CHAPTER 6

Shares and Distributions

ARTICLE 1

Shares

**SECTION 33‑6‑101.** Authorized shares.

 (a) The articles of incorporation must prescribe the classes of shares and the number of shares of each class that the corporation is authorized to issue. If more than one class of shares is authorized, the articles of incorporation must prescribe a distinguishing designation for each class, and, prior to the issuance of shares of a class, the preferences, limitations, and relative rights of that class must be described in the articles of incorporation. All shares of a class must have preferences, limitations, and relative rights identical with those of other shares of the same class except to the extent otherwise permitted by Section 33‑6‑102.

 (b) The articles of incorporation must authorize (1) one or more classes of shares that together have unlimited voting rights, and (2) one or more classes of shares (which may be the same class or classes as those with voting rights) that together are entitled to receive the net assets of the corporation upon dissolution.

 (c) The articles of incorporation may authorize one or more classes of shares that:

 (1) have special, conditional, or limited voting rights, or no right to vote, except to the extent prohibited by Chapters 1 through 20 of this Title;

 (2) are redeemable or convertible as specified in the articles of incorporation (i) at the option of the corporation, the shareholder or another person, or upon the occurrence of a designated event; (ii) for cash, indebtedness, securities, or other property; (iii) in a designated amount or in an amount determined in accordance with a designated formula or by reference to extrinsic data or events;

 (3) entitle the holders to distributions calculated in any manner, including dividends that may be cumulative, noncumulative, or partially cumulative;

 (4) have preference over any other class of shares with respect to distributions, including dividends and distributions upon the dissolution of the corporation.

 (d) The description of the designations, preferences, limitations, and relative rights of share classes in subsection (c) is not exhaustive.

HISTORY: Derived from 1976 Code Section 33‑9‑10 [1962 Code Section 12‑15.1; 1952 Code Sections 12‑53, 12‑211, 12‑212; 1942 Code Sections 7693, 7694, 7696, 7726, 7729, 7731; 1932 Code Sections 7693, 7694, 7696, 7726, 7729, 7731; Civ. C. ‘22 Sections 4267, 4268, 4270, 4301, 4304; Civ. C. ‘12 Sections 2800, 2801, 2803, 2834, 2837; Civ. C. ‘02 Sections 1856, 1857, 1859, 1880, 1883; 1896 (22) 92, 94; 1897 (22) 522; 1900 (23) 386; 1901 (23) 712; 1903 (24) 75; 1920 (31) 754; 1923 (33) 157; 1927 (35) 218; 1928 (35) 1256; 1936 (39) 1337; 1942 (42) 1448; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444 Section 2], Section 33‑9‑190 [1962 Code Section 12‑15.18; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], and Section 33‑9‑250 [1962 Code Section 12‑15.24; 1962 (52) 1996; 1963 (53)327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

Section 6.01 (Section 33‑6‑101) adopts a new terminology from that traditionally used in corporation statutes to describe classes of shares that may be created, but makes only limited substantive changes from earlier versions of the Model Act. Traditional corporation statutes work from a perceived inheritance of concepts of “common shares” and “preferred shares” that at one time may have had considerable meaning but that today often do not involve significant distinctions. It is possible under modern corporation statutes to create classes of “common” shares that have important preferential rights and classes of “preferred” shares that are subordinate in all important economic aspects or that are indistinguishable from common shares in either voting rights or entitlement to participate in the assets of the corporation upon dissolution. The revised Model Act breaks away from the inherited concepts of “common” and “preferred” shares and develops more general language to reflect the actual flexibility in the creation of classes of shares that exists in modern corporate practice. The words “common shares” or “preferred shares” are no longer used in the revised Model Act, though the words appear in a few instances in examples appearing in the Official Comment.

1. Section 6.01(a) (Section 33‑6‑101(a)).

Section 6.01(a) (Section 33‑6‑101(a)) requires that the articles of incorporation prescribe the classes of shares and the number of shares of each class that the corporation is authorized to issue. If the articles authorize the issue of only one class of shares, no designation or description of the shares is required, it being understood that these shares have both the power to vote and the power to receive the net assets of the corporation upon dissolution. See section 6.01(b) (Section 33‑6‑101(b)). Shares with both of these characteristics are usually referred to as “common shares” or “common stock,” but no specific designation is required by the Model Act.

If more than one class of shares is authorized, the preferences, limitations, and relative rights of each class of shares must be described in the articles of incorporation before any shares of that class are issued, or the board of directors may be given authority to establish them under section 6.02 (Section 33‑6‑102). These descriptions constitute the “contract” of the holders of those classes of shares with respect to their interest in the corporation and must be set forth in sufficient detail reasonably to define their interest. The designations, preferences, limitations, and relative rights of shares with one or more special or preferential rights which may be authorized are further described in section 6.01(c) (Section 33‑6‑101(c)).

If more than one class is authorized (or if only one class is originally authorized but at some future time one or more other classes of shares are added by amendment), the preferences, limitations, and relative rights of each class or classes of shares, including the class or classes that possess the fundamental characteristics of voting and residual equity financial interests, must be described before shares of those classes are issued. If both fundamental characteristics are placed exclusively in a single class of shares, that class may be described simply as “common shares” or by statements such as the “shares have general distribution and voting rights,” the “shares have all the rights of common shares,” or the “shares have all rights not granted to the class A shares.”

If the articles of incorporation create classes of shares that divide these fundamental rights among two or more classes of shares, it is necessary that the rights be clearly allocated among the classes. Specificity is required only to the extent necessary to differentiate the relative rights of the respective classes. For examples, where one class has a liquidation preference over another, it is necessary to specify only the preferential liquidation right of that class; in the absence of a contrary provision in the articles, the remaining class would be entitled to receive the net assets remaining after the liquidation preference has been satisfied.

More than one class of shares may be designated as “common shares,” however, each must have a “distinguishing designation” under section 6.01(a) (Section 33‑6‑101(a)), e.g., “nonvoting common shares” or “class A common shares,” and the rights of the classes must be described. For example, if a corporation authorizes two classes of shares with equal rights to share in all distributions and with identical voting rights except that one class is entitled exclusively to elect one director and the second class is entitled exclusively to elect a second director, the two classes may be designated, e.g., as “Class A common” and Class B common,” and described e.g., as “a class of common shares with the right to elect one director.” What is required is language that makes the location of these rights clear.

Rather than describing the terms of each class of shares in the articles of incorporation, the corporation may delegate to the board of directors under section 6.02 (Section 33‑6‑102) the power to establish the terms of a class of shares (or of a series within a class of shares) if no shares of that class (or series) have previously been issued. Those terms, however, must be set forth in an amendment to the articles of incorporation before the shares are issued.

2. Section 6.01(b) (Section 33‑6‑101(b)).

Section 6.01(b) (Section 33‑6‑101(b)) requires that every corporation authorize one or more classes of shares that have the two fundamental characteristics of having unlimited voting rights and the right to receive the net assets of the corporation upon its dissolution. These two fundamental characteristics need not be placed in a single class of shares but may be divided as desired. It is nevertheless essential that the corporation always have authorized shares with these two characteristics, and section 6.03 (Section 33‑6‑103) requires that shares having in the aggregate these characteristics always be outstanding.

Section 6.01(b) (Section 33‑6‑101(b)) ensures that there is always in existence one or more classes of shareholders who share in the ultimate residual interest in the corporation and who are entitled to elect a board of directors and make other fundamental decisions with respect to the corporation.

3. Section 6.01(c) (Section 33‑6‑101(c)).

Section 6.01(c) (Section 33‑6‑101(c)) lists the principal features that are customarily incorporated into classes of shares. Section 6.01(d) (Section 33‑6‑101(d)) makes clear that this listing is not exhaustive.

a. In general.

Section 6.01(c) (Section 33‑6‑101(c)) authorizes creation of classes of shares with limited or residual rights without significant limitation. In earlier versions of the Model Act and in the statutes of many states, certain types of rights or privileges are not permitted. Many such statutes, for example, prohibit the creation of a class of voting shares without preferential financial rights that is callable at the discretion of the corporation (“callable common shares”). Another common prohibition is against shares that have the power to be converted at the option of the shareholder into other classes of shares that have preferential financial rights, or into debt securities of the corporation (“upstream” conversion privileges). For the reasons set forth below, these restrictions are not preserved in the revised Model Act.

b. Voting of shares.

Any class of shares may be granted multiple or fractional votes per share without limitation. See section 7.21 (Section 33‑7‑210). Shares of any class may also be made nonvoting “except to the extent prohibited by this Act.” This “except” clause refers to the provisions in the Model Act that permit shares that are designated to be nonvoting to vote as separate voting groups on amendments to articles of incorporation and other organic changes in the corporation that directly affect that class (sections 7.26 and 10.04 (Section 33‑7‑260 and 33‑10‑104). In addition, shares may be given voting rights that are limited or conditional (e.g., on the passing of a specified number of dividends). Section 6.01(b) (Section 33‑6‑101(b)), however, requires that there always be one or more classes of shares that together have unlimited voting rights.

c. Redemption of shares.

Section 6.01(c)(2) (Section 33‑6‑101(c)(2)) permits classes of shares to be made redeemable on the terms set forth in the articles of incorporation. Under this section, shares may be made “redeemable” at the option of the holder, the corporation, or another person; shares redeemable at the option of the corporation are sometimes called “callable shares,” while shares redeemable at the option of the shareholder are sometimes described as involving a “put.” The Model Act permits either type of redemption for any class of shares and thereby permits the creation of redeemable or callable shares without limitation (subject only to the provisos that the class or classes of shares described in section 6.01(b) (Section 33‑6‑101(b)) must always exist and that at least one share of each class with those rights or powers must be outstanding under section 6.03 (Section 33‑6‑103)).

Earlier versions of the Model Act and the statutes of many states contain a direct or indirect prohibition against callable voting shares or callable common shares. Even where such a prohibition exists, however, the same effect can be obtained by the use of consensual share transfer restrictions (see section 6.27 (Section 33‑6‑270)). If it is possible to create what is essentially a callable voting share by agreement, there is no reason why such provisions should not be built directly and publicly into the capital structure of the corporation if that is desired.

The recognition of a redemption that is a “put” exercisable by the holders of the shares (or a third person such as holders of other classes of shares) is also new to the Model Act and is not permitted in many states. However, consensual share transfer restrictions may create a right that is indistinguishable from such a right of redemption, and a right of redemption is expressly recognized by many states in connection with certain specialized classes of corporations such as open‑end investment companies. As described below, if a right of redemption is recognized, prohibitions in earlier versions of the Model Act and many state statutes against “upstream” conversions serve no purpose.

The amount to be paid upon the redemption of shares under section 6.01(c)(2) (Section 33‑6‑101(c)(2)) may be fixed in the articles of incorporation or “determined in accordance with a designated formula or by reference to extrinsic data or events.” The reference to “extrinsic data or events” is intended to permit the redemption price to be established on the basis of matters external to the corporation, such as the purchase price of other shares, the level of the prime rate, the effective interest rate at which the corporation may obtain short‑or long‑term financing, the consumer price index or a designated currency ratio. While a designated price formula or references must be set out in the articles of incorporation, the board of directors may be given limited authority to implement the provisions.

All redemptions of shares are subject to the restrictions on distributions set forth in section 6.40 (Section 33‑6‑400). See section 6.03(b) (Section 33‑6‑103(b)).

d. Convertibility of shares.

Section 6.01(c)(2) (Section 33‑6‑101(c)(2)) also permits shares of any class to be made convertible into shares of any other class or into cash, indebtedness, securities, or other property of the corporation or another person.

As described above, earlier versions of the Model Act and the statutes of many states prohibit so‑called “upstream” conversions, that is, shares convertible into debt securities or into a class of shares having prior or superior preference rights. See, e.g., N.Y. BUS. CORP. LAW. ANN. Section 519(a)(1) (McKinney 1963). This restriction was eliminated from the Model Act since it was recognized that the power to make shares redeemable at the option of the shareholder for cash (see section 6.01(c)(2)(iii) (Section 33‑6‑101(c)(2)(iii)) should logically permit the shares to be redeemable or convertible at the option of the shareholder into other shares with senior preferential rights. Creditors of the corporation and holders of shares with preferential rights are less seriously affected by a conversion of shares into debt or into shares with preferential rights than they would be by the redemption of the shares for money, which is permitted by the revised Model Act, subject to the limitations of section 6.40 (Section 33‑6‑400). Shares made “redeemable” for debt under section 6.01(c)(2)(ii) (Section 33‑6‑101(c)(2)(ii)), achieve the same effect as a right to “convert” shares into debt securities.

4. Examples of classes of shares permitted by Section 6.01 (Section 33‑6‑101).

Section 6.01 (Section 33‑6‑101) authorizes the creation of new or innovative classes of shares without limitation or restriction. The section is basically enabling rather than restrictive since corporations often find it necessary to create new and innovative classes of shares for a variety of reasons, and with the disclosure of the terms of the new classes in the articles of incorporation that are a matter of public record there is no reason to restrict the power to create these classes. Innovative classes of shares may be created in connection with raising debt or equity capital. Securities with novel provisions are often created to meet perceived corporate needs in specific circumstances or because of financial problems generated by market conditions for capital. Novel classes of shares may also be created in order to effectuate desired control relationships among the participants in a venture. Classes of shares are likely to be used for this purpose in closely held corporations, whether or not statutory close corporation status is elected, but may also be used for this purpose by publicly held corporations.

Examples of innovative classes of shares are the following:

(1) Shares of one class may be authorized to elect a specified number of directors while shares of a second class may be authorized to elect the same or a different number of directors.

(2) Shares of one class may be entitled to vote as a separate voting group on certain transactions, but shares of two or more classes may be only entitled to vote together as a single voting group on the election of directors and other matters.

(3) Shares of one class may be non‑voting or may be given multiple or fractional votes per share.

(4) Shares of one class may be entitled to different dividend rights or rights on dissolution than shares of another class.

These examples are intended to be illustrative only and not to exhaust the variations permissible under the Model Act.

A corporation has power to issue debt securities under section 3.02(7) (Section 33‑3‑102(7)). Although section 6.01 (Section 33‑6‑101) authorizes the creation of interests that usually will be classed as “equity” rather than “debt,” it is permissible to create classes of securities under section 6.01 (Section 33‑6‑101) that have some of the characteristics of debt securities. These securities are often referred to as “hybrid securities.” Section 6.01 (Section 33‑6‑101) of the Model Act does not limit the development of hybrid securities, and equity securities may be created under the Model Act that embody any characteristics of debt that may be desired. Unlike some state statutes, however, the Model Act restricts the power to vote to securities classed as “shares” in the articles of incorporation. [Note: Under Section 33‑1‑400(23) of this act, creditors may be given voting rights pursuant to provisions in the debtor corporation’s articles of incorporation. Therefore, the last sentence of this paragraph is inapplicable in South Carolina. See the South Carolina Reporters’ Comments to Section 33‑7‑210.].

SOUTH CAROLINA REPORTERS’ COMMENTS

Section 33‑6‑101 is intended to provide corporations with a great deal of flexibility in capital structure. Virtually no limits are imposed upon the variations in characteristics, rights, and preferences which may be granted to classes and series of shares, so long as some combination of shares is outstanding which, in the aggregate, has unlimited voting rights and complete liquidation rights (see Paragraph 2 of the Official Comment). The 1981 South Carolina Business Corporation Act’s statutory distinction between “common” and “preferred” shares is discontinued.

Subsection (a). Classes of shares, their characteristics, and the number of shares authorized to be issued within each class must appear in the corporation’s articles, although certain powers may be reserved in the articles to the board of directors (see Section 33‑6‑102). These provisions are changed little in effect from Section 33‑9‑10(a) and (c) of the 1981 South Carolina Business Corporation Act.

Subsection (b). At all times a corporation must have outstanding a class or combination of classes of shares which, in the aggregate, possess unlimited voting rights, and a class or combination of classes which, in the aggregate, possess complete rights to net proceeds upon liquidation. There is no requirement that any single class of shares has both voting and liquidation rights. This provision creates a presumption that, if a corporation has only one class of authorized shares, such class possesses unlimited voting rights and complete rights to net proceeds upon liquidation.

Subsection (c). An upstream conversion was prohibited by Section 33‑9‑100(b)(5) of the 1981 South Carolina Business Corporation Act. Subsection (c), which places no limits on that into which shares may be converted, permits an upstream conversion.

The restraints on convertibility appearing in Section 33‑9‑250 of the 1981 South Carolina Business Corporation Act, which were intended to keep the capital accounts in balance, have been discontinued.

A corporation’s power to issue debt securities, including convertible securities, which were provided for in Section 33‑9‑250(b) and (c) of the 1981 South Carolina Business Corporation Act, is found at Section 33‑3‑102(7) of this act.

DERIVATION: 1984 Model Act Section 6.01.

CROSS REFERENCES

Amendment of articles: generally, see Sections 33‑10‑101 et seq.

Articles of incorporation generally, see Section 33‑2‑102.

Certificates for shares, see Section 33‑6‑250.

Close corporations, Statutory Close Corporation Supplement, see Sections 33‑18‑101 et seq.

Consideration for shares, see Section 33‑6‑210.

Debt securities, see Section 33‑3‑102.

Distributions to shareholders, see Section 33‑6‑400.

Fractional shares, see Section 33‑6‑104.

Nonvoting shareholders’ right to notice, see Sections 33‑7‑104, 33‑10‑103, 33‑11‑103, 33‑12‑102, and 33‑14‑102.

Options, see Section 33‑6‑240.

Outstanding shares, see Section 33‑6‑103.

Preemptive rights, see Section 33‑6‑300.

Redemption, see Section 33‑6‑103.

Series of shares, see Section 33‑6‑102.

Shares without certificate, see Section 33‑6‑260.

Voting by nonvoting shares, see Section 33‑10‑104.

Voting by voting groups of shares, see Sections 33‑7‑250 and 33‑7‑260.

Voting rights generally, see Section 33‑7‑210.

Library References

Corporations 62, 63.1, 69.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 126 to 129, 131 to 132, 144 to 145, 148 to 162.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Banks and Banking Section 57, Method of Issuance.

S.C. Jur. Banks and Banking Section 60, Redemption and Convertibility.

Forms

South Carolina Legal and Business Forms Section 1:10 , Corporate Finance‑Shares of Stock.

South Carolina Legal and Business Forms Section 1:110 , Classes of Stock‑Common and Preferred‑Voting Rights.

South Carolina Legal and Business Forms Section 1:126 , Redemption of Shares.

Attorney General’s Opinions

The use of terms “common” or “class A common” to designate shares having preferences as to dividends or other distributions is prohibited by this section [Code 1962 Section 12‑15.1] absent a valid waiver by holders of regular common shares. 1965‑66 Op Atty Gen, No. 2046, p 125.

**SECTION 33‑6‑102.** Terms of class or series determined by board of directors.

 (a) If the articles of incorporation so provide, the board of directors may determine, in whole or part, the preferences, limitations, and relative rights (within the limits set forth in Section 33‑6‑101) of (1) any class of shares before the issuance of any shares of that class or (2) one or more series within a class before the issuance of any shares of that series.

 (b) Each series of a class must be given a distinguishing designation.

 (c) All shares of a series must have preferences, limitations, and relative rights identical with those of other shares of the same series and, except to the extent otherwise provided in the description of the series, with those of other series of the same class.

 (d) Before issuing any shares of a class or series created under this section, the corporation must deliver to the Secretary of State for filing articles of amendment, which are effective without shareholder action, that set forth:

 (1) the name of the corporation;

 (2) the text of the amendment determining the terms of the class or series of shares;

 (3) the date it was adopted; and

 (4) a statement that the amendment was duly adopted by the board of directors.

HISTORY: Derived from 1976 Code Section 33‑9‑30 [1962 Code Section 12‑15.2; 1952 Code Section 12‑212; 1942 Code Section 7731; 1932 Code Section 7731; 1927 (35) 218; 1928 (35) 1256; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], and Section 33‑9‑40 [1962 Code Section 12‑15.3; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

Section 6.02 (Section 33‑6‑102) permits the board of directors, if authority to do so is contained in the articles, to fix the terms of a class of shares to meet corporate needs, including current requirements of the securities market or the exigencies of negotiations for acquisition of other corporations or properties, without the necessity of holding a shareholders’ meeting to amend the articles. This section therefore permits prompt action and gives desirable flexibility. The articles of incorporation may also create “series” of shares within a class (rather than designating that “series” as a separate class) if that is deemed desirable.

The board of directors may create new series without a class or set the terms of a class or series only if there are no outstanding shares of that class or series. This section recognizes that in some contexts there is no substantive difference between a “class” and a “series within a class,” and that the labels are often a matter of convenience. In appropriate circumstances, a series may be treated as a class of shares that has one or both of the fundamental characteristics described in section 6.01(b)(Section 33‑6‑101(b)).

Shares of stock to be issued in different classes or series that vary in terms to be set by the board of directors are sometimes referred to as “blank stock.” The granting of the power to vary the terms gives the board of directors broad power to affect the capital structure of the corporation. Exercise of this power may in some circumstances dilute the interest of existing shareholders. But on balance it is desirable to permit this flexibility.

The power to vary the terms of “blank stock” for series of the same class extends to all the permitted variables set forth in section 6.01(c) (Section 33‑6‑101(c)).

Subsection (e) requires a simple official filing to amend the articles so there will be a public record of the class or series the corporation intends to issue. The amendment may be made without shareholder action. See section 10.02 (Section 33‑10‑102).

SOUTH CAROLINA REPORTERS’ COMMENTS

The provisions of Section 33‑6‑102 are very similar to those of Sections 33‑9‑30 and 33‑9‑40 of the 1981 South Carolina Business Corporation Act, permitting the shareholders, through the articles, to authorize shares in series within classes and to empower the directors to establish the rights and preferences of classes or series. This power may be granted in whole or in part, as was the case under Section 33‑9‑400(a). The directors must exercise this power through a procedure very similar to that of former Section 33‑9‑40(b), (c), (d), and (e). Unlike former Section 33‑9‑30, however, Section 33‑6‑102 does not limit the characteristics which may be varied among series.

DERIVATION: 1984 Model Act Section 6.02.

CROSS REFERENCES

Amendment of articles of incorporation, see Sections 33‑10‑101 et seq.

Certificates for shares, see Section 33‑6‑250.

“Deliver” includes mail, see Section 33‑1‑400.

Distributions, see Section 33‑6‑400.

Effective time and date of filing, see Section 33‑1‑230.

Filing fees, see Section 33‑1‑220.

Filing requirements, see Section 33‑1‑200.

Redemption of shares, see Sections 33‑6‑101 and 33‑6‑103.

Series or class as voting group, see Sections 33‑1‑400, 33‑7‑250, 33‑7‑260, and 33‑10‑104.

Shares without certificates, see Section 33‑6‑260.

Standards of conduct for directors, see Sections 33‑8‑300 through 33‑8‑320.

Voting by voting group, see Sections 33‑7‑250 and 33‑7‑260.

“Voting group” defined, see Section 33‑1‑400.

Library References

Corporations 69.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 129, 131 to 132, 144 to 145, 152 to 162.

RESEARCH REFERENCES

Forms

South Carolina Legal and Business Forms Section 1:61 , Articles of Amendment.

South Carolina Legal and Business Forms Section 1:101 , Stock Structure‑Two Classes of Shares With Par Value‑Designation of Rights, Preferences, Restrictions and Limitations.

South Carolina Legal and Business Forms Section 1:112 , Classes of Stock‑Common and Two Classes of Preferred.

South Carolina Legal and Business Forms Section 1:167 , Dissolution‑Liquidation Preference.

South Carolina Legal and Business Forms Section 1:203 , Shareholders’ Rights‑Authentication of Certificates Issued for Shares of Capital Stock‑More Than One Class.

Attorney General’s Opinions

No conflict exists between this section [Code 1962 Section 12‑15.3] and Code 1962 $ 12‑19.4, and a corporate board of directors may issue preferred shares in series without prior shareholder approval where articles of incorporation vest such authority in the board of directors. 1969‑70 Op Atty Gen, No. 3018, p 305.

NOTES OF DECISIONS

In general 1

1. In general

Applied as to building and loan associations in Griffin v. White (S.C. 1936) 182 S.C. 219, 189 S.E. 127.

**SECTION 33‑6‑103.** Issued and outstanding shares.

 (a) A corporation may issue the number of shares of each class or series authorized by the articles of incorporation. Shares that are issued are outstanding shares until they are reacquired, redeemed, converted, or canceled.

 (b) The reacquisition, redemption, or conversion of outstanding shares is subject to the limitations of subsection (c) of this section and to Section 33‑6‑400.

 (c) At all times that shares of the corporation are outstanding, one or more shares that together have unlimited voting rights and one or more shares that together are entitled to receive the net assets of the corporation upon dissolution must be outstanding.

HISTORY: Derived from 1976 Code Section 33‑9‑20 [1962 Code S 12‑15.1; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

Section 6.03 (Section 33‑6‑103) permits the corporation to issue shares up to the number of shares authorized in the articles of incorporation and provides that shares that are issued are outstanding shares for purposes of this Act until they are reacquired, redeemed, converted, or cancelled. The determination of the number of shares to be issued is usually made by the board of directors but may be reserved by the articles of incorporation to the shareholders. The only requirements are that no class of shares be over‑issued and that one or more shares of a class or classes that together have unlimited voting power and one or more shares of a class or classes that together are entitled to the net assets of the corporation upon dissolution at all times must be outstanding.

Shares of any class that are outstanding may be made subject to share transfer restrictions that may result in contractual obligations by the corporation to reacquire shares. The validity of such share transfer restriction is today not open to serious question. See section 6.27 (Section 33‑6‑270). The corporation may also acquire outstanding shares of any class pursuant to a voluntary transaction between the shareholder and the corporation. All contractual or voluntary reacquisitions are subject to the restrictions set forth in subsection (c) of this section and to section 6.40 (Section 33‑6‑400). The corporation may also reacquire shares pursuant to a right of redemption (or an obligation to redeem) established in the articles of incorporation. See section 6.01(c)(2) (Section 33‑6‑101(c)(2)). All such redemptions of shares are also subject to the restrictions of subsections (c) of this section and to section 6.40 (Section 33‑6‑400). Shares of the class or classes described in section 6.01(b) (Section 33‑6‑101(b)) may be reacquired or redeemed by the corporation in any of the foregoing ways to the same extent as shares of any other class, subject, however, to the overriding requirement of section 6.03(c) (Section 33‑6‑103(c)) that at all times at least shares that meet the requirements of section 6.01(b) (Section 33‑6‑101(b)) be outstanding.

The provisions of the revised Model Act are consistent with the specialized class of corporation known as the open‑end investment company, which permits unlimited redemptions of shares at net asset value at the request of shareholders. Sections 6.01 and 6.03 (Sections 33‑6‑101 and 33‑6‑103) permit the classes of shares with voting and dissolution rights to be made redeemable without limitation. The requirement of section 6.03(c) (Section 33‑6‑103(c)) that at least one share be outstanding is also consistent with an unlimited right of redemption since that section only applies while there are shares of stock outstanding. If an open‑end investment company or any other corporation should redeem all of its outstanding shares, it should file articles of dissolution under chapter 14 at or before the time the last share is redeemed.

SOUTH CAROLINA REPORTERS’ COMMENTS

Reacquired but uncanceled shares are considered authorized but unissued; the concepts of “treasury” shares and “retired” shares have been discontinued. See Section 33‑6‑310(a).

DERIVATION: 1984 Model Act Section 6.03.

CROSS REFERENCES

Cancelation of shares, see Section 33‑10‑106.

Certificates for shares, see Section 33‑6‑250.

Classes of shares generally, see Section 33‑6‑101.

Consideration for shares, see Section 33‑6‑210.

Dissolution of corporation, see Section 33‑14‑101 et seq.

Reacquisition of shares, see Section 33‑6‑310.

Redemption of shares, see Sections 33‑6‑101 and 33‑6‑103.

Share dividends, see Section 33‑6‑230.

Shares without certificates, see Section 33‑6‑260.

Voting by voting groups, see Sections 33‑7‑250 and 33‑7‑260.

“Voting group” defined, see Section 33‑1‑400.

Voting by nonvoting class of shares, see Section 33‑10‑104.

Library References

Corporations 69.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 129, 131 to 132, 144 to 145, 152 to 162.

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S.C. Jur. Banks and Banking Section 57, Method of Issuance.

NOTES OF DECISIONS

In general 1

1. In general

Where stock was issued as collateral security, the issue was not void and as the stockholders knew of the issue, they were estopped from asserting that the issue was ultra vires because it was not fully paid as required under this section. Granite Brick Co. v. Titus, 1915, 226 F. 557, 141 C.C.A. 313.

The signature of a purchaser of corporate stock as receipt on the certificate stub is not an essential prerequisite to a valid issuance of stock. Bain v. Rogers (S.C. 1930) 158 S.C. 417, 155 S.E. 619. Corporations And Business Organizations 1378

**SECTION 33‑6‑104.** Fractional shares.

 (a) A corporation may:

 (1) issue fractions of a share or pay in money the value of fractions of a share;

 (2) arrange for disposition of fractional shares by the shareholders;

 (3) issue scrip in registered or bearer form entitling the holder to receive a full share upon surrendering enough scrip to equal a full share.

 (b) Each certificate representing scrip must be conspicuously labeled “scrip” and must contain the information required by Section 33‑6‑250(b).

 (c) The holder of a fractional share is entitled to exercise the rights of a shareholder, including the right to vote, to receive dividends, and to participate in the assets of the corporation upon liquidation. The holder of scrip is not entitled to any of these rights unless the scrip provides for them.

 (d) The board of directors may authorize the issuance of scrip subject to any condition considered desirable, including that the:

 (1) scrip is void if not exchanged for full shares before a specified date; and

 (2) shares for which the scrip is exchangeable may be sold and the proceeds paid to the scripholders.

HISTORY: Derived from 1976 Code Section 33‑9‑120 [1962 Code Section 12‑15.11; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

Fractional shares may arise from a share dividend that, as applied to a particular holder, does not produce an even multiple of shares; they may also result from fractional stock splits, from reverse splits, and from reclassifications and mergers. Although corporations are authorized to issue fractional shares, which are vested proportionately with the same rights as full shares, the creation of fractional shares often creates administrative difficulties, particularly for voting and dividend purposes.

Section 6.04 (Section 33‑6‑104) authorizes handling fractional shares in various ways, including:

(1) The corporation may issue scrip instead of fractional shares. Scrip confers none of the substantive rights of shareholders, but only authorizes holders to combine scrip certificates in amounts aggregating a full share and then to exchange them for a full share. This aggregation must occur within the time and subject to the conditions set initially by the board of directors and stated in the scrip certificate. Scrip that is not combined and exchanged becomes void. To protect shareholders against forfeiture of their interest, however, it is usually provided that the shares represented by scrip certificates not exchanged by the expiration date are to be sold and the proceeds held, either indefinitely or for a stated period, for the benefit of the scripholders and paid to them on surrender of their scrip certificate. Scrip has been widely used in lieu of fractional shares. The New York Stock Exchange, while not requiring the use of any particular method for the settlement of fractional share interests, has established a policy relating to the minimum rights and privileges that scrip issued by registered companies must provide. N.Y.S.E. LISTED COMPANY MANUAL Section 703.02(B).

(2) The corporation may authorize the immediate sale of all fractional share interests, thereby avoiding the expense and delay of scrip and the inconvenience of recognizing fractional shares. While this procedure denies shareholders the benefit of any subsequent rise in the market, it protects them against any subsequent decline and ensures them of recognition based on market values contemporaneous with the transaction. Since these transactions necessarily involve less than one full share for each shareholder, the amount involved in subsequent price changes is usually modest.

One variation of “going private” transactions to eliminate public shareholders in a corporation largely owned by management interests involves a reverse share split at a ratio that reduces all public shareholders’ interest to a fractional share, followed by the reduction of the fractional interests to cash under this section. See “Guidelines on Going Private,” 37 BUS. LAW. 313 (1981).

Under this section fractional shares may be certificated or uncertificated. There is no difference in treatment of certificated or uncertificated shares for this purpose. See sections 6.25 and 6.26 (Sections 33‑6‑250 and 33‑6‑260).

SOUTH CAROLINA REPORTERS’ COMMENTS

Except for subsection (b), the provisions of Section 33‑6‑104 do not represent any material change from those of Section 33‑9‑120 of the 1981 South Carolina Business Corporation Act.

DERIVATION: 1984 Model Act Section 6.04.

CROSS REFERENCES

Dissenter’s rights, see Section 33‑13‑102.

Redemption, see Section 33‑6‑103.

Share dividends, see Section 33‑6‑230.

Library References

Corporations 69.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 129, 131 to 132, 144 to 145, 152 to 162.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Banks and Banking Section 59, Fractional Shares.

ARTICLE 2

Issuance of Shares

**SECTION 33‑6‑200.** Subscription for shares before incorporation.

 (a) A subscription for shares entered into before incorporation is irrevocable for six months unless the subscription agreement provides a longer or shorter period or all the subscribers agree to revocation.

 (b) The board of directors may determine the payment terms of subscriptions for shares that were entered into before incorporation, unless the subscription agreement specifies them. A call for payment by the board of directors must be uniform so far as practicable as to all shares of the same class or series, unless the subscription agreement specifies otherwise.

 (c) Shares issued pursuant to subscriptions entered into before incorporation are fully paid and nonassessable when the corporation receives the consideration specified in the subscription agreement.

 (d) If a subscriber defaults in payment of money or property under a subscription agreement entered into before incorporation, the corporation may collect the amount owed as any other debt. Alternatively, unless the subscription agreement provides otherwise, the corporation may rescind the agreement and may sell the shares if the debt remains unpaid more than twenty days after the corporation sends written demand for payment to the subscriber.

 (e) A subscription agreement entered into after incorporation is a contract between the subscriber and the corporation subject to Section 33‑6‑210.

HISTORY: Derived from 1976 Code Section 33‑9‑60 [1962 Code Section 12‑15.5; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

Agreements for the purchase of shares to be issued by a corporation are typically referred to as “subscriptions” or “subscription agreements.” Section 6.20 (Section 33‑6‑200) deals exclusively with preincorporation subscriptions, that is, subscriptions entered into before the corporation was formed. Preincorporation subscriptions have often been considered to be revocable offers rather than binding contracts. Since the corporation is not in existence, it cannot be a party to the agreement and the consideration established for the shares is not determined by the board of directors. While preincorporation subscriptions entered into simultaneously by several subscribers may be considered a binding contract between or among the subscribers, not all factual situations lend themselves to contractual analysis. Because of the uncertainty of the legal enforceability of these transactions, section 6.20 (Section 33‑6‑200) provides a simple set of legal rules applicable to the enforcement of preincorporation subscriptions by the corporation after its formation. It does not address the extent to which preincorporation subscriptions may constitute a contract between or among subscribers, and other subscribers may enforce whatever contract rights they have without regard to section 6.20 (Section 33‑6‑200).

Section 6.20(a) (Section 33‑6‑200(a)) provides that preincorporation subscriptions are irrevocable for six months unless the subscription agreement provides that they are revocable or that they are irrevocable for some other period. Nevertheless, all the subscribers to shares may agree at any time that a subscriber may withdraw in part from his commitment to subscribe for shares, that a subscriber may revoke his subscription entirely, or that the period or irrevocability may continue for an additional stated period. If the corporation accepts the subscription during the period of irrevocability, the subscription becomes a contract binding on both the subscribers and the corporation. The terms of this contract are set forth in sections 6.20(b) and (d) (Sections 33‑6‑200(b) and (d)).

Section 6.20(b) (Section 33‑6‑200(b)) provides that after incorporation the board of directors may determine the payment terms of subscriptions but these calls must be uniform so far as practicable as to all shares of the same class or series unless the subscriptions provide otherwise. Section 6.20(d) (Section 33‑6‑200(d)) provides alternative methods of enforcement of preincorporation subscriptions by the corporation. If the consideration for the subscription involves the payment of money or conveyance of property, the corporation may, in the event of nonpayment, collect the amount due as any other debt. Alternatively, unless the subscription agreement provides otherwise, the corporation may rescind the agreement and may resell the shares after 20 days’ notice to the subscriber.

Section 6.20(c) (Section 33‑6‑200(c)) provides that shares issued pursuant to preincorporation subscriptions are fully paid and nonassessable when the corporation receives the subscription price. The liability of the subscriber to pay the purchase price is addressed in section 6.22 (Section 33‑6‑220). Section 6.20 (Section 33‑6‑200) does not address the liability of transferees of shares which may be issued before the subscription price is paid or the power of the corporation to cancel for nonpayment shares that have been issued before payment of the full subscription price. Issued shares represented by unpaid subscriptions are subject to cancellation for nonpayment to the same extent as shares issued for promissory notes or shares issued before the consideration therefor is paid. See the Official Comment to sections 6.21 (Section 33‑6‑210) and 6.22 (Section 33‑6‑220).

Postincorporation subscriptions are contracts between the corporation and the investor by which the corporation agrees to issue shares for a stated consideration and the investor agrees to purchase the shares for that consideration. Postincorporation subscriptions are simple contracts subject to the power of the board of directors and they may contain any mutually acceptable provisions subject to section 6.21 (Section 33‑6‑210). Section 6.20(e) (Section 33‑6‑20(e)) states, for completeness, that postincorporation subscriptions are contracts between the corporation and the subscriber subject to section 6.21 (Section 33‑6‑21).

SOUTH CAROLINA REPORTERS’ COMMENTS

In the 1981 South Carolina Business Corporation Act, all subscriptions, whether preincorporation or postincorporation, were governed by the same set of rules. The present Code, at Section 33‑6‑200, treats preincorporation subscriptions in generally traditional ways. Postincorporation subscriptions, however, are relegated to Section 33‑6‑210, which deals with corporations’ agreements to sell shares.

Section 33‑9‑60(d) and (e) of the 1981 South Carolina Business Corporation Act permitted, in some circumstances, forfeiture of shares for which the subscription price had not been paid. Section 33‑6‑200(d) provides for rescission instead. A corporation’s payments upon rescission would be distributions (see Section 33‑1‑400(6) (definition of “distribution”)), so that this alternative would be available to a corporation only if it had legal funds under Section 33‑6‑400.

DERIVATION: 1984 Model Act Section 6.20.

CROSS REFERENCES

Consideration for shares, see Section 33‑6‑210.

Effective date of notice, see Section 33‑1‑410.

Liability of shareholders for acts or debts of corporation, generally, see Section 33‑6‑220.

“Notice” defined, see Section 33‑1‑410.

Library References

Corporations 30(1), 69, 75.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 67 to 84, 87 to 90, 129, 131 to 132, 144 to 145, 152 to 162, 184, 187 to 192, 205, 209 to 211.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Banks and Banking Section 55, Payment for Shares.

Forms

South Carolina Legal and Business Forms Section 1:3 , Preincorporation‑Subscription Agreements.

South Carolina Legal and Business Forms Section 1:13 , Corporate Finance‑Enforcement of Subscription Agreement.

South Carolina Legal and Business Forms Section 1:246 , Resolution‑To Call for Full Amount of Unpaid Subscription.

NOTES OF DECISIONS

In general 1

1. In general

Statute requiring that stock subscriptions must be in writing to be enforceable had no application, and decedent’s estate was estopped to deny that he was a subscriber for one‑third interest in corporation shares, where there was a mutual enforceable agreement among incorporators to organize corporation, each contracting to own one‑third of the shares of stock therein, and decedent acted as an officer of the corporation. Duncan v. Brookview House, Inc. (S.C. 1974) 262 S.C. 449, 205 S.E.2d 707.

**SECTION 33‑6‑210.** Issuance of shares.

 (a) The powers granted in this section to the board of directors may be reserved to the shareholders by the articles of incorporation.

 (b) The board of directors may authorize shares to be issued for consideration consisting of any tangible or intangible property or benefit to the corporation, including cash, promissory notes, services performed, written contracts for services to be performed, or other securities of the corporation.

 (c) Before the corporation issues shares, the board of directors must determine that the consideration received or to be received for shares to be issued is adequate. That determination by the board of directors is conclusive insofar as the adequacy of consideration for the issuance of shares relates to whether the shares are validly issued, fully paid, and nonassessable.

 (d) When the corporation receives the consideration for which the board of directors authorized the issuance of shares, the shares issued therefor are fully paid and nonassessable.

 (e) Except as otherwise provided in subsection (f), the corporation must place in escrow shares issued for a contract for future services or benefits or for a promissory note. Any share dividends in respect of the shares escrowed also must be placed in escrow. Distributions in respect of escrowed shares must be escrowed or credited against their purchase price. The shares and distributions escrowed must remain in escrow until the services are performed, the note is paid, or the benefits are received. If the services are not performed, the note is not paid, or the benefits are not received, the shares escrowed and the distributions credited may be canceled in whole or in part and the distributions escrowed may be reclaimed by the corporation.

 (f) A corporation subject to the registration requirements of Section 12 of the Securities Exchange Act of 1934 may issue shares for a contract for future services without having to place the shares and share dividends and distributions in respect of the shares in escrow and without having to credit distributions against their purchase price if the shares are issued or authorized pursuant to a plan that has been approved by the shareholders of the corporation.

HISTORY: Derived from 1976 Code Section 33‑9‑60 [1962 Code Section 12‑15.5; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], Section 33‑9‑70 [1962 Code Section 12‑15.6; 1952 Code Sections 12‑232, 12‑233; 1942 Code Sections 7728, 7731; 1932 Code Sections 7728, 7731; Civ. C. ‘22 Section 4303; Civ. C. ‘12 Section 2836; Civ. C. ‘02 Section 1882; 1896 (22) 92; 1897 (22) 522; 1927 (35) 218; 1928 (35) 1256; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], and Section 33‑9‑80 [1962 Code Section 12‑15.7; 1952 Code Section 12‑232; 1942 Code Section 7728; 1932 Code Section 7728; Civ. C. ‘22 Section 4303; Civ. C. ‘12 Section 2836; Civ. C. ‘02 Section 1882; 1896 (22) 92; 1897 (22) 522; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2; 1992 Act No. 376, Sections 1, 2.

OFFICIAL COMMENT

The financial provisions of the Model Act reflect a modernization of the concepts underlying the capital structure and limitations on distributions of corporations. This process of modernization began with amendments in 1980 to the 1969 Model Act that eliminated the concepts of “par value” and “stated capital,” and further modernization occurred in connection with the development of the revised Act in 1984. Practitioners and legal scholars have long recognized that the statutory structure embodying “par value” and “legal capital” concepts is not only complex and confusing but also fails to serve the original purpose of protecting creditors and senior security holders from payments to junior security holders. Indeed, to the extent security holders are led to believe that it provides this protection, these provisions may be affirmatively misleading. The Model Act has therefore eliminated these concepts entirely and substituted a simpler and more flexible structure that provides more realistic protection to these interests. Major aspects of this new structure are:

(1) the provisions relating to the issuance of shares set forth in this and the following sections;.

(2) the provisions limiting distributions by corporations set forth in section 6.40 (Section 33‑6‑400) and discussed in the Official Comment to that section; and.

(3) the elimination of the concept of treasury shares described in the Official Comment to section 6.31 (Section 33‑6‑310).

Section 6.21 (Section 33‑6‑210) incorporates not only the elimination of the concepts of par value and stated capital from the Model Act in 1980 but also eliminates the earlier rule declaring certain kinds of property ineligible as consideration for shares. The caption of the section, “Issuance of Shares by the Board of Directors,” reflects the change in emphasis from imposing restrictions on the issuance of shares to establishing general principles for their issuance. The section replaces two sections captioned, respectively, “Consideration for Shares” (section 18) and “Payment for Shares” (section 19) in the 1969 Model Act.

Since shares need not have a par value, under section 6.21 (Section 33‑6‑210) there is no minimum price at which specific shares must be issued and therefore there can be no “watered stock” liability for issuing shares below an arbitrarily fixed price. The price at which shares are issued is primarily a matter of concern to other shareholders whose interests may be diluted if shares are issued at unreasonably low prices or for overvalued property. This problem of equality of treatment essentially involves honest and fair judgments by directors and cannot be effectively addressed by an arbitrary doctrine establishing a minimum price for shares such as “par value” provided under older statutes.

Section 6.21(b) (Section 33‑6‑210(b)) specifically validates contracts for future services (including promoters’ services), promissory notes, or “any tangible or intangible property or benefit to the corporation,” as consideration for the present issue of shares. The term “benefit” should be broadly construed to include, for example, a reduction of a liability, a release of a claim, or benefits obtained by a corporation by contribution of its shares to a charitable organization or as a prize in a promotion. In the realities of commercial life, there is sometimes a need for the issuance of shares for contract rights or such intangible property or benefits. And, as a matter of business economics, contracts for future services, promissory notes, and intangible property or benefits often have value that is as real as the value of tangible property or past services, the only types of property that many older statutes permit as consideration for shares. Thus, only business judgment should determine what kind of property should be obtained for shares, and a determination by the directors meeting the requirements of section 8.30 to accept a specific kind of valuable property for shares should be accepted and not circumscribed by artificial or arbitrary rules.

The issuance of some shares for cash and other shares for promissory notes, contracts for past or future services, or for tangible or intangible property or benefits, like the issuance of shares for an inadequate consideration, opens the possibility of dilution of the interests of other shareholders. For example, persons acquiring shares for cash may be unfairly treated if optimistic values are placed on past or future services of intangible benefits being provided by other persons. The problem is particularly acute if the persons providing services, promissory notes, or property or benefits of debatable value are themselves connected with the promoters of the corporation or with its directors. Protection of shareholders against abuse of the power granted to the board of directors to determine that shares should be issued for intangible property or benefits is provided in part by the requirement that the board must act in accordance with the requirements of section 8.30 (Section 33‑8‑300), and, if applicable, section 8.31 (Section 33‑8‑310), in determining that the consideration received for shares is adequate, and in part by the requirement of section 16.21 (Section 33‑16‑210) that the corporation must inform all shareholders annually of all shares issued during the previous year for promissory notes or promises of future services.

Accounting principles are not specified in the Model Act, and the board of directors is not required by the statute to determine the “value” of noncash consideration received by the corporation (as was the case in earlier versions of the Model Act). In many instances, property or benefit received by the corporation will be of uncertain value; if the board of directors determines that the issuance of shares for the property or benefit is an appropriate transaction that protects the shareholders from dilution, that is sufficient under section 6.21 (Section 33‑6‑210). The board of directors does not have to make an explicit “adequacy” determination by formal resolution; that determination may be inferred from a determination to authorize the issuance of shares for a specified consideration.

Section 6.21 (Section 33‑6‑210) also does not require that the board of directors determine the value of the consideration to be entered on the books of the corporation, though the board of directors may do so if it wishes. Of course, a specific value must be placed on the consideration received for the shares for bookkeeping purposes, but bookkeeping details are not the statutory responsibility of the board of directors. The statute also does not require the board of directors to determine the corresponding entry on the right‑hand side of the balance sheet under owner’s equity to be designated as “stated capital” or be allocated among “stated capital” and other surplus accounts. The corporation, however, may determine that the shareholders’ equity accounts should be divided into these traditional categories if it wishes.

The second sentence of section 6.21(c) (Section 33‑6‑210(c)) describes the effect of the determination by the board of directors that consideration is adequate for the issuance of shares. That determination, without more, is conclusive to the extent that adequacy is relevant to the question whether the shares are validly issued, fully paid, and nonassessable. Section 6.21(c) (Section 33‑6‑210(c)) provides that shares are fully paid and nonassessable when the corporation receives the consideration for which the board of directors authorized their issuance. Whether shares are validly issued may depend on compliance with corporate procedural requirements, such as issuance within the amount authorized in the articles of incorporation or holding a directors’ meeting upon proper notice and with a quorum present. The Model act does not address the remedies that may be available for issuances that are subject to challenge. This somewhat more elaborate clause replaces the provision in earlier versions of the Model Act and many state statutes that the determination by the board of directors of consideration for the issuance of shares was “conclusive in the absence of fraud in the transaction.”

Shares issued pursuant to the preincorporation subscriptions are governed by section 6.20 (Section 33‑6‑200) and not this section.

The revised Model Act does not address the question whether validly issued shares may thereafter be cancelled on the grounds of fraud or bad faith if the shares are in the hands of the original shareholder or other persons who were aware of the circumstances under which they were issued when they acquired the shares. It also leaves to the Uniform Commercial Code other questions relating to the rights of persons other than the person acquiring the shares from the corporation. See the Official Comment to section 6.22 (Section 33‑6‑220).

Section 6.21(e) (Section 33‑6‑210(e)) permits the board of directors to determine that shares issued for promissory notes or for contracts for future services or benefits be placed in escrow or their transfer otherwise restricted until the services are performed, the benefits received, or the notes are paid. The section also defines the rights of the corporation with respect to these shares. If the shares are issued without being restricted as provided in this subsection, they are validly issued insofar as the adequacy of consideration is concerned. See section 6.22 (Section 33‑6‑220) and its Official Comment.

Section 6.21(a) (Section 33‑6‑210(a)) provides that the powers granted to the board of directors by this section may be reserved to the shareholders by the articles of incorporation. No negative inference should be drawn from section 6.21(a) (Section 33‑6‑210(a)) with respect to the efficacy of similar provisions under other sections of the Model Act.

SOUTH CAROLINA REPORTERS’ COMMENTS

Section 33‑6‑210 is very similar in concept to the 1981 South Carolina Business Corporation Act provisions, but simpler in operation because par value and capital accounts need not be taken into account. Section 33‑6‑210 is more flexible than the prior Code in permitting issuance of shares for promissory notes or services or benefits to be rendered in the future, but requires that such shares be placed in escrow pursuant to subsection (e) until such note has been paid or such services or benefits have been rendered. Distributions of shares in respect of escrowed shares must be escrowed themselves; these include both dividends paid in shares of stock and stock splits. See Section 33‑6‑230. Any property distributions in respect of escrowed shares must be applied to the consideration for such shares. “Distribution” is defined at Section 33‑6‑400. Unless otherwise agreed, the record owner of any shares escrowed pursuant to subsection (e) may exercise all voting rights to which the shares would be entitled if they were not held in escrow.

This section differs from the Model Act Official Text in three respects. First, the Model Act does not require that agreements to issue shares for future services be in writing. Second, the Model Act Official Text of subsection (e) authorizes, but does not require as does this act, that shares issued for notes or future services be escrowed. Third, the provisions in subsection (e) regarding distributions on shares held in escrow are not included in the Model Act Official Text.

DERIVATION: 1984 Model Act Section 6.21.

CROSS REFERENCES

Certificateless shares, see Section 33‑6‑260.

Certificates for shares, see Section 33‑6‑250.

Committees, see Section 33‑8‑250.

Distributions, see Section 33‑6‑400.

Liability of subscribers and shareholders, see Section 33‑6‑220.

Par value shares, see Section 33‑2‑102.

Preincorporation subscriptions for shares, see Section 33‑6‑200.

Report to shareholders on certain consideration for shares, see Section 33‑16‑210.

Share dividends, see Section 33‑6‑230.

Share options, see Section 33‑6‑240.

Share transfer restrictions, see Section 33‑6‑270.

Standards of conduct for directors, see Sections 33‑8‑300 through 33‑8‑320.

Federal Aspects

Section 12 of Securities Exchange Act of 1934, see 15 U.S.C.A. Section 78l.

Library References

Corporations 69, 75.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 129, 131 to 132, 144 to 145, 152 to 162, 184, 187 to 192, 205, 209 to 211.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Banks and Banking Section 55, Payment for Shares.

S.C. Jur. Banks and Banking Section 57, Method of Issuance.

Forms

South Carolina Legal and Business Forms Section 1:3 , Preincorporation‑Subscription Agreements.

South Carolina Legal and Business Forms Section 1:12 , Corporate Finance‑Consideration for Shares.

South Carolina Legal and Business Forms Section 1:55 , Formation‑Articles of Incorporation.

South Carolina Legal and Business Forms Section 1:121 , Issuance of Stock‑When Authorized by Directors.

South Carolina Legal and Business Forms Section 1:241 , Resolution‑Issuance of Stock.

South Carolina Legal and Business Forms Section 1:242 , Resolution‑Issuance of Stock‑For Legal Services.

Attorney General’s Opinions

No conflict exists between this section [Code 1962 Section 12‑19.4] and Code 1962 Section 12‑15.3, and a corporation board of directors may issue preferred shares in series without prior shareholder approval where articles of incorporation vest such authority in the board of directors. 1969‑70 Op Atty Gen, No 3018, p 305.

**SECTION 33‑6‑220.** Liability of shareholders.

 (a) A purchaser from a corporation of its own shares is not liable to the corporation or its creditors with respect to the shares except to pay the consideration for which the shares were authorized to be issued (Section 33‑6‑210) or specified in the subscription agreement (Section 33‑6‑200).

 (b) Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct.

HISTORY: Derived from 1976 Code Section 33‑11‑230 1962 Code Section 12‑16.23; 1952 Code Section 12‑72; 1942 Code Section 7677; 1932 Code Section 7677; Civ. C. ‘22 Section 4251; Civ. C. ‘12 Section 2784; Civ. C. ‘02 Section 1843; R. S. 1500; 1905 (24) 842; 1940 (41) 1636; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

With the elimination of the concepts of par value and watered stock in 1980, the sole obligation of a purchaser of shares from the corporation, as set forth in section 6.22(a) (Section 33‑6‑220(a)), is to pay the consideration established by the board of directors (or the consideration specified in the subscription, in the case of preincorporation subscriptions). The consideration for the shares may consist of promissory notes, contracts for future services, or tangible or intangible property or benefits, and, if the board of directors so decide, the delivery of the notes, contracts, or accrual of the benefits constitute full payment for the shares. See the Official Comment to section 6.21 (Section 33‑6‑210). Upon the transfer to the corporation of the consideration so determined or specified, the shareholder has no further responsibility to the corporation or its creditors “with respect to the shares,” though the shareholder may have continuing obligations under a contract or promissory note entered into in connection with the acquisition of shares.

Section 6.22(a) (Section 33‑6‑220(a)) deals only with the responsibility for payment by the purchaser of shares from the corporation. The revised Model Act leaves to the Uniform Commercial Code questions with respect to the rights of subsequent purchasers of shares and the power of the corporation to cancel shares if the consideration is not paid when due. See sections 8‑202 and 8‑301 of the UNIFORM COMMERCIAL CODE (Sections 36‑8‑202 and 36‑8‑301 of the 1976 South Carolina Code).

Section 6.22(b) (Section 33‑6‑220(b)) sets forth the basic rule of nonliability of shareholders for corporate acts or debts that underlies modern corporation law. Unless such liability is provided for in the articles of incorporation, see section 2.02(b)(v), (Section 33‑2‑102(b)(v)) shareholders are not liable for corporate obligations, though the last clause recognizes that such liability may be assumed voluntarily or by other conduct.

SOUTH CAROLINA REPORTERS’ COMMENTS

Section 33‑6‑220(a) contains the traditional formulation upon which the limited liability of shareholders is based; this provision is similar to that of Section 33‑11‑230(a) of the 1981 South Carolina Business Corporation Act. Section 33‑6‑220(b) makes explicit what the prior Code left to implication, that a shareholder is not liable for corporate obligations by virtue of being a shareholder; he must do more to become subject to such obligations.

DERIVATION: 1984 Model Act Section 6.22.

CROSS REFERENCES

Articles of incorporation, see Section 33‑2‑102.

Consideration for shares, see Section 33‑6‑210.

Share transfer restrictions, see Section 33‑6‑270.

Subscriptions for shares, see Section 33‑6‑200.

Library References

Corporations 1.4, 1.6(13), 78, 215 to 241.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 9 to 14, 16, 184, 188, 192, 205, 209 to 211, 414 to 425.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Banks and Banking Section 75, Extent of Liability.

Forms

South Carolina Legal and Business Forms Section 1:14 , Shareholders‑Generally.

Treatises and Practice Aids

Bogert ‑ the Law of Trusts and Trustees Section 720, Liabilities Arising from Mere Ownership.

NOTES OF DECISIONS

In general 1

Burden of proof 2

Post‑judgment interest 3

1. In general

Under South Carolina law, in analyzing claim to pierce corporate veil, court should consider: (1) whether corporation was grossly undercapitalized; (2) its failure to observe corporate formalities; (3) non‑payment of dividends; (4) insolvency of debtor corporation at time; (5) siphoning of funds of corporation by dominant stockholder; (6) non‑functioning of other officers or directors; (7) absence of corporate records; and (8) whether corporation was merely facade for operations of dominant stockholder. University Medical Associates of Medical University of S.C. v. UnumProvident Corp., 2004, 335 F.Supp.2d 702. Corporations And Business Organizations 1043

Generally, a corporation will be looked upon as a legal entity until sufficient reason to the contrary appears; but when the notion of legal entity is used to protect fraud, justify wrong, or defeat public policy, the law will regard the corporation as an association of persons. Hunting v. Elders (S.C.App. 2004) 359 S.C. 217, 597 S.E.2d 803, rehearing denied, certiorari granted, certiorari dismissed. Corporations And Business Organizations 1036; Corporations And Business Organizations 1037; Corporations And Business Organizations 1038

Dominant shareholder’s siphoning of funds from corporation that operated bar that served driver who was already intoxicated supported piercing corporate veil to impose personal liability in motorist’s personal injury case on shareholder, as alter ego of corporation; shareholder siphoned off $400,000 to $800,000 over a three‑year period, and shareholder left in the till only so much as was needed to pay basic expenses. Hunting v. Elders (S.C.App. 2004) 359 S.C. 217, 597 S.E.2d 803, rehearing denied, certiorari granted, certiorari dismissed. Corporations And Business Organizations 1073

Factors of injustice and fundamental unfairness supported piercing corporate veil of corporation that operated bar that served driver who was already intoxicated, to impose liability in motorist’s personal injury suit on dominant shareholder; shareholder knew of claim against corporation, but acted in a self‑serving and unfair manner by siphoning off substantial sums of money, commingling and transferring assets which he held in his own name to different entities, transferring stock in the corporation to other individuals without a valuable consideration, and then finally dissolving the corporation. Hunting v. Elders (S.C.App. 2004) 359 S.C. 217, 597 S.E.2d 803, rehearing denied, certiorari granted, certiorari dismissed. Corporations And Business Organizations 1073

The trial court properly pierced the corporate veil to make the majority shareholder individually and personally liable for his corporation’s admitted debt where he and his wife owned 100 percent of the stock and were the only 2 officers and directors, the corporation was headquartered in their home, they set his salary based on what was needed to meet their expenses at home, they held neither formal directors’ meetings nor shareholders’ meetings, they neither declared nor distributed dividends on outstanding stock, and he knew of the corporate debt, yet used available money for other purposes. Cumberland Wood Products, Inc. v. Bennett (S.C.App. 1992) 308 S.C. 268, 417 S.E.2d 617.

2. Burden of proof

In South Carolina, the equitable doctrine of piercing the corporate veil is not to be applied without substantial reflection and the party seeking to have the corporate identity disregarded has the burden of proving the doctrine should be applied. University Medical Associates of Medical University of S.C. v. UnumProvident Corp., 2004, 335 F.Supp.2d 702. Corporations And Business Organizations 1032; Corporations And Business Organizations 1086(2)

3. Post‑judgment interest

Dominant shareholder of corporation that operated bar that served driver who was already intoxicated was liable for post‑judgment interest in motorist’s personal injury case; when corporate veil was pierced, debts of corporation became shareholder’s individual debts. Hunting v. Elders (S.C.App. 2004) 359 S.C. 217, 597 S.E.2d 803, rehearing denied, certiorari granted, certiorari dismissed. Corporations And Business Organizations 1073

**SECTION 33‑6‑230.** Share dividends.

 (a) 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.

 (b) Shares of one class or series may not be issued as a share dividend in respect of shares of another class or series unless (1) the articles of incorporation so authorize, (2) a majority of the votes entitled to be cast by the class or series to be issued approves the issue, or (3) there are no outstanding shares of the class or series to be issued.

 (c) If the board of directors does not fix the record date for determining shareholders entitled to a share dividend, it is the date the board of directors authorizes the share dividend.

HISTORY: Derived from 1976 Code Section 33‑9‑160 [1962 Code Section 12‑15.15; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

A share dividend is solely a paper transaction: No assets are received by the corporation for the shares and any “dividend” paid in shares does not involve the distribution of property by the corporation to its shareholders. Section 6.23 (Section 33‑6‑230) therefore recognizes that such a transaction involves the issuance of shares “without consideration,” and section 1.40(6) (Section 33‑1‑400(6)) excludes it from the definition of a “distribution.” Such transactions were treated in a fictional way under the old “par value” and “stated capital” statutes, which treated a share dividend as involving transfers from a surplus account to stated capital and assumed that par value shares could be issued without receiving any consideration by reason of that transfer of surplus.

The par value statutory treatment of share dividend transactions distinguished a share “split” from a dividend. In a share “split” the par value of the former shares was divided among the new shares and there was no transfer of surplus into the stated capital account as in the case of a share “dividend.” Since the Model Act has eliminated the concept of par value, the distinction between a “split” and a “dividend” has not been retained and both types of transactions are referred to simply as “share dividends.” A distinction between “share dividends” and “share splits,” however, continues to exist in other contexts—for example, in connection with transactions by publicly held corporations, see N.Y.S.E. LISTED COMPANY MANUAL Section 703.02(a), or corporations that have optionally retained par value for the shares. The change made in the Model Act is not intended to affect the manner in which transactions by these corporations are handled or described but simply reflects the elimination of artificial legal distinctions based on the par value statutes.

A “reverse stock split” is not a share dividend under this section of the Model Act. A reverse split involves an amendment to the articles of incorporation reducing the number of authorized shares, not the issuance of additional shares.

Share dividends may create problems when a corporation has more than a single class of shares. The requirement that a share dividend be “pro rata” only applies to shares of the same class or series; if there are two or more classes entitled to receive a share dividend in different proportions, the dividend will have to be allocated appropriately.

The distribution of shares of one class to holders of another class may dilute the equity of the holders of the first class. Therefore, subsection (b) permits the distribution of shares of one class to the holders of another class only if one or more of the following conditions are met: (1) the articles of incorporation expressly authorize the transaction, (2) the holders of the class being distributed consent to the distribution, or (3) there are no holders of the class being distributed.

SOUTH CAROLINA REPORTERS’ COMMENTS

In the absence of the concepts of treasury shares and capital accounts, pro rata dividends in shares become paper transactions with few ramifications in corporate law. Section 33‑6‑230(a) permits such an issuance to be for no consideration; Section 33‑1‑400(6) excludes such an issuance from the definition of “distribution”.

The 1981 South Carolina Business Corporation Act permitted dividends to be paid to holders of one class of shares in shares of another class, under certain circumstances. Section 33‑6‑230 permits similar dividends in similar circumstances and, additionally, permits such dividends when no shares are outstanding in the class being distributed.

Without capital accounts to be taken into account, it is not necessary to distinguish between stock splits and share dividends. Accordingly, stock splits are treated as share dividends and are governed by Section 33‑6‑230.

DERIVATION: 1984 Model Act Section 6.23.

CROSS REFERENCES

Action by shareholders, see Sections 33‑7‑101 through 33‑7‑104.

Classes of shares, see Sections 33‑6‑101 and 33‑6‑102.

Consideration for shares, see Section 33‑6‑210.

Distributions to shareholders, generally, see Section 33‑6‑400.

Fractional shares, see Section 33‑6‑104.

Record date, see Section 33‑7‑107.

Series of shares, see Section 33‑6‑102.

Library References

Corporations 157.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 294, 302.

**SECTION 33‑6‑240.** Share options; restrictions and conditions for owners of specified percentage of shares.

 (A) A corporation may issue rights, options, or warrants for the purchase of shares of the corporation. The board of directors shall determine the terms upon which the rights, options, or warrants are issued, their form and content, and the consideration for which the shares are to be issued.

 (B) In the case of a public corporation, the terms and conditions of such rights, options, or warrants may include, without limitation, restrictions or conditions that preclude or limit the exercise, transfer, or receipt of the rights, options, or warrants by the holder or holders or beneficial owner or owners of a specified number or percentage of the outstanding voting shares of the public corporation or by any transferee or any such holder or owner, or that invalidate or void the rights, options, or warrants held by the holder or owner or by the transferee. Determinations by the board of directors whether to impose, enforce, waive, or otherwise render ineffective any such restrictions or conditions may be judicially reviewed in an appropriate proceeding.

HISTORY: Derived from 1976 Code Section 33‑9‑90 [1962 Code Section 12‑15.8; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2; 1998 Act No. 328, Section 1.

OFFICIAL COMMENT

A specific provision authorizing the creation of share options and share rights appears in many state statutes. Even though corporations doubtless have the inherent power to issue share options and share rights, specific authorization is desirable because of the economic importance of options and rights, and because of the need to establish the primacy of the board of directors in determining the consideration received by the corporation for rights and options. The creation of incentive compensation plans for directors, officers, agents, and employees is basically a matter of business judgment and the good faith determination by the board of directors should therefore be conclusive. This is as true for incentive plans that involve the issuance of share options or rights as for those that involve the payment of cash. In appropriate cases incentive plans may involve the granting of options at prices below the current market prices of the shares.

Section 6.24 (Section 33‑6‑240) does not require shareholder approval of share options or rights as incentive plans. Of course, prior shareholder approval may be required as a discretionary matter, in order to comply with the requirements of national security exchanges for the listing of securities, see N.Y.S.E. LISTED COMPANY MANUAL Section 309.00, or to acquire the benefits of federal law conditioned upon shareholder approval of such plans, see S.E.C. Rule 16b‑3(a), 17 C.F.R. Section 240‑16b‑3(a).

The reference to the “form of a right, option, or warrant in section 6.24 (Section 33‑6‑240) permits the board of directors to designate the interests issued under section 6.24 (Section 33‑6‑240) as options, warrants, rights, or by some other name, and to evidence these interests by certificates, contracts, letter agreements, or in other forms that are appropriate under the circumstances. Rights, options, or warrants may be issued together with or independently of the corporation’s issue and sale of its shares or other securities.

Some publicly held corporations have delegated administration of programs involving incentive compensation in the form of share rights or options to compensation committees composed of nonmanagement directors, subject to the general authority of the board of directors.

SOUTH CAROLINA REPORTERS’ COMMENTS

Section 33‑6‑240 is a simple authorization to issue rights, options, or warrants to purchase shares. Terms and consideration are entirely in the discretion of the board of directors, and therefore, subject to the statutory duty of care of Section 33‑8‑300. Unlike Section 33‑9‑90(b) of the 1981 South Carolina Business Corporation Act, Section 33‑6‑240 does not specify the contents of any instrument evidencing rights, options, or warrants. In addition, unlike Section 33‑9‑90(c) of the 1981 South Carolina Business Corporation Act, Section 33‑6‑240 does not require shareholder approval of share incentive plans. Corporations deeming such safeguards to be desirable could provide for them in their articles.

DERIVATION: 1984 Model Act Section 6.24.

CROSS REFERENCES

Committees, see Section 33‑8‑250.

Compensation, see Section 33‑3‑102.

Consideration for shares, see Section 33‑6‑210.

Distributions to shareholders, see Section 33‑6‑400.

Report to shareholders on certain consideration for shares, see Section 33‑16‑210.

Standards of conduct for directors, see Sections 33‑8‑300 through 33‑8‑320.

Library References

Corporations 72, 113 to 115.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 146 to 147, 220 to 228, 233 to 250.

Notes of Decisions

In general 1

1. In general

Whether corporation’s owner promised prior option holder to preserve holder’s right to exercise option to purchase 7.5 percent of stock in corporation despite execution of written agreement terminating their business relationship, and whether option holder relied on that promise to his detriment, were questions for jury on option holder’s claim for promissory estoppel. North American Rescue Products, Inc. v. Richardson (S.C. 2015) 411 S.C. 371, 769 S.E.2d 237, rehearing denied. Estoppel 119

Termination agreement between corporation and prior option holder unambiguously terminated any right that option holder had to purchase 7.5% of corporation’s stock, despite option holder’s assertion that agreement was merely one part of three‑part agreement which was meant to be executed contemporaneously with others, where agreement explicitly stated that all agreements, understandings, undertakings or arrangements that arose out of parties’ Outline of Business Arrangement were terminated, that both parties were released from “all claims and potential claims of any nature whatsoever” arising out of Outline, and although provision of agreement purported to reserve option holder’s right to purchase stock in corporation under separate option contract, no such contract was ever executed by parties. North American Rescue Products, Inc. v. Richardson (S.C. 2015) 411 S.C. 371, 769 S.E.2d 237, rehearing denied. Corporations and Business Organizations 1319(4)

**SECTION 33‑6‑250.** Form and content of certificates.

 (a) Shares may be represented by certificates, but need not be so represented, subject to the provisions of Section 33‑6‑260(a). Unless Chapters 1 through 20 of this Title or another statute expressly provides otherwise, the rights and obligations of shareholders are identical whether or not their shares are represented by certificates.

 (b) At a minimum, each share certificate must state on its face:

 (1) the name of the issuing corporation and that it is organized under the laws of this State;

 (2) the name of the person to whom issued; and

 (3) the number and class of shares and the designation of the series, if any, the certificate represents.

 (c) If the issuing corporation is authorized to issue different classes of shares or different series within a class, the designations, relative rights, preferences, and limitations applicable to each class and the variations in rights, preferences, and limitations determined for each series (and the authority of the board of directors to determine variations for future series) must be summarized on the front or back of each certificate. Alternatively, each certificate may state conspicuously on its front or back that the corporation will furnish the shareholder this information on request in writing and without charge.

 (d) Each share certificate (1) must be signed (either manually or in facsimile) by two officers designated in the bylaws or by the board of directors and (2) may bear the corporate seal or its facsimile.

 (e) If the person who signed (either manually or in facsimile) a share certificate no longer holds office when the certificate is issued, the certificate is nevertheless valid.

HISTORY: Derived from 1976 Code Section 33‑9‑110 [1962 Code Section 12‑15.10; 1952 Code Section 12‑241; 1942 Code Section 7681; 1932 Code Section 7681; Civ. C. ‘22 Section 4255; Civ. C. ‘12 Section 2788; Civ. C. ‘02 Section 1847; R. S. 1503; 1905 (24) 872; 1929 (36) 144; 1957 (50) 61; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

This section sets forth the minimum requirements for share certificates. A corporation whose shares are not publicly traded will normally issue certificates that meet these minimum requirements and little more. Securities that are publicly traded, on the other hand, must contain reasonable safeguards against fraudulent duplication; for this reason, regulations by exchanges contain technical requirements relating to design, workmanship, engraving, and printing. Also, exchange requirements may require signatures of a transfer agent and registrar as well as designated corporate officers. All these requirements are in addition to the minimum requirements of the Model Act.

Certificateless shares are permitted under section 6.25(a) (Section 33‑6‑250(a)) upon compliance with section 6.26 (Section 33‑6‑260). Section 6.25(a) (Section 33‑6‑250(a)) makes it clear that there are no differences in the rights and obligations of shareholders, whether or not their shares are represented by certificates, other than mechanical differences, such as the means by which instructions for transfer are communicated to the issuer, necessitated by the use or nonuse of certificates. If share transfer restrictions are imposed, conspicuous references must appear on the certificate if they are to be binding on third persons without knowledge of the restrictions. See section 6.27 (Section 33‑6‑270).

Under section 6.25 (Section 33‑6‑250) all signatures on a share certificate may be facsimiles. This change, which has been adopted recently in several states, gives recognition to the fact that a purchaser of publicly traded shares will hardly ever be in a position to determine whether a manual signature on a stock certificate is in fact the authorized signature of an officer or the transfer agent or registrar. From the standpoint of the issuing corporation of publicly traded securities, if a share certificate requiring a manual signature is stolen and the signature thereafter forged, the corporation may defend on lack of genuineness under section 8‑202(3) of the UNIFORM COMMERCIAL CODE (see Section 36‑8‑202(3) of the 1976 South Carolina Code). But this defense is not effective against a bona fide purchaser when the forged signature has been placed on the certificate by an employee of the issuer or registrar or transfer agent entrusted with handling the certificates (UCC Section 8‑205) (Section 36‑8‑205 of the 1976 South Carolina Code). It is likely that a corporation would therefore follow the same security precautions for blank certificates requiring manual signatures as for those not requiring them. At the same time, the time and expense required for manual signatures has been eliminated.

SOUTH CAROLINA REPORTERS’ COMMENTS

Corporations are permitted to issue shares not evidenced by certificates subject to the enactment of rules governing the issuance, registration, and transfer of such shares. See the Reporters’ Comments to Section 33‑6‑260.

Section 33‑6‑250 effectively requires corporations not summarizing terms of shares on the certificate to stand ready to provide them upon request. With respect to appearance on share certificates of share transfer restrictions, see Section 33‑6‑270.

Section 33‑6‑250 does not require an authenticating agent’s original signature on shares signed by corporate officers only in facsimile, as did the 1981 South Carolina Business Corporation Act.

DERIVATION: 1984 Model Act Section 6.25.

CROSS REFERENCES

Certificateless shares, see Section 33‑6‑260.

Classes of shares, see Sections 33‑6‑101 and 33‑6‑102.

“Conspicuous” defined, see Section 33‑1‑400.

Descriptions of classes, see Section 33‑6‑101.

Fractional shares, see Section 33‑6‑104.

Officers, see Section 33‑8‑400.

Series of shares, see Section 33‑6‑102.

Share transfer restrictions, see Section 33‑6‑270.

RESEARCH REFERENCES

Forms

South Carolina Legal and Business Forms Section 1:11 , Corporate Finance‑Stock Certificates.

South Carolina Legal and Business Forms Section 1:101 , Stock Structure‑Two Classes of Shares With Par Value‑Designation of Rights, Preferences, Restrictions and Limitations.

South Carolina Legal and Business Forms Section 1:112 , Classes of Stock‑Common and Two Classes of Preferred.

South Carolina Legal and Business Forms Section 1:167 , Dissolution‑Liquidation Preference.

South Carolina Legal and Business Forms Section 1:203 , Shareholders’ Rights‑Authentication of Certificates Issued for Shares of Capital Stock‑More Than One Class.

South Carolina Legal and Business Forms Section 1:236 , Stock Certificate.

**SECTION 33‑6‑260.** Shares without certificates.

 (A) Unless the articles of incorporation or bylaws provide otherwise, the board of directors of a corporation may authorize the issue of some or all of the shares of any or all of its classes or series without certificates to the extent that investment securities not evidenced by certificates are authorized by Chapter 8 of Title 36 of the South Carolina Uniform Commercial Code. The authorization does not affect shares already represented by certificates until the shares or certificates are surrendered to the corporation.

 (B) Within a reasonable time after the issue or transfer of shares to a shareholder without certificates, the corporation must send the shareholder a written statement containing the information required on a certification by Section 33‑6‑250(b) and (c) and Section 33‑6‑270, if applicable.

HISTORY: Derived from 1976 Code Section 33‑9‑110 [1962 Code Section 12‑15.10; 1952 Code Section 12‑241; 1942 Code Section 7681; 1932 Code Section 7681; Civ. C. ‘22 Section 4255; Civ. C. ‘12 Section 2788; Civ. C. ‘02 Section 1847; R. S. 1503; 1905 (24) 872; 1929 (36) 144; 1957 (50) 61; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2; 2001 Act No. 67, Section 10; 2004 Act No. 221, Section 13.

OFFICIAL COMMENT

Section 6.26(a) (Section 33‑6‑260(a)) authorizes the creation of uncertificated shares either by original issue or in substitution for shares previously represented by certificates. This subsection gives the board of directors the widest discretion so that a particular class and series of shares might be entirely represented by certificates, entirely uncertificated, or represented partly by each. The second sentence ensures that a corporation may not treat as uncertificated, and accordingly transferable on its books without due presentation of a certificate, any shares for which a certificate is outstanding.

The statement required by section 6.26(b) (Section 33‑6‑260(b)) ensures that holders of uncertificated shares will receive from the corporation the same information that the holders of certificates receive when certificates are issued. There is no requirement that this information be delivered to purchasers of uncertificated shares before purchase.

Detailed rules with respect to the issuance, transfer, and registration of both certificated and uncertificated shares appear in article 8 of the UNIFORM COMMERCIAL CODE. In general terms there are no differences between certificated and uncertificated securities except in matters such as their manner of transfer. See the Official Comment to section 6.25 (Section 33‑6‑250).

South Carolina Reporters’ Comment To 2000 Revision

This section permits corporations wishing to issue securities not represented by certificates to do so using the rules found in Chapter 8 of Title 36 of the South Carolina Uniform Commercial Code. Chapter 8 of Title 36 was comprehensively amended effective July 1, 2000, deleting, among other things, the requirement that issuers of uncertificated securities provide information statements to new holders of such securities. This section has been amended in conformity, deleting the requirement for information statements found in former subsection (b). The balance of the amendment to this Section was nonsubstantive.

CROSS REFERENCES

Form and content of certificates, generally, see Section 33‑6‑250.

RESEARCH REFERENCES

Forms

South Carolina Legal and Business Forms Section 1:11 , Corporate Finance‑Stock Certificates.

**SECTION 33‑6‑270.** Restriction on transfer or registration of shares or other securities.

 (a) The articles of incorporation, bylaws, an agreement among shareholders, or an agreement between shareholders and the corporation may impose restrictions on the transfer or registration of transfer of shares of the corporation. A restriction does not affect shares issued before the restriction was adopted unless the holders of the shares are parties to the restriction agreement or voted in favor of the restriction.

 (b) A restriction on the transfer or registration of transfer of shares is valid and enforceable against the holder or a transferee of the holder if the restriction is authorized by this section and its existence is noted conspicuously on the front or back of the certificate or is contained in the information statement required by Section 33‑6‑260(b). Unless so noted, a restriction is not enforceable against a person without knowledge of the restriction.

 (c) A restriction on the transfer or registration of transfer of shares is authorized:

 (1) to maintain the corporation’s status when it is dependent on the number or identity of its shareholders;

 (2) to preserve exemptions under federal or state securities law;

 (3) for any other reasonable purpose.

 (d) A restriction on the transfer or registration of transfer of shares may:

 (1) obligate the shareholder first to offer the corporation or other persons (separately, consecutively, or simultaneously) an opportunity to acquire the restricted shares;

 (2) obligate the corporation or other persons (separately, consecutively, or simultaneously) to acquire the restricted shares;

 (3) require the corporation, the holders of any class of its shares, or another person to approve the transfer of the restricted shares, if the requirement is not manifestly unreasonable;

 (4) prohibit the transfer of the restricted shares to designated persons or classes of persons, if the prohibition is not manifestly unreasonable.

 (e) For purposes of this section, “shares” includes a security convertible into or carrying a right to subscribe for or acquire shares.

HISTORY: 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

Share transfer restrictions are widely used by both publicly held and closely held corporations for a variety of appropriate purposes. Although most courts have upheld reasonable share transfer restrictions, a few have rigidly followed the common law rule that they constituted restraints on alienation and should be strictly construed. As a result, some cases have invalidated restrictions outright or construed them narrowly so as not to cover specific transfers. By prescribing reasonable rules to govern the use of transfer restrictions, section 6.27 (Section 33‑6‑270) should guide practitioners in their use and encourage a more uniform and favorable judicial reception.

Examples of the uses of share transfer restrictions include:

(1) a close corporation may impose share transfer restrictions to qualify for the close corporation election under the Model Statutory Close Corporation Supplement (See Ch. 18);.

(2) a corporation with relatively few shareholders may impose share transfer restrictions to ensure that current shareholders will be able to control who may participate in the corporation’s business;.

(3) a corporation with relatively few shareholders may impose share transfer restrictions to ensure that shareholders who wish to retire will be able to liquidate their investment without disrupting corporate affairs;.

(4) a corporation with few shareholders may impose share transfer restrictions in an effort to ensure that estates of deceased shareholders will be able to liquidate the closely held shares and that the Internal Revenue Service will accept the liquidated value of the shares as their value for estate tax purposes;.

(5) a professional corporation may impose share transfer restrictions to ensure that its treatment of retiring or deceased shareholders is consistent with the canons of ethics applicable to the profession in question;.

(6) a corporation may impose share transfer restrictions to ensure that its election of subchapter S treatment under the Internal Revenue Code will not be unexpectedly terminated; and.

(7) a publicly held or closely held corporation issuing securities pursuant to an exemption from federal or state securities act registration may impose share transfer restrictions to ensure that subsequent transfers of shares will not result in the loss of the exemption being relied upon.

This listing, while not exhaustive, illustrates the flexibility of share transfer restrictions, their widespread use, and the importance of having a statute dealing with them.

Section 6.27(a) (Section 33‑6‑270(a)) generally authorizes the imposition of transfer restrictions on “shares,” although the caption of the section refers to “shares and other securities.” Section 6.27(e) (Section 33‑6‑270(e)) defines “shares” for purposes of section 6.27 (Section 33‑6‑270) to include securities “convertible into or carrying a right to subscribe for or acquire shares;” the phrase “other securities” in the title thus describes the broader scope of this section resulting from the definition in section 6.27(e) (Section 33‑6‑270(e)).

Share transfer restrictions are usually created by provisions in the bylaws or articles of incorporation but may also be created by contract between the corporation and some or all the shareholders or between or among the shareholders themselves. However, if shares are originally issued free of restriction, they may not thereafter be subjected to a transfer restriction without the consent of the holder, evidenced by a vote in favor of the amendment to the articles or bylaws creating the restriction, or by being a party to the contract creating the restriction.

The terms of a restriction on transfer do not need to be set forth in full or summarized in detail on a certificate or information statement required by section 6.26(b) (Section 33‑6‑260(b)) for uncertificated securities. Rather, section 6.27(b) (Section 33‑6‑270(b)) provides that in the case of a certificated security, the existence of the restriction must be conspicuously set forth on the front or back of the certificate; in the case of an uncertificated security, the existence of the restriction must be noted in the information statement. There is no requirement that the notation on an information statement be conspicuous.

If a transferee knows of the restriction he is bound by it even though the restriction is not noted on the certificate or information statement.

Section 6.27(c) (Section 33‑6‑270(c)) describes the purposes for which restrictions may be imposed while section 6.27(d) (Section 33‑6‑270(d)) describes the types of restrictions that may be imposed.

Section 6.27(c) (Section 33‑6‑270(c)) enumerates certain purposes for which share transfer restrictions may be imposed, but does not limit the purposes since section 6.27(c)(3) (Section 33‑6‑270(c)(3)) permits restrictions “for any other reasonable purpose.” Examples of the “status” referred to in section 6.27(c)(1) (Section 33‑6‑270(c)(1)) are the election of close corporation status under the Model Statutory Close Corporation Supplement, the subchapter S election under the Internal Revenue Code, and entitlement to a program or eligibility for a privilege administered by governmental agencies or national securities exchanges. Specific references in section 6.27 (Section 33‑6‑270) to subchapter S and other statutes were not made because of the possibility that the Internal Revenue Code or other statute may be amended or recodified after the adoption of the Model Act.

Section 6.27(c)(2) (Section 33‑6‑270(c)(2)) permits restrictions on transfers of shares to ensure availability of exemptions under state or federal securities acts. Share transfer restrictions for other purposes are permitted by section 6.23(c)(3) (Section 33‑6‑230(c)(3)) so long as the purpose is reasonable. It is unnecessary to inquire into the reasonableness of the purposes specifically enumerated in sections 6.27(c)(1) and (2) (Section 33‑6‑270(c)(1) and (2).

The types of restrictions referred to in section 6.27(d)(1) (Section 33‑6‑270(d)(1)) (option agreements) and (2) (buy‑sell agreements) are imposed as a matter of contractual negotiation and do not prohibit the outright transfer of shares. Rather, they designate to whom shares or other securities must be offered at a price established in the agreement or by a formula or method agreed to in advance. By contrast, the restrictions described in sections 6.27(d)(3) and (4) (Section 33‑6‑270(d)(3) and (4)) may permanently limit the market for shares by disqualifying all or some potential purchasers. As a result the restriction imposed by these two provisions must not be “manifestly unreasonable.”

SOUTH CAROLINA REPORTERS’ COMMENTS

Free transferability of ownership is a basic characteristic of corporations. Restrictions on share transfer were disfavored strongly at common law as restraints on alienation, and continue to be controversial. The majority of states have enacted statutes permitting share transfer restrictions in limited circumstances.

Prior to adoption of Section 33‑6‑270, restrictions on transfer of securities were a matter of common law in South Carolina, they but generated little litigation. In Alderman v. Alderman, 178 S.C. 9, 181 S.E. 897 (1935), the South Carolina Supreme Court took the view that shares of stock were shareholder property (as opposed to contracts between shareholder and issuer) of which the holder could dispose in reasonable ways not offensive to public policy. In Alderman, a disposition was upheld which had the effect of restricting transfer. In McLeod v. Sandy Island Corp., 265 S.C. 1, 216 S.E.2d 746 (1975), the Court reaffirmed that shares are property and may be disposed of as the owner chooses unless such right of disposition is “properly restricted”. Restrictions, the Court held, are to be construed narrowly.

Uniformity is desirable particularly in rules governing the circulation of securities. Section 33‑6‑270 is intended to promote uniformity in share transfer restrictions by codifying generally accepted rules addressing the purpose for which share transfer restrictions may be used, the manner in which such transfers may be restricted, and against whom such restrictions can be enforced.

Section 33‑6‑270(c) describes the purposes for which share transfer restrictions may be used. Subsections (c)(1) and (c)(2) permit restrictions related to compliance with regulatory schemes. Subsection (c)(3) permits restraints for any other purpose which is “reasonable.” In general, restrictions have been found reasonable when they have related to the purposes for which the corporation was formed. For example, restrictions for the purpose of limiting the share ownership in a close corporation are reasonable in purpose.

Section 33‑6‑270(d) permits four manners of restriction. Those permitted by subsections (d)(1) (right of first refusal) and (d)(2) (a “put” option), strictly speaking, do not restrain alienation; they permit control over the first offeree only. Such arrangements are not highly controversial at common law. Restrictions permitted by subsections (d)(3) and (d)(4), however, can have the effect of limiting the market for shares, and at common law their acceptability is less clear. At present, the common law trend is to allow such restrictions if they are not unreasonable. Section 33‑6‑270(d) permits them if they are not “manifestly unreasonable.” Reasonableness refers, as under subsection (c), to purpose. The intention of the section is to permit Subsections (d)(3) and (d)(4) restrictions when they are related to some purpose for which the corporation was formed and do not restrain alienation in a scope or manner unrelated to such purpose. To defeat the restriction, such unreasonableness must be “manifest”—clear, requiring no subtle analysis to be recognized. The phrasing of subsections (d)(3) and (d)(4) places the burden on the one who alleges unreasonableness.

In effect, Section 33‑6‑270(d) describes narrowly drawn circumstances, to be narrowly construed, in which the presumption of free transferability of shares can be rebutted. The presumption may reasonably be relied on even in the face of permissible restrictions, in circumstances described in Section 33‑6‑270(a) and (b). Section 33‑6‑270(a) provides that restrictions applied to outstanding shares are not enforceable against holders who do not agree to the restrictions. Subsection (b) provides that even if “authorized by this section” a restriction is not enforceable unless it is “noted conspicuously on the front or back of the certificate.” Section 36‑8‑240 of the South Carolina Uniform Commercial Code is to similar effect, although it applies only to restrictions “imposed by the issuer”, while Section 33‑6‑270 applies to restrictions imposed either by the issuer or by shareholders.

DERIVATION: 1984 Model Act Section 6.27.

CROSS REFERENCES

Certificates for shares, see Section 33‑6‑250.

Classes of shares, see Section 33‑6‑101.

Close corporations, Statutory Close Corporation Supplement, see Sections 33‑18‑101 et seq.

Consideration for shares, see Section 33‑6‑210.

“Conspicuous” defined, see Section 33‑1‑400.

Debt securities, see Section 33‑3‑102.

Dissenters’ rights, see Section 33‑13‑240.

Information statement, see Sections 33‑6‑250 and 33‑6‑260.

Professional corporations, Professional Corporation Supplement, see Sections 33‑19‑101 et seq.

Library References

Corporations 113, 130.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 220, 272 to 275.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Banks and Banking Section 58, Transfer of Shares.

Forms

South Carolina Legal and Business Forms Section 1:11 , Corporate Finance‑Stock Certificates.

South Carolina Legal and Business Forms Section 1:129 , Stock Transfers‑Authorization of Restrictions.

South Carolina Legal and Business Forms Section 1:237 , Endorsement on Certificate‑Stock Transfer Restrictions.

**SECTION 33‑6‑280.** Expense of issue.

 A corporation may pay the expenses of selling or underwriting its shares, and of organizing or reorganizing the corporation, from the consideration received for shares.

HISTORY: Derived from 1976 Code Section 33‑9‑100 [1962 Code Section 12‑15.9; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

The original purpose of this section was to deal with the problems created by the concepts of “par value” and “stated capital;” it permitted the corporation to expend its capital for “the reasonable charges and expenses of” organization without fear of making the shares not fully paid or assessable because the assets were reduced below the aggregate par value of the issued shares.

Under the modern capitalization principles set forth in the Model Act (see the Official Comment to section 6.21 (Section 33‑6‑210)), there is no basis for the fear that shares issued properly under section 6.21 (Section 33‑6‑210) can be made assessable because of the subsequent use of the proceeds. While section 6.28 (Section 33‑6‑280) thus may be technically unnecessary, it was believed to be desirable to retain in the Model Act a general authorization to the corporation to pay its expenses of formation and raising capital out of its original capitalization. The reference to “reasonable” charges and expenses was deleted on the theory that the test for these expenses should be no different from the test for expenses of any other type.

The concluding language in the original Model Act, “without rendering the shares not fully paid or assessable,” was also deleted as unnecessary and confusing in the context of the revisions to the financial provisions of the Model Act.

This section has been rarely cited or referred to in court decisions even though it appears in a large number of state statutes.

SOUTH CAROLINA REPORTERS’ COMMENTS

A similar provision was found in 1981 South Carolina Business Corporation Act Section 33‑9‑100(b).

Compensation in the form of discounts from issue price granted to participants in the distribution of an issuance of shares, such as selling group members, dealers, or underwriters, would be considered “expenses” for purpose of this section. Accordingly, shares would not be rendered assessable because of having been distributed subject to such discounts.

CROSS REFERENCES

Consideration for shares, see Section 33‑6‑210.

Fully paid shares, see Section 33‑6‑210.

Liability of shareholders, see Section 33‑6‑220.

ARTICLE 3

Subsequent Acquisition of Shares by Shareholders and Corporation

**SECTION 33‑6‑300.** Shareholders’ preemptive rights.

 (a) The shareholders of a corporation have a preemptive right to acquire the corporation’s unissued shares except to the extent the articles of incorporation otherwise provide.

 (b) Unless a statement is included in the articles of incorporation that ‘the corporation elects not to have preemptive rights’ (or words of similar import), the following principles apply except to the extent the articles of incorporation expressly provide otherwise:

 (1) The shareholders of the corporation have a preemptive right, granted on uniform terms and conditions prescribed by the board of directors to provide a fair and reasonable opportunity to exercise the right, to acquire proportional amounts of the corporation’s unissued shares upon the decision of the board of directors to issue them.

 (2) A shareholder may waive his preemptive right. A waiver evidenced by a writing is irrevocable even though it is not supported by consideration.

 (3) There is no preemptive right with respect to:

 (i) shares issued as compensation to directors, officers, agents, or employees of the corporation, its subsidiaries, or affiliates;

 (ii) shares issued to satisfy conversion or option rights created to provide compensation to directors, officers, agents, or employees of the corporation, its subsidiaries, or affiliates;

 (iii) shares authorized in the articles of incorporation that are issued within six months from the effective date of incorporation;

 (iv) shares sold otherwise than for money.

 (4) Holders of shares of any class without general voting rights but with preferential rights to distributions or assets have no preemptive rights with respect to shares of any class.

 (5) Holders of shares of any class with general voting rights but without preferential rights to distributions or assets have no preemptive rights with respect to shares of any class with preferential rights to distributions or assets unless the shares with preferential rights are convertible into or carry a right to subscribe for or acquire shares without preferential rights.

 (6) Shares subject to preemptive rights that are not acquired by shareholders may be issued to any person for a period of one year after being offered to shareholders at a consideration set by the board of directors that is not lower than the consideration set for the exercise of preemptive rights. An offer at a lower consideration or after the expiration of one year is subject to the shareholders’ preemptive rights.

 (c) For purposes of this section, “shares” includes a security convertible into or carrying a right to subscribe for or acquire shares.

 (d) The sale or other disposition by the corporation of shares or securities not subject to a preemptive right under this section, or under the articles of incorporation as permitted by this section, shall not impair any remedy which any shareholder may have for a breach of duty by the board of directors.

HISTORY: Derived from 1976 Code Section 33‑11‑210 [1962 Code Section 12‑16.21; 1952 Code Section 12‑275; 1942 Code Section 7688; 1932 Code Section 7688; Civ. C. ‘22 Section 4262; Civ. C. ‘12 Section 2795; Civ. C. ‘02 Section 1851; 1899 (22) 54; 1903 (24) 72; 1904 (24) 436; 1962 (52) 1996; 1963 (53) 327; 1964 (53) 1910; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

[Note: This Act retains the “opt‑out” format in Section 33‑11‑210 of the 1981 South Carolina Business Corporation Act rather than the “opt‑in” format of the 1984 Model Act. See the South Carolina Reporters’ Comments.].

Section 6.30(a) (Section 33‑6‑300(a)) adopts an “opt in” provision for preemptive rights: Unless an affirmative reference to these rights appears in the articles of incorporation, no preemptive rights exist. Whether or not preemptive rights are elected, however, the directors’ fiduciary duties extend to the issuance of shares. Issuance of shares at favorable prices to directors (but excluding other shareholders) or the issuance of shares on a nonproportional basis for the purpose of affecting control rather than raising capital may violate that duty. These duties, it is believed, form a more rational structure of regulation than the technical principles of traditional preemptive rights.

Section 6.30(b) (Section 33‑6‑300(b)) provides a standard model for preemptive rights if the corporation desires to exercise the “opt in” alternative of section 6.30(a) (Section 33‑6‑300(a)). The simple phrase, “the corporation elects to have preemptive rights,” or words of similar import, results in the rest of subsection (b) becoming applicable to the corporation. But a corporation may qualify or limit any of the rules set forth in subsection (b) by express provisions in the articles of incorporation if the rules are felt to be undesirable or inappropriate for the specific corporation. The purposes of this standard model for preemptive rights are (1) to simplify drafting articles of incorporation and (2) to provide a simple checklist of business considerations for the benefit of attorneys who are considering the inclusion of preemptive rights in articles of incorporation.

The provisions of section 6.30(b) (Section 33‑6‑300(b)) establish rules for most of the problems involving preemptive rights. Thus subsection (b)(1) defines the general scope of the preemptive right giving appropriate recognition to the discretion of the board of directors in establishing the terms and conditions for exercise of that right. Subsection (b)(2) creates rules with respect to the waiver of these rights. Subsection (b)(3) lists the principal exceptions to preemptive rights, including a six‑month period during which initial capital can be raised by a newly formed corporation without regard to the preemptive rights of persons who have previously acquired shares. Subsections (b)(4) and (b)(5) provide rules for the often‑difficult problems created when preemptive rights are recognized in corporations with more than a single class of shares. These problems are discussed further below. Subsection (b)(6) defines the status of preemptive rights after a shareholder has elected not to exercise a proffered preemptive right: for a period of one year thereafter the corporation may dispose of the shares at the same or a higher price. A corporation deciding to offer shares at a lower price must reoffer the shares preemptively to the shareholders before selling them to third persons.

As indicated above, any portion of section 6.30(b) (Section 33‑6‑300(b)) that is felt not to be appropriate for a specific corporation may be amended or deleted by appropriate provision in the articles of incorporation.

The model provision dealing with preemptive rights in section 6.30(b) (Section 33‑6‑300(b)) is primarily designed to protect voting power within the corporation from dilution. For this reason, section 6.30(c) (Section 33‑6‑300(c)) contains a special definition of “shares” to ensure that the preemptive rights of shareholders, if these rights are granted, apply to all securities that are convertible into or carry a right to acquire voting shares.

On the other hand, preemptive rights also may serve in part the function of protecting the equity participation of shareholders. This combination of functions creates no problem in a corporation that has authorized only a single class of shares but may occasionally create problems in corporations with more complex capital structures. In many multiple‑class corporate financial structures, the issuance of additional shares of one class does not adversely affect other classes. For example, the issuance of additional general voting shares without preferential rights normally does not affect either the limited voting power or equity participation of holders of shares with preferential rights; holders of shares with preferential equity participation rights but without general voting rights should therefore have no preemptive rights with respect to general voting shares without preferential rights. See subsections (b)(4) and (b)(5). Classes of shares that may give rise to possible conflict between the protection of voting interests and equity participation when the board of directors desires to issue additional shares include classes of nonvoting shares without preferential rights and classes of shares with both preferential rights to distributions and general voting rights. Attorneys who draft articles of incorporation with classes of shares that may give rise to these conflicts should consider the precise application of section 6.30(b) (Section 33‑6‑300(b)) with respect to preemptive rights for these classes and define more carefully the scope of the preemptive rights desired.

SOUTH CAROLINA REPORTERS’ COMMENTS

This section carries forward the “opt‑out” format for preemptive rights in Section 33‑11‑210 of the 1981 South Carolina Business Corporation Act. Therefore, preemptive rights automatically apply unless the articles of incorporation otherwise provide. The 1984 Model Act, on the other hand, utilizes an “opt‑in” format under which preemptive rights only apply if the articles of incorporation so provide. Continuation of the “opt‑out” format in the 1981 Act avoids potential transition problems for corporations existing at the effective date of this act. Corporations in existence at the effective date of this act having provisions in their articles of incorporation opting out of preemptive rights will not have to take any action to continue to be exempt from this section.

Although this section uses the “opt‑out” format, it incorporates the substantive provisions in subsection (b) of the Model Act, which sets forth statutory rules that apply if a corporation has preemptive rights. These rules offer more protection to existing shareholders than the equivalent provisions of Section 33‑11‑220 of the 1981 South Carolina Business Corporation Act.

Subsection (d) of this section also carries forward subsection (e) of former Section 33‑11‑210. This subsection makes it clear that a sale of shares not subject to preemptive rights by a corporation is nevertheless subject to the director’s usual duties (see Section 33‑8‑300). This subsection is applicable even if a corporation has a provision in its articles of incorporation exempting it from any preemptive rights.

Section 33‑6‑300(b)(6) is similar to Section 33‑11‑210(c)(9) of the 1981 South Carolina Business Corporation Act in permitting shares not taken up by shareholders to be offered generally for sale at the issue price; the new provision adds, however, that the price of such shares may be lowered after one year and that any preemptive rights are revived at the new price.

The two‑year, new‑corporation suspension of preemptive rights of Section 33‑11‑210(c)(4) of the 1981 South Carolina Business Corporation Act is shortened to six months by new Section 33‑6‑300(b)(3)(iii).

DERIVATION: 1984 Model Act Section 6.30, with major amendments. See South Carolina Reporters’ Comments.

CROSS REFERENCES

Articles of incorporation, see Section 33‑2‑102.

Consideration for shares, see Section 33‑6‑210.

Debt securities, see Section 33‑3‑102.

Distributions, see Sections 33‑1‑400 and 33‑6‑400.

Fractional shares, see Section 33‑6‑104.

Share classes and series, see Sections 33‑6‑101 and 33‑6‑102.

Share options, see Section 33‑6‑240.

Standards of conduct for directors, see Sections 33‑8‑300 through 33‑8‑320.

Library References

Corporations 158, 159.

Westlaw Topic No. 101.

C.J.S. Corporations Section 132.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Banks and Banking Section 70, Shareholders’ Preemptive Rights.

Forms

South Carolina Legal and Business Forms Section 1:14 , Shareholders‑Generally.

**SECTION 33‑6‑310.** Corporation’s acquisition of own shares.

 (a) A corporation may acquire its own shares, and shares so acquired constitute authorized but unissued shares.

 (b) If the articles of incorporation prohibit the reissue of acquired shares, the number of authorized shares is reduced by the number of shares acquired, effective upon amendment of the articles of incorporation.

 (c) The board of directors may adopt articles of amendment under this section without shareholder action and deliver them to the Secretary of State for filing. The articles must set forth:

 (1) the name of the corporation;

 (2) the reduction of the number of authorized shares, itemized by class and series; and

 (3) the total number of authorized shares, itemized by class and series, remaining after reduction of the shares.

HISTORY: Derived from 1976 Code Section 33‑9‑180 [1962 Code Section 12‑15.17; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], Section 33‑9‑190 [1962 Code Section 12‑15.18; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], and Section 33‑9‑210 [1962 Code Section 12‑15.20; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

The elimination of the concepts of “par value” and “stated capital” in the 1980 amendments to the Model Act (see the Official Comment to section 6.21 (Section 33‑6‑210)) permitted the simplification of a number of other sections of the Act and the elimination of several historical concepts that primarily served the purpose of ameliorating problems created by retention of the concepts of “par value” and “stated capital.”

One concept eliminated by the 1980 amendments was that of treasury shares. The status of once‑issued but reacquired shares was an uneasy one under the traditional statutes. It was universally recognized that a corporation’s shares in its own hands are not an asset any more than authorized but unissued shares. As an economic matter payments made by a corporation to repurchase its own shares must be viewed as a distribution of corporate assets by the corporation rather than as an acquisition of an asset. Further, conventional statutes gave treasury shares an intermediate status between issued and unissued: they were treated as outstanding shares for some purposes, and they could be resold or disposed of by the corporation (presumably) without regard to restrictions that might be imposed on the original issuance of shares by the corporation. Finally, the accounting treatment for treasury shares was complex, confusing, and to some extent unrealistic since the capital accounts often did not reflect transactions in treasury shares.

Under the 1980 revisions of the financial provisions in the Model Act the concept of treasury shares is unnecessary. Authorized but unissued shares of the corporation may be issued on the same basis and with the same freedom as treasury shares under earlier statutes. Attorneys’ opinions on the legality of the issuance of shares under the revised Model Act will therefore be unaffected by the elimination of the technical distinction between original shares and treasury shares. A possible exception to these statements is that the concept of treasury shares may have permitted listed companies to save modestly on stock exchange listing fees in some cases that may not be available under the revised Model Act provisions.

Section 6.31(a) (Section 33‑6‑310(a)) restates the fundamental power of a corporation to reacquire its own shares. Such a transaction constitutes a “distribution” by the corporation (see the definition of that term in section 1.40 (Section 33‑1‑400)) and is subject to the limitations of section 6.40 (Section 33‑6‑400).

Shares that are reacquired by the corporation become authorized but unissued shares under section 6.31(b) (Section 33‑6‑310(b)) unless the articles prohibit reissue, in which event they are cancelled. Section 6.31(c) (Section 33‑6‑310(c)) requires a simplified official filing to reflect the reduction of authorized shares. This provision is included in order that there be a public record of the number of authorized shares that a corporation may issue. The amendment may be made without shareholder action. See section 10.02 (Section 33‑10‑102).

Until the amendment referred to in section 6.31(c) (Section 33‑6‑310(c)) is effective, the corporation has power to reissue the reacquired shares despite a prohibition in the articles of incorporation. In such a case, the action of the directors in issuing the shares may be challengeable but the shares so issued would be fully paid and nonassessable if issued in conformity with section 6.21 (Section 33‑6‑210).

SOUTH CAROLINA REPORTERS’ COMMENTS

A share repurchase is a “distribution” under Section 33‑1‑400(6), so that legal funds for share repurchase must be determined according to Section 33‑6‑400.

DERIVATION 1984 Model Act Section 6.31.

CROSS REFERENCES

Acquisition as “distribution”, see Section 33‑1‑400.

Amendment of articles of incorporation, see Sections 33‑10‑101 et seq.

Annual report, see Sections 12‑20‑30 and 33‑16‑220.

“Deliver” includes mail, see Section 33‑1‑400.

Distributions to shareholders generally, see Section 33‑6‑400.

Effective time and date of amendment, see Section 33‑1‑230.

Filing fees, see Section 33‑1‑220.

Filing requirements, see Section 33‑1‑200.

Issuance of shares, see Section 33‑6‑210.

Standards of conduct for directors, see Sections 33‑8‑300 through 33‑8‑320.

Library References

Corporations 376.

Westlaw Topic No. 101.

C.J.S. Corporations Section 561.

ARTICLE 4

Distributions

**SECTION 33‑6‑400.** Distributions to shareholders.

 (a) A board of directors may authorize and the corporation may make distributions to its shareholders subject to restriction by the articles of incorporation and the limitation in subsection (c).

 (b) If the board of directors does not fix the record date for determining shareholders entitled to a distribution (other than one involving a repurchase or reacquisition of shares), it is the date the board of directors authorizes the distribution.

 (c) No distribution may be made if, after giving it effect:

 (1) the corporation would not be able to pay its debts as they become due in the usual course of business; or

 (2) the corporation’s total assets would be less than 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 shareholders whose preferential rights are superior to those receiving the distribution.

 (d) The board of directors may base a determination that a distribution is not prohibited under subsection (c) either on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances or on a fair valuation or other method that is reasonable in the circumstances.

 (e) The effect of a distribution under subsection (c) is measured:

 (1) in the case of distribution by purchase, redemption, or other acquisition of the corporation’s shares, as of the earlier of (i) the date money or other property is transferred or debt incurred by the corporation or (ii) the date the shareholder ceases to be a shareholder with respect to the acquired shares;

 (2) in the case of any other distribution of indebtedness, as of the date the indebtedness is distributed;

 (3) in all other cases, as of (i) the date the distribution is authorized if the payment occurs within one hundred twenty days after the date of authorization or (ii) the date the payment is made if it occurs more than one hundred twenty days after the date of authorization.

 (f) A corporation’s indebtedness to a shareholder incurred by reason of a distribution made in accordance with this section is at parity with the corporation’s indebtedness to its general, unsecured creditors except to the extent subordinated by agreement.

HISTORY: Derived from 1976 Code Section 33‑9‑150 [1962 Code Section 12‑15.14; 1952 Code Section 12‑201; 1942 Code Section 7724‑3; 1932 Code Section 1353; Cr. C. ‘22 Section 244; Cr. C. ‘12 Section 211; 1909 (26) 21; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], Section 33‑9‑170 [1962 Code Section 12‑15.16; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], 33‑9‑190 R 1988 No. 444 Section 2; Recod as 33‑6‑101 and 33‑6‑400 by 1988 No. 444 Section 2, Section 33‑9‑180 [1962 Code Section 12‑15.17; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], Section 33‑9‑190 [1962 Code Section 12‑15.18; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], Section 33‑9‑200 [1962 Code Section 12‑15.19; 1962 (52) 1996; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], Section 33‑9‑210 [1962 Code Section 12‑15.20; 1962 (52) 1996; 1963 (53) 327; 1981 Act No. 146, Section 2; Repealed, 1988 Act No. 444, Section 2], and Section 33‑9‑260 [1985 Act No. 72 Section 6; Repealed, 1988 Act No. 444, Section 2]; 1988 Act No. 444, Section 2.

OFFICIAL COMMENT

The reformulation of the statutory standards governing distributions is another important change made by the 1980 revisions to the financial provisions of the Model Act. It has long been recognized that the traditional “par value” and “stated capital” statutes do not provide significant protection against distributions of capital to shareholders. While most of these statutes contained elaborate provisions establishing “stated capital,” “capital surplus,” and “earned surplus” (and often other types of surplus as well), the net effect of most statutes was to permit the distribution to shareholders of most or all of the corporation’s net assets—its capital along with its earnings—if the shareholders wished this to be done. However, statutes also generally imposed an equity insolvency test on distributions that prohibited distributions of assets if the corporation was insolvent or if the distribution had the effect of making the corporation insolvent or unable to meet its obligations as they were projected to arise.

The financial provisions of the revised Model Act, which are based on the 1980 amendments, sweep away all the distinctions among the various types of surplus but retain restrictions on distributions built around both the traditional equity insolvency and balance sheet tests of earlier statutes.

1. THE SCOPE OF SECTION 6.40 (Section 33‑6‑400).

Section 1.40 (Section 33‑1‑400) defines “distribution” to include virtually all transfers of money, indebtedness of the corporation or other property to a shareholder in respect of the corporation’s shares. It thus includes cash or property dividends, payments by a corporation to purchase its own shares, distributions of promissory notes or indebtedness, and distributions in partial or complete liquidation or voluntary or involuntary dissolution. Section 1.40 (Section 33‑1‑400) excludes from the definition of “distribution” transactions by the corporation in which only its own shares are distributed to its shareholders. These transactions are called “share dividends” in the revised Model Business Corporation Act. See section 6.23 (Section 33‑6‑230).

Section 6.40 (Section 33‑6‑400) imposes a single, uniform test on all distributions. Many of the old “par value” and “stated capital” statutes provided tests that varied with the type of distribution under consideration or did not cover certain types of distributions at all.

2. EQUITY INSOLVENCY TEST.

As noted above, older statutes prohibited payment of dividends if the corporation was, or as a result of the payment would be, insolvent in the equity sense. This test is retained, appearing in section 6.40(c)(1) (Section 33‑6‑400(c)(1)).

For an on‑going business enterprise the equity insolvency test requires that decisions be based on a cash flow analysis that is itself based on a business forecast and budget for a sufficient period of time to permit a conclusion that known obligations of the corporation can reasonably be expected to be satisfied over the period of time that they will mature. It is not sufficient simply to measure current assets against current liabilities, or determine that the present estimated “liquidation” value of the corporation’s assets would produce sufficient funds to satisfy the corporation’s existing liabilities.

In determining whether a corporation is, or as a result of a proposed distribution would be rendered, insolvent, the board of directors may rely on information supplied by the officers of the corporation. It is not necessary for them to know of the details of the cash flow analysis if the proposed distribution involves no significant risk of equity insolvency. Judgments, further, must of necessity be made on the basis of information in the hands of the board of directors when a distribution is authorized. See section 8.30 (Section 33‑8‑300).

3. RELATIONSHIP TO THE FEDERAL BANKRUPTCY ACT AND OTHER FRAUDULENT CONVEYANCE STATUTES.

The revised Model Business Corporation Act establishes the validity of distributions from the corporate law standpoint under section 6.40 (Section 33‑6‑400) and determines the potential liability of directors for improper distributions under sections 8.30 and 8.33 (Section 33‑8‑300 and 33‑8‑330). The federal Bankruptcy Act and state fraudulent conveyance statutes, on the other hand, are designed to enable the trustee or other representative to recapture for the benefit of creditors funds distributed to others in some circumstances. In light of these diverse purposes, it was not thought necessary to make the tests of section 6.40 (Section 33‑6‑400) identical with the tests for insolvency under these various statutes.

4. BALANCE SHEET TEST.

Section 6.40(c)(2) (Section 33‑6‑400(c)(2)) requires that, after giving effect to any distribution, the corporation’s assets equal or exceed its liabilities plus (with some exceptions) the dissolution preferences of senior equity securities. Section 6.40(d) (Section 33‑6‑400(d)) authorizes asset and liability determinations to be made for this purpose on the basis of either (1) financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances or (2) a fair valuation or other method that is reasonable in the circumstances. The determination of a corporation’s assets and liabilities and the choice of the permissible basis on which to do so are left to the judgment of its board of directors. In making a judgment under section 6.40(d) (Section 33‑6‑400(d)), the board may rely under section 8.30 (Section 33‑8‑300) upon opinions, reports, or statements, including financial statements and other financial data prepared or presented by public accountants or others.

Section 6.40 (Section 33‑6‑400) does not incorporate technical accounting terminology and specific accounting concepts. Accounting terminology and concepts are constantly under review and subject to revision by the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, the Securities and Exchange Commission, and others. In making determinations under this section, the board of directors may make judgments about accounting matters, taking into account its right to rely upon professional or expert opinion and its obligation to be reasonably informed as to pertinent standards of importance that bear upon the subject at issue.

In a corporation with subsidiaries, the board of directors may rely on unconsolidated statements prepared on the basis of the equity method of accounting (see American Institute of Certified Public Accountants, APB Opinion No. 18 (1971)) as to the corporation’s investee corporations, including corporate joint ventures and subsidiaries, although other evidence would be relevant in the total determination.

a. Generally accepted accounting principles.

The directors will normally be entitled to use generally accepted accounting principles and to give presumptive weight to the advice of professional accountants with respect to their application. But section 6.40 (Section 33‑6‑400) only requires the use of accounting practices and principles that are reasonable in the circumstances, and does not constitute a statutory enactment of generally accepted accounting principles. The widespread controversy concerning various accounting principles, and their continuous reevaluation, suggest that a statutory standard of reasonableness, rather than of generally accepted accounting principles, is appropriate. The Model Act does not reject generally accepted accounting principles; on the contrary, it is expected that their use will be the basic rule in most cases. The statutory language does, however, require informed business judgment applying particular accounting principles to the entire circumstances that exist at the time.

b. Other principles.

If a corporation’s financial statements are not presented in accordance with generally accepted accounting principles, a board of directors should normally consider the extent to which the assets may not be fairly stated or the liabilities may be understated in determining the aggregate amount of assets and liabilities.

Section 6.40(d) (Section 33‑6‑400(d)) specifically permits determinations to be made under section 6.40(c)(2) (Section 33‑6‑400(c)(2)) on the basis of a fair valuation or other method that is reasonable in the circumstances. Thus the statute authorizes departures from historical cost accounting and sanctions the use of appraisal methods to determine the funds available for distributions. No particular method of valuation is prescribed in the statute, since different methods may have validity depending upon the circumstances, including the type of enterprise and the purpose for which the determinations is made. For example, it is inappropriate to apply a “quick‑sale liquidation” value to an enterprise in most cases, particularly with respect to the payment of normal dividends. On the other hand, a “quick‑sale” valuation might be appropriate in certain circumstances for an enterprise in the course of liquidation or of reducing its asset or business base by a material degree. In most cases, a fair valuation method or a going‑concern basis would be appropriate if it is believed that the enterprise will continue as a going concern.

In determining the value of assets, all of the assets of a corporation, whether or not reflected in the financial statements (e.g., a valuable executory contract), should be considered. Ordinarily a corporation should not selectively revalue assets. Likewise, all of a corporation’s obligations and commitments should be considered and quantified to the extent appropriate and possible. In any event, section 6.40(d) (Section 33‑6‑400(d)) imposes upon the board of directors the responsibility of applying under section 6.40(c)(2) (Section 33‑6‑400(c)(2)) a method of determining the aggregate amounts of assets and liabilities that is reasonable in the circumstances.

Section 6.40(d) (Section 33‑6‑40(d)) also refers to some “other method that is reasonable in the circumstances.” This phrase is inserted to comprehend within section 6.40(c)(2) (Section 33‑6‑40(c)(2)) the wide variety of possibilities that might not be considered to fall under a “fair valuation” but might be reasonable in the circumstances of a particular case.

5. PREFERENTIAL DISSOLUTION RIGHTS AND THE BALANCE SHEET TEST.

Section 6.40(c)(2) (Section 33‑6‑400(c)(2)) provides that a distribution may not be made unless the total assets of the corporation exceed its liabilities plus the amount that would be needed to satisfy any shareholders’ superior preferential rights upon dissolution if the corporation were to be dissolved at the time of the distribution. This requirement in effect treats preferential dissolution rights of classes or series of shares for distribution purposes as equivalent to liabilities rather than as equity interests, and carries forward analogous treatment of shares having preferential dissolution rights from earlier versions of the Model Act. In making the calculation of the amount that must be added to the liabilities of the corporation to reflect the preferential dissolution rights, the assumption should be made that the preferential dissolution rights are to be established pursuant to the articles of incorporation (or resolution creating a series having preferential dissolution rights) as of the date of the distribution or proposed distribution. The amount so determined must include arrearages in preferential dividends if the articles of incorporation or resolution require that they be paid upon the dissolution of the corporation. In the case of shares having both a preferential right upon dissolution and additional nonpreferential rights, only the preferential portion of the rights should be taken into account. The treatment of preferential dissolution rights of classes of shares set forth in section 6.40(c)(2) (Section 33‑6‑400(c)(2)) is applicable only to the balance sheet test and is not applicable to the equity insolvency test of section 6.40(c)(1) (Section 33‑6‑400(c)(1)). The treatment of preferential rights mandated by this section may always be eliminated by an appropriate provision in the articles of incorporation.

6. TIME OF MEASUREMENT.

Section 6.40(e)(3) (Section 33‑6‑400(e)(3)) provides that the time for measuring the effect of a distribution for compliance with the insolvency and balance sheet tests for all distributions not involving the reacquisition of shares or the distribution of indebtedness is the date of authorization, if the payment occurs within 120 days following the authorization; if the payment occurs more than 120 days after the authorization, however, the date of payment must be used. If the corporation elects to make a distribution in the form of its own indebtedness under section 6.40(e)(2) (Section 33‑6‑400(e)(2)), the validity of that distribution must be measured as of the time of distribution.

Section 6.40(e)(1) (Section 33‑6‑400(e)(1)) provides a different rule for the time of measurement when the distribution involves a reacquisition of shares. See part 8a below.

7. RECORD DATE.

Section 6.40(b) (Section 33‑6‑400(b)) fixes the record date (if the board of directors does not otherwise fix it) for distributions other than those involving a repurchase or reacquisition of shares as the date the board of directors authorizes the distribution. No record date is necessary for a repurchase or reacquisition of shares from one or more specific shareholders. The board of directors has discretion to set a record date for a repurchase or reacquisition if it is to be pro rata and to be offered to all shareholders as of a specified date.

8. APPLICATION TO REPURCHASES OR REDEMPTION OF SHARES.

The application of the equity insolvency and balance sheet tests to distributions that involve the purchase or redemption of shares creates unique problems; section 6.40 (Section 33‑6‑400) provides specific rules for the resolution of these problems as described below.

a. Time of measurement.

Section 6.40(e)(1) (Section 33‑6‑400(e)(1)) provides that the time for measuring the effect of a distribution under section 6.40(c) (Section 33‑6‑400(c), if shares of the corporation are reacquired, is the earlier of (i) the payment date, or (ii) the date the shareholder ceased to be a shareholder with respect to the shares.

b. When tests are applied to redemption‑related debt.

In an acquisition of its shares, a corporation may transfer property or incur debt to the former holder of the shares. The case law on the status of this debt is conflicting. However, share repurchase agreements involving payment for shares over a period of time are of special importance in closely held corporate enterprises. Section 6.40(e) (Section 33‑6‑400(e)) provides a clear rule for this situation; the legality of the distribution must be measured at the time of the issuance or incurrence of the debt, not at a later date when the debt is actually paid. Of course, this does not preclude a later challenge of a payment on account of redemption‑related debt by a bankruptcy trustee on the ground that it constitutes a preferential payment to a creditor.

c. Priority of debt distributed directly or incurred in connection with a redemption.

Section 6.40(f) (Section 33‑6‑400(f)) provides that indebtedness created to purchase shares or issued as a distribution is on a parity with the indebtedness of the corporation to its general, unsecured creditors, except to the extent subordinated by agreement. General creditors are better off in these situations than they would have been if cash or other property had been paid out for the shares or distributed (which is proper under the statute), and no worse off than if cash had been paid out to the shareholders, which was then lent back to the corporation, making the shareholders creditors. The parity created by section 6.40(f) (Section 33‑6‑400(f)) therefore is logically consistent with the rule established by section 6.40(e) (Section 33‑6‑400(e)) that these transactions should be judged at the time of the issuance of the debt.

SOUTH CAROLINA REPORTERS’ COMMENTS

1. Introduction.

The law governing the Anglo‑American concept of business corporations has long had as an aim that those investing in or lending to a corporation have a basis for confidence that the capital of the corporation will not be dissipated unduly, but will be preserved insofar as possible to generate new value or to be available in liquidation. This aim has traditionally been approached through statutory employment of the capital accounts concept: Corporations have been required to prepare a balance sheet including prescribed accounts reflecting the source of a corporation’s capital and the relative permanence of that capital in the corporation. These accounts were determined on the basis of par value. The concept of par value developed early in the law of corporations as a way to prevent jobbers from charging different investors different prices for shares of the same offering. Par value was the established initial offering price; purchasers “at par” each came in on an equal basis. Accordingly, par value multiplied by the number of shares sold in a venture yielded the capitalization of the venture. This capitalization would be represented on the balance sheet by an account with a name such as “restricted capital”. The amount of capital represented by such an account was not available for distributions (that is, disbursements of value in respect of shares, such as dividends). When value was added to the company by profit or by sales of shares at prices higher than par value, such value was represented in the balance sheet by accounts with such names as “capital surplus” and “earned surplus”. Distributions were permitted, in appropriate circumstances, up to the amounts represented by these accounts. The point was to make distributions only out of value added and to preserve intact the fundamental capitalization upon which investors and lenders had relied in deciding whether to invest or lend. Distributions were not to be permitted to diminish or “impair” capital.

Present‑day methods of share distribution have rendered par value unnecessary to serve its initial function; virtually the sole function of the concept in present business corporation statutes is to assist in computing the capital accounts, although most statutes provide means of calculating the accounts without using par value, to enable corporations to issue no‑par stock. The concept of par value, in short, no longer is needed.

Compliance with a capital accounts system adds considerable complexity and restriction to corporate accounting in respect of shares and distributions. Does such a system provide protection worth the added complexity and restriction? In the view of many, the answer is no. The capital accounts system, with its emphasis on liquidation value, no longer addresses the concerns of investors or lenders. It is capable of being manipulated and is therefore potentially misleading. It founds legality of distributions upon a fiction bearing little relationship to legitimate corporate financial practices and goals.

These matters are addressed in more detail in B. Manning, A CONCISE TEXTBOOK ON LEGAL CAPITAL (Foundation Press, 2d ed. 1981).

Prior to 1985, legality of distributions by South Carolina corporations was calculated on the basis of the capital accounts concept. In 1985, Section 33‑9‑260 was engrafted upon the 1981 South Carolina Business Corporation Act, ending the required use of the capital accounts method of calculating legal distributions. The operative provisions of former Section 33‑11‑260 were in all material respects identical to those of Section 33‑6‑400 of this act. Accordingly, the adoption of this section represented not the appearance of something new but acknowledgement that references in the prior South Carolina Business Corporation Acts to the capital accounts concept were surplusage, subsumed by the breadth of discretion permitted by Section 33‑6‑400. The provisions of Section 33‑6‑400 are sufficiently broad that boards of directors wishing to continue to calculate legality of distributions using capital accounts may continue to do so if to do so would be reasonable under the circumstances (see Section 33‑6‑400(d)).

The departure of the capital accounts concept from the South Carolina Business Corporation Act ended the usefulness of par value for corporation finance purposes.

The purpose of Section 33‑6‑400 is to protect creditors and shareholders from misapplication of capital. Compared to its predecessor provisions in the former South Carolina Business Corporation Act, Section 33‑6‑400 is intended to broaden the acceptable basis for determining that a distribution is permitted. The method for making such a determination is simplified and rationalized with modern views of creditor and shareholder security. In these ways, Section 33‑6‑400 is intended to provide more meaningful protection to creditors and shareholders while diminishing directors’ exposure to lawsuits based on illegal distributions.

The 1981 South Carolina Business Corporation Act contained different tests for legality of share repurchase than for other kinds of distributions. The present Code contains only one set of tests, found at Section 33‑6‑400(c), and the broad definition of “distribution” at Section 33‑1‑400(6) makes these tests applicable to share repurchase and every other transfer of value from the corporation to shareholder in respect of shares, except stock dividends.

2. Subsection (c).

Subsection (c) preserves the two tests of Section 33‑9‑260(c) of the 1981 South Carolina Business Corporation Act: an equity insolvency test at subsection (c)(1) and a balance sheet test at subsection (c)(2).

The equity insolvency test was the basic test in the 1981 South Carolina Business Corporation Act even before the 1985 amendment. Former Section 33‑9‑150 provided that dividends were not to be paid “when the corporation is insolvent or when the payment of the dividend would render the corporation insolvent”. “Insolvent” was defined at Section 33‑1‑20(15) of the 1981 South Carolina Business Corporation Act as “inability of the corporation to pay its debts as they become overdue [sic] in the usual course of its business.” These words are virtually identical to those of Section 33‑6‑400(c)(1) and are intended to have the same meaning, so that South Carolina corporations are confronted with nothing new or unfamiliar in this respect.

The balance sheet test of subsection (c)(2) performs the same function as did the old capital‑accounts rules, which is to demonstrate that on a pro forma basis a contemplated distribution would leave the corporation’s capital unimpaired. The basis on which this demonstration may be made is broadened considerably (see the discussion of subsection (d) below).

“Total liabilities” in subsection (c)(2) includes preferences upon liquidation. In many cases, depending upon the provisions of covenants accompanying the issue of senior securities, such preferences will include accrued cumulative dividends. Because the amount of preferences is to be calculated as though the corporation were being liquidated on the date of the proposed distribution, accrued cumulative dividends which would have been payable only upon some contingency which had not occurred by such date would not be included in the total amount of preferences.

3. Subsection (d).

Subsection (d) is intended to protect directors while affording them wide discretion in choosing a basis on which to make the calculations required by subsection (c). For example, if in the circumstances generally accepted accounting principles furnish a reasonable basis for preparing financial statements for use in the calculations required by subsection (c), then subsection (d) provides that such principles “may” be used. Generally accepted accounting principles are so broadly applicable that the Official Comment to this section observes that “directors will normally be entitled” to employ them “and to give presumptive weight to the advice of professional accountants with respect to their application.” Directors are not required to employ such principles, however, and, even when such principles would be reasonable, in the words of subsection (d), may use “any other method that is reasonable in the circumstances.”

The directors’ determination that a distribution is not prohibited under subsection (c) is a business judgment to be measured against the standard of care of Sections 33‑8‑300 and 33‑8‑330. Once it is shown that directors formed their judgment in good faith, using ordinary prudence and in the reasonable belief that the action taken was in the corporation’s best interests, courts do not look behind the directors’ judgment or substitute their judgment for that of the directors. It is not intended that courts consider whether every available source of information was exhausted by the directors in forming their judgment, or whether certain sources of information should have been taken into account by the directors but were not.

DERIVATION: 1984 Model Act Section 6.40.

CROSS REFERENCES

“Distribution” defined, see Section 33‑1‑400.

Liability for unlawful distributions, see Section 33‑8‑330.

Record date, see Section 33‑7‑107.

Redemption, see Sections 33‑6‑101 and 33‑6‑103.

Restrictions on issued and outstanding shares, see Section 33‑6‑103.

Sale of assets other than in regular course of business, see Section 33‑12‑102.

Share dividends, see Section 33‑6‑230.

Standards of conduct for directors, see Sections 33‑8‑300 through 33‑8‑320.

Library References

Corporations 151 to 157.

Westlaw Topic No. 101.

C.J.S. Corporations Sections 156, 293 to 302.

RESEARCH REFERENCES

Encyclopedias

S.C. Jur. Banks and Banking Section 69, Distributions to Shareholders.

S.C. Jur. Banks and Banking Section 75, Extent of Liability.

S.C. Jur. Banks and Banking Section 83, Declaration of Dividends.

Forms

South Carolina Legal and Business Forms Section 1:136 , Dividend Rights.

South Carolina Legal and Business Forms Section 1:200 , Shareholders’ Rights‑Declaration of Dividends‑Limitations.

South Carolina Legal and Business Forms Section 1:214 , Board of Directors‑Power to Declare Dividends.

South Carolina Legal and Business Forms Section 1:251 , Resolution‑Declaration of Dividend.

Notes of Decisions

In general 1

1. In general

Court’s prior erroneous determination in action by creditor against insolvent corporation’s directors under South Carolina’s Statute of Elizabeth governing fraudulent conveyances, that South Carolina law did not recognize derivative suits by creditors, was law of the case on corporate directors’ motion for judgment as a matter of law; determination would not work a manifest injustice, since creditor would recover on fraudulent conveyance claim. PCS Nitrogen, Inc. v. Ross Development Corp., 2015, 126 F.Supp.3d 611. Courts 99(6)

Through a derivative suit under South Carolina law, a shareholder can reverse the distribution that renders a corporation insolvent and return the distributed assets to the corporation, making the corporation again solvent and restoring the shareholders’ residual ownership interests in the corporation. PCS Nitrogen, Inc. v. Ross Development Corp., 2015, 126 F.Supp.3d 611. Corporations and Business Organizations 2025

Provision of South Carolina Business Corporations Act prohibiting distributions making a corporation insolvent did not preclude suit by creditor against corporate directors for improper distributions; corporation was already insolvent at the time the challenged distributions were made, and provision addressed only a shareholder’s rights to challenge distributions rendering a corporation insolvent. PCS Nitrogen, Inc. v. Ross Development Corp., 2015, 126 F.Supp.3d 611. Corporations and Business Organizations 1993