is found in the Louisiana statute,²⁵ it is qualified and to a considerable degree nullified by the following clause:

In any case where the directors are held liable for the sole reason of having acted negligently, the directors [who are] jointly and severally liable to the extent of the payments made by them, shall have a cause and right of action against each of the shareholders for the proportionate amount of the unlawful . . . distribution received by such shareholder.²⁶

The first two provisions appear to reflect a legislative policy that a director should be primarily liable for the illegal withdrawal, even if he simply failed to exercise "that diligence, care and skill which ordinarily prudent men in like position would exercise under similar conditions."²⁷ The receiving shareholder is called upon only if the director cannot pay a judgment, or if the director acted reasonably under the circumstances. The additional provision in the Louisiana act, on the other hand, offsets the balance of priorities set up in the first two sections by giving the negligent director an unconditional cause of action against the shareholder.

¹⁴ See Henn, *Corporations* § 319, at 487 (1961).

¹⁵ Del. Code Ann. tit. 8, § 244(e) (1953).

¹⁶ Kan. Gen. Stat. Ann. § 17-3225 (1949).

¹⁷ N.J. Stat. Ann. § 14:11-5 (1939).

¹⁸ N.M. Stat. Ann. § 15-3-18 (1953).

¹⁹ W. Va. Code Ann. § 3025(1) (1961).

²⁰ *Kleinberg v. Schwartz*, 87 N.J. Super. 216, 225, 208 A.2d 803, 808 (1965).

²¹ *Id.* at 224, 208 A.2d at 808.

²² Idaho Code Ann. § 30-131 (1948).

²³ Ky. Rev. Stat. Ann. § 271.275 (1963).

²⁴ Wash. Rev. Code Ann. § 23.01.260 (1961).

²⁵ La. Rev. Stat. § 12.27(B) (1950).

²⁶ La. Rev. Stat. § 12.27(C) (1950).

²⁷ La. Rev. Stat. § 12.27(A) (1950).

Finally, Virginia takes a somewhat different approach and adopts the fourth alternative condition to shareholder liability. If a director participates in an illegal distribution of assets to the shareholder and is held liable, he "shall be entitled to contribution from the stockholders who accepted or received such . . . assets . . ." ²⁸ Unlike Louisiana, which gives the director a cause of action against the shareholder only if the director was negligent in assenting to the distribution, Virginia gives the director the right to contribution from the shareholder even if the director's actions were in willful violation of the statute.

The first step which must be taken in an attempt to evaluate the strict liability statutes is to determine whether a creditor is entitled to the absolute protection which such statutes provide. Should the shareholder be forced to return the assets he received in order to restore the stated capital, regardless of his state of mind? The affirmative answer contained in the statutes noted above is subject to question, since it fails to take into account what the nature of the creditor's risk should be. The rationale behind the notification statutes²⁹ and the statutes against the impairment of capital³⁰ is that the creditor has a legal right to rely on the status of the stated capital at the time he extends credit to the corporation. It can be extremely difficult to determine when the distribution of assets has reached a point of capital reduction.³¹ Hence, the directors are held to a standard of reasonableness when they deal with stated capital; they will be liable for reducing stated capital contrary to statutory requirements only if they were negligent.³² The creditor, therefore, takes the risk that a director acting reasonably under the circumstances may impair stated capital. When a shareholder is reasonable in not knowing that the corporation has reduced stated capital in order to repurchase his shares, the creditor should likewise be held to have taken the risk of such an occurrence. There is no acceptable argument favoring the application of a standard of reasonableness to the director while the recipient shareholder is made an insurer against an unauthorized capital impairment. It is unrealistic to argue that the parties can easily be placed in their original positions simply by taking the assets back from the shareholder and returning the shares to him; the shareholder may have reinvested these assets so that they are no longer readily available to him. It is also unrealistic to characterize the selling shareholder as a mere donee of corporate assets over whom the creditor must have priority. A repurchase is often a business transaction which can be of substantial benefit to the corporation, particularly as a vehicle for removing a strong shareholder who has been obstructing management policy but who is willing to be bought out. If a move is made to have the corporation buy the shareholder out, and if the latter acts reason-

²⁸ Va. Code Ann. § 13.1-44 (1964). For a similar provision in reference to the receipt of illegal dividends, see W. Va. Code Ann. § 3090 (1961), and in reference to receipt of reduction surplus, see Tex. Bus. Corp. Act art. 2.41(6) (Supp. 1956).

²⁹ See statutes cited notes 15-19 *supra*.

³⁰ See statutes cited note 7 *supra*.

³¹ See, e.g., *Randall v. Bailey*, 23 N.Y.S.2d 173 (Sup. Ct. 1940), *aff'd*, 288 N.Y. 280, 43 N.E.2d 43 (1942).

³² See statutes cited notes 22-25 *supra*.

ably in accepting the corporate assets, the creditor should be held to have taken the risk that this transaction might lead to a capital impairment.

The strict standard also ignores the distinction between a shareholder-vendor in a large corporation and one in a close corporation. A strong argument can be made that a standard of liability should be flexible enough to recognize a difference in the relative positions of a shareholder in a close corporation, who is likely to be well informed, and a shareholder in a large public corporation, who may have very little to do with the finances of the business. A shareholder who knows, or under the circumstances should know, that the corporation has impaired its capital in order to repurchase his shares should be more disfavored in the eyes of the law than a shareholder who has no chance of obtaining such knowledge and hence no reasonable opportunity to put a stop to the transaction.

More importantly, it should be pointed out that a strict standard of liability on the shareholder is not an effective method of deterring the evils which the legislature is seeking to avoid. It is the director who is in the best position to prevent a reduction of stated capital and the consequent dangers of favoritism to insiders, creation of artificial market prices, and fraud on creditors.³³ The legislatures have felt that the best way to discourage the director's participation in such a reduction is to impose a standard of negligence on him.³⁴ In analyzing ways to deter the director, it is relevant to determine what effect the imposition of a given standard of liability on the receiving shareholder will have on the director's actions. If there is a strict standard on the shareholder and a right of contribution in the negligent director against such shareholder, the director can almost always count on having a substantial part of a judgment against him satisfied by the shareholder. Such a situation is not likely to be as conducive to encouraging care in the director's actions as would be the case if the director had a right of contribution against the shareholder only when the latter was negligent in receiving corporate assets, or indeed if the director had no right of contribution against the shareholder at all.

Since a strict standard of liability on the shareholder cannot be justified in terms of its having a deterrent influence on the director, and further, since it has been argued above that the nature of the creditor's risk does not demand absolute assurance that stated capital will be unimpaired at all times, the question remains whether a strict standard of liability on the shareholder is justified as an adequate deterrent on the shareholder himself. It is submitted that the shareholder will not be substantially less careful in reselling his shares if he is held to a test of reasonableness as opposed to a standard of absolute liability. It should also be noted that the strict standard is likely to discourage the shareholder from reselling his shares at all, and as indicated above, such a reluctance is likely to deprive the corporation of an effective method of eliminating a dissenting shareholder to the mutual satisfaction of all parties.

³³ See notes 2, 3 *supra* and accompanying text.

³⁴ See statutes cited notes 22-25 *supra*.

III. SHAREHOLDER'S LIABILITY BASED ON HIS KNOWLEDGE

A substantial number of states give the shareholder a complete defense to an action against him for the illegal receipt of corporate assets through a repurchase transaction: his ignorance of the illegality. The statute usually first imposes liability on the director, and then gives him a right of contribution against a shareholder if the latter knew that the distribution of assets to him was illegal:

Any director against whom a claim shall be asserted . . . for the . . . distribution of assets of a corporation and who shall be held liable thereon, shall be entitled to contribution from the shareholders who accepted or received any such . . . assets, knowing such . . . distribution to have been in violation of this act, in proportion to the amounts received by them respectively.³⁵

Although such a statute correctly takes into consideration the shareholder's state of mind, the liability of the director should be kept separate from that of the shareholder, since entitling the director to have the shareholder contribute to the payment of a judgment against him,³⁶ does not encourage care in the director and possibly encourages the opposite. A strong argument can be made that the director will be more inclined to exercise care if he knows that he alone will have to satisfy a judgment against him.

Some states subject the shareholder to a direct cause of action in addition to liability through contribution. In Ohio, a shareholder who "knowingly" receives an illegal distribution is directly liable to the corporation³⁷ and is subject to the director's right of contribution.³⁸ Similar provisions are found in Connecticut,³⁹ North Carolina,⁴⁰ and Wisconsin.⁴¹ Oklahoma also subjects the shareholder to a direct cause of action; however, in addition to the defense of ignorance, the statute gives the shareholder another way out. He is liable "providing the corporation is adjudged insolvent or bankrupt in any action or proceeding begun within two (2) years after such purchase . . ."⁴² California had the same section but for the existence of a one-

³⁵ Alaska Stat. § 10.05.225 (1962). Accord, Ark. Stat. Ann. § 64-308 (Rep. 1966); Colo. Rev. Stat. Ann. § 31-5-14(7) (1963); Miss. Code Ann. § 5309-92 (1964); Tex. Bus. Corp. Act art. 2.41(E) (1956); Utah Code Ann. § 16-10-44 (1953); Wyo. Stat. Ann. 17-36.41 (1957).

³⁶ Cf. N.Y. Bus. Corp. Law § 719(d)(2) (McKinney 1963), giving the director the right to have the corporation rescind the repurchase and recover for the benefit of the director "the amount of such purchase price from any seller"; N.C. Gen. Stat. § 55-32(j) (1965), giving the director the right of "reimbursement or exoneration" from the shareholder.

³⁷ Ohio Rev. Code Ann. § 1701.95(C) (1965).

³⁸ Ohio Rev. Code Ann. § 1701.95(D) (1965).

³⁹ Conn. Gen. Stat. Ann. §§ 33-321(b)(4), -359 (1958).

⁴⁰ N.C. Gen. Stat. §§ 55-32(j), -54 (1965).

⁴¹ Wis. Stat. Ann. § 180.40(5)(a), (b) (1957). See Note, 1953 Wis. L. Rev. 380.

⁴² Okla. Stat. Ann. tit. 18, § 1.150 (1953). Compare Fla. Stat. Ann. § 608.55 (1956); Mass. Gen. Laws Ann. ch. 156B, § 45 (Supp. 1965); N.C. Gen. Stat. § 55-54 (1965); Vt. Stat. Ann. tit. 11, § 362 (1958). Pennsylvania removes the defense of ignorance if at the time of the transaction (1) the corporation is insolvent, and (2) the net assets

year limitation rather than two.⁴³ The California provision was repealed in 1945.⁴⁴ Apparently, the theory behind such a provision is that if the corporation is insolvent, or nearly so, as a result of the repurchase, but yet has a good chance of getting back on its feet within a relatively short period of time, then the chances are slim that anyone will be hurt by the repurchase. Hence, the time provision is inserted in the hope that the corporation will be able to revive itself. The creditor is in effect told to wait one or two years before suing.⁴⁵

One of the most difficult problems in this area is the definition of "knowledge." What state of mind is necessary before the selling shareholder is liable? When the statute states that the shareholder is liable if he received assets "knowing such . . . distribution to have been in violation of this act,"⁴⁶ the statute clearly would include *actual* knowledge of the improper capital reduction. It is not clear, however, to what extent the statute applies to a shareholder with *less* than actual knowledge. California tries to be somewhat more explicit:

When a corporation, in violation of any provision of this division, purchases directly or indirectly shares issued by it, . . . any share-

have fallen below an amount sufficient to satisfy the preferential rights of shareholders in the event of liquidation. Pa. Stat. Ann. tit. 15, § 2852-707 (1958).

⁴³ California presently has *no* time limitation. Cal. Corp. Code § 1715 (West 1955).

⁴⁴ For the legislative history of this statute, see *England v. Christensen*, 243 Cal. App. 2d 478, 494-95, 52 Cal. Rptr. 402, 412-13 (1966).

⁴⁵ Consideration must be given to the Uniform Fraudulent Conveyance Act: Every conveyance made and every obligation incurred by a person who is or thereby will be rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration.

Utah Code Ann. § 25-1-4 (1953). The state of mind of a selling shareholder is irrelevant if, in fact, the corporation is insolvent at the time of the repurchase or is thereby rendered insolvent. In fact, state of mind is irrelevant whenever the corporation is left with an "unreasonably small capital":

Every conveyance made without fair consideration, when the person making it is engaged, or is about to engage, in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors, and as to other persons who become creditors during the continuance of such business or transaction, without regard to his actual intent.

Utah Code Ann. § 25-1-5 (1953).

Clearly, a shareholder does not give "fair consideration" if the corporation is insolvent when he returns his shares to the corporation in exchange for the purchase price, since the repurchased shares, whether subsequently retired or treated as treasury stock, are hardly worth much to a corporation in such condition. However, the situation is different if the corporation is only on the borderline of insolvency and has a reasonable chance of reviving itself. The reacquired shares represent an "opportunity to acquire new assets for the corporate treasury by creating new obligations." *Borg v. International Silver Co.*, 11 F.2d 147, 150 (2d Cir. 1925). As such, they should be considered valuable to the corporation (i.e., a "fair consideration") if there exists a reasonable chance of creating the new obligations by reselling the shares purchased. It can also be argued that a dissident shareholder who removes himself from the corporation by reselling his shares has given something to the corporation by his very act of removal, independent of the inherent value of the repurchased shares.

⁴⁶ See statutes cited note 35 *supra*.

holder . . . who sells such shares with knowledge that the corporation is the purchaser and with knowledge of facts indicating the impropriety of the purchase is liable to the corporation⁴⁷

New York⁴⁸ and Oklahoma⁴⁹ have similar provisions.

It is unclear why the statute includes a provision that a shareholder must know that his own corporation is purchasing his shares. If the shareholder knows that he has received a distribution of assets which is illegal because an improper reduction of capital occurred, would he not also know that his own corporation was the purchaser? It is difficult to conceive of a situation in which the shareholder would know the former fact but not the latter. An unlikely possibility is the situation of a shareholder selling his shares on the open market where the broker informs the shareholder that he has a corporate buyer who is willing to reduce its stated capital in order to make the purchase. If this shareholder knows that such a corporation exists, but does not know that the corporation is his own, does he nevertheless have knowledge of a fact "indicating the impropriety" under the California statute?

The latter question raises the further problem of determining to whom the fact must indicate the impropriety: to a particular shareholder or to a reasonable shareholder under the circumstances? In the recent case of *England v. Christensen*,⁵⁰ the California court refused to consider whether the selling shareholders had actual knowledge of the impropriety. "Their state of mind as to the impropriety of the transaction was immaterial since knowing the facts they were chargeable with knowledge that the law prohibited the transaction."⁵¹ In view of the circumstances of that case, it could be "inferred" that the shareholders had the requisite knowledge to make them liable under the statute.⁵² Hence the court is applying a reasonableness standard: as reasonable shareholders they should have known of the impropriety.

The court insisted that the rule adopted was not the equivalent of a rule requiring proof that the shareholders had actual knowledge of the impropriety itself. If, however, a shareholder knows a particular fact which indicates an impropriety, it is difficult to avoid the conclusion that he knows in some degree the impropriety itself. The statute does not say "knowledge of events which in fact are improper"; rather, the statute seems to require knowledge of events *indicating* an impropriety to this shareholder or to a reasonable shareholder. It is arguable that the knowledge requirement can be separated into two parts: knowledge of the fact, and knowledge of the indications stemming from that fact.

In Pennsylvania, a shareholder will not be liable "unless he knew or should have known from facts within his own knowledge of the illegality of such . . . distribution at the time of his receipt thereof."⁵³ This formulation

⁴⁷ Cal. Corp. Code § 1715 (West 1955).

⁴⁸ N.Y. Bus. Corp. Law § 719(d)(2) (McKinney 1963).

⁴⁹ Okla. Stat. Ann. tit. 18, § 1.149 (1953). But see § 1.150 of the same title.

⁵⁰ 243 Cal. App. 2d 478, 52 Cal. Rptr. 402 (1966).

⁵¹ Id. at 497, 52 Cal. Rptr. at 414.

⁵² Ibid.

⁵³ Pa. Stat. Ann. tit. 15, § 2852-707 (1958).

makes it clear that actual knowledge of the impropriety is not needed. However, the statute refers only to facts actually within the shareholder's "own knowledge," and does not seem to include facts of which the shareholder should have been aware.

A distinction should be made among the following situations: (1) where there is actual knowledge of a fact, (2) where, under the circumstances, there should have been knowledge of that fact, (3) where there is actual knowledge that the fact can be characterized as improper, and (4) where, under the circumstances, there should have been knowledge that the fact can be characterized as improper. A provision which takes into account all four situations is the following:

No shareholder shall be liable unless he had knowledge of facts, or should have had knowledge of facts, which indicated the impropriety of the distribution, or should have indicated such impropriety, at the time of said purchase.

Suppose a shareholder, desirous of selling his stock to the corporation, knows that six months ago the directors were contemplating bankruptcy; or suppose that in view of the shareholder's dealings with the directors, he should have known of this contemplated action. As a reasonable shareholder, he should know that the corporation might reduce its stated capital in order to make the purchase six months later. Not knowing the intricacies of the corporate balance sheet, the shareholder may not know the exact moment when the capital is reduced, *i.e.*, he may not have actual knowledge of the impropriety. However, he has knowledge, or should have knowledge, of a fact which should indicate an impropriety to him. If he had no actual knowledge of the contemplated bankruptcy, he may not be liable under the Pennsylvania statute even though he should have known of this fact. If he had actual knowledge of the contemplated bankruptcy, but had no actual knowledge that a repurchase in such circumstances would be improper, he may not be liable under the California statute, even though he should have known that it would be improper. In both of the latter hypotheticals, however, the shareholder would be liable under the formulation suggested above.

IV. CONCLUSION

It is submitted that the following statutory proposal best accommodates both the need to discourage the dangers incident to a corporate repurchase out of stated capital, and the desire not to impose on the shareholder an unnecessarily burdensome liability.

LIABILITY OF SHAREHOLDER RESELLING HIS SHARES TO THE CORPORATION

- A. When a corporation purchases its own shares in violation of this Act or of the restrictions in the articles of incorporation, a shareholder who accepts or receives any distribution in pursuance thereof shall be liable to the corporation for the amount so accepted or received, *provided*, that said corporation is adjudged

insolvent or bankrupt in any action or proceeding begun within one (1) year after such purchase.

- B. If the corporation is not adjudged insolvent or bankrupt within one (1) year after said purchase, a shareholder who accepts or receives any distribution in pursuance thereof shall be liable to the corporation for the amount so accepted or received, *provided* that said shareholder had knowledge of facts, or should have had knowledge of facts which indicated the impropriety of the distribution, or should have indicated an impropriety, at the time of said purchase.
- C. A director liable under this Act shall have no right of contribution against the shareholder.

It should be noted that since the director is normally liable for a willful or negligent distribution of corporate assets in violation of the repurchase provisions, the corporation under the proposed statute might obtain a double recovery—one from the director and one from the shareholder. This is not considered undesirable, however, since the main objective of the liability statute is not simply to return the parties to their initial positions before the repurchase, but to encourage the use of care in a repurchase transaction so as to minimize the dangers which could result. For the same reason, the proposed provisions do not provide contribution for the director against the shareholder.

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