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## NOTES

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# SHAREHOLDERS' AGREEMENTS IN ALASKA AFTER *HIKITA V. NICHIRO GYOGYO* *KAISHA, LTD.* \*

### I. INTRODUCTION

The Alaska Business Corporation Act,<sup>1</sup> which has remained relatively unaltered since it was enacted in 1957,<sup>2</sup> is based, in the main, on the original American Bar Foundation Model Business Corporation Act.<sup>3</sup> Both suffer from the same major deficiency: they attempt to create a single statutory framework for the organization of all corporations, but their provisions are designed to meet the problems of large public-issue corporations, virtually ignoring the special needs of closely held corporations. In the thirty years since the enactment of the Alaska Business Corporation Act, many states have recognized the problems with this unitary approach and have adopted legislation which makes the corporate form more flexible.<sup>4</sup> These modern corporation codes typically contain a special chapter that allows the participants in a closely held corporation to depart from the traditional

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1. ALASKA STAT. §§ 10.05.003-.828 (1985).

2. 1957 Alaska Sess. Laws ch. 126, at 164 (although the Alaska Business Corporation Act was extensively revised with 1980 Alaska Session Laws ch. 123 (un-paginated), the basic format of the code was not altered).

3. MODEL BUSINESS CORP. ACT (1960) (amended 1969, 1984).

4. See ALA. CODE §§ 10-2A-300 to -313 (1980); ARIZ. REV. STAT. ANN. §§ 10-201 to -218 (1977 & Supp. 1986); CAL. CORP. CODE §§ 158, 204, 300 (West Supp. 1987); DEL. CODE ANN. tit. 8, § 341-356 (1983 & Supp. 1986); FLA. STAT. § 607.107 (1977); GA. CODE ANN. § 14-2-120 (1982); HAW. REV. STAT. § 416.75 (1985); ILL. ANN. STAT. ch. 32, paras. 1201-1216 (Smith-Hurd Supp. 1987); KAN. STAT. ANN. §§ 17-7201 to -7216 (1981); ME. REV. STAT. ANN. tit. 13A, § 102(5) (1981); MD. CORPS. & ASS'NS CODE ANN. §§ 4-101 to -603 (1985 & Supp. 1986); MICH. COMP. LAWS ANN. § 450.1463 (West Supp. 1987); MINN. STAT. ANN. § 302A.011(6a) (West 1985); MONT. CODE ANN. § 35-1-515 (1987); N.J. STAT. ANN. § 14A:5-21 (West Supp. 1987); N.Y. BUS. CORP. LAW § 620 (McKinney 1986); N.C. GEN. STAT. § 55-73 (1982); N.D. CENT. CODE § 10-19.1-01(6) (1985); OHIO REV. CODE ANN. § 1701.591 (Anderson Supp. 1986); PA. STAT. ANN. tit. 15, §§ 1371-1386 (Purdon Supp. 1987); R.I. GEN. LAWS § 7-1.1-51 (1985); S.C. CODE ANN. § 33-11-220 (Law.

pattern of corporate management by adopting measures such as high vote requirements and stock transfer restrictions upon compliance with certain formalities.<sup>5</sup> Section 354 of the Delaware General Corporation Law captures the spirit of this modern approach to the close corporation when it states that no shareholders' agreement or corporate bylaw of a close corporation "shall be [deemed] invalid on the ground that it is an attempt . . . to treat the corporation as if it were a partnership . . . ."<sup>6</sup>

The enactment of separate provisions for close corporations has encouraged courts to depart from the strict construction of corporation statutes that dominated corporate jurisprudence at the beginning of this century.<sup>7</sup> This more liberal approach is typified by the New York Court of Appeals' decision in *Zion v. Kurtz*.<sup>8</sup> This case determined the validity of a Delaware corporation's shareholders' agreement which proscribed any corporate action without the consent of the minority shareholder. The agreement fell within the scope of the traditional rule that agreements which impinge upon the authority of the board of directors are void as against public policy.<sup>9</sup> The corporation had not been formally incorporated as a close corporation in compliance with section 343 of the Delaware General Corporation Law<sup>10</sup> and, thus, the agreement fell outside the safe harbor of section 350.<sup>11</sup> The New York Court of Appeals held that this failure of technical compliance should be ignored in view of the absence of harm to a third party and "the liberal legislative purpose demonstrated by the Delaware [close corporation] statutes . . . ."<sup>12</sup>

The need for specific provisions for close corporations to be added to the Alaska Business Corporation Act<sup>13</sup> has already been pointed out in an earlier edition of this journal.<sup>14</sup> In the absence of a close corporation statute in Alaska, shareholders' agreements play a pivotal

Co-op. 1977); TEX. REV. CIV. STAT. ANN. art. 12.01-.54 (Vernon Supp. 1987); VA. CODE ANN. § 13.1-655 (1985); WIS. STAT. ANN. § 180.995 (West Supp. 1986).

5. See, e.g., DEL. CODE ANN. tit. 8, § 342 (1983).

6. *Id.* § 354.

7. See, e.g., *Jackson v. Hooper*, 76 N.J. Eq. 592, 75 A. 568 (1910); *Manson v. Curtis*, 223 N.Y. 313, 119 N.E. 559 (1918).

8. 50 N.Y.2d 92, 405 N.E.2d 681, 428 N.Y.S.2d 199 (1980).

9. See, e.g., *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.*, 297 N.Y. 174, 77 N.E.2d 633 (1948).

10. DEL. CODE ANN. tit. 8, § 343 (1983) (for a corporation to qualify as a close corporation under Delaware law, the certificate of incorporation must state that the corporation is a close corporation, state that the number of shareholders is limited to 30, and include a restriction on the transferability of shares).

11. *Id.* § 350 (agreements which restrict the power of directors are valid).

12. *Zion*, 50 N.Y.2d at 102 n.3, 405 N.E.2d at 685 n.3, 428 N.Y.S. 2d at 204 n.3.

13. ALASKA STAT. §§ 10.05.003-.828 (1985).

14. Note, *Close Corporations in Alaska*, 17 U.C.L.A.-ALASKA L. REV. 123, 167 (1977).

function, since they allow investors in a close corporation to inject some flexibility into the existing statutory scheme. Through a shareholders' agreement participants in a closely held corporation typically attempt to allocate control, employment, participation or policy. These agreements, however, are only useful to the extent that courts will enforce them. Otherwise, they represent little more than a wish list that can be ignored by the majority whenever there is a disagreement. Until recently, the absence in Alaska of any case law on shareholders' agreements left their validity open to speculation.<sup>15</sup> Litigation surrounding the demise of Adak Aleutian Processors, Inc. ("AAP")<sup>16</sup> has now resolved some of these uncertainties. Unfortunately, in the two AAP cases, the Alaska Supreme Court took a capricious attitude to the related issue of whether a shareholder has standing to sue for breach of an agreement. In the first AAP case, *Norman v. Nichiro Gyogyo Kaisha, Ltd.*,<sup>17</sup> the court decided that the AAP shareholders' agreement could only be enforced by the corporation or through a shareholders' derivative action. In the second AAP case, *Hikita v. Nichiro Gyogyo Kaisha, Ltd.*,<sup>18</sup> the court reversed its earlier decision and held that the breach of the AAP agreement gave rise to a direct cause of action as well as a corporate cause of action.

This note first analyzes the AAP litigation's determination of the validity of particular provisions of the shareholders' agreement. Second, the note reviews the Alaska Supreme Court's analysis of the standing issue. The final section points out the problems with this approach and presents an alternative approach to this issue.

## II. VALIDITY OF SHAREHOLDERS' AGREEMENTS IN ALASKA

Adak Aleutian Processors, Inc., was formed in November 1972 by Isaac C. Norman. Its major asset was a five year lease from the United States Navy of certain land and buildings on Finger Bay, Adak Island.<sup>19</sup> The declared purpose of the corporation was to establish a land-based fish processing facility on this property.<sup>20</sup> In order to achieve this objective, Norman needed to attract other investors with sufficient funds and expertise in the fishing industry.<sup>21</sup> In June of 1973, Norman sold thirty percent of the AAP stock to Alaska Foods, a Washington corporation, thirty percent to Nippon Gyogyo Kaisha, Ltd. ("NGK"), a Japanese corporation, and ten percent to Market

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15. *See id.*

16. *See infra* notes 37-43 and accompanying text.

17. 645 P.2d 191 (Alaska 1982).

18. 713 P.2d 1197 (Alaska 1986).

19. *Id.* at 1198.

20. *See* Articles of Incorporation of Adak Aleutian Processors, art. 3(a), *reprinted in* Brief for Appellant exhibit 1 at 9, *Hikita*, 713 P.2d 1197 (No. S-0494).

21. *Norman*, 645 P.2d at 192.

Place, a Hawaiian corporation. All of these companies were already involved in the fishing industry. Alaska Foods was wholly owned by Alaska Shokai, a Japanese corporation. Alaska Shokai was controlled by Takehiro Hikita, who with his family owned ninety percent of its stock.<sup>22</sup> Norman retained twenty percent of the AAP stock, the remaining ten percent having been transferred to the son of Akira Otani, the vice-president, treasurer, and manager of Market Place, as a finder's fee to Akira for introducing Norman to the other investors.<sup>23</sup> Norman, Alaska Foods, NGK, and Market Place entered into a complicated purchase agreement under which the stock was to be paid for in installments. Until it was fully paid, the stock was to be held in an escrow account, but the purchasers were to receive the voting rights immediately.<sup>24</sup>

All of the AAP shareholders entered into a separate shareholders' agreement,<sup>25</sup> which became the basis of the subsequent litigation in *Norman v. Nichiro Gyogyo Kaisha, Ltd.*<sup>26</sup> and *Hikita v. Nichiro Gyogyo Kaisha, Ltd.*<sup>27</sup> The agreement required all shareholders to exert their best efforts to achieve the corporate and business purposes of AAP.<sup>28</sup> It also contained a voting agreement<sup>29</sup> and stock transfer restrictions,<sup>30</sup> and it enumerated the distribution rights to the corporation's product,<sup>31</sup> as well as the specific obligations owed by NGK, Alaska Foods, and Market Place to AAP "in furtherance of [AAP's] corporate and business purposes."<sup>32</sup> Specifically, NGK agreed to furnish funds for the construction of the Finger Bay facilities, to provide AAP with working capital, and to furnish technical assistance to AAP for the Adak operations.<sup>33</sup> Alaska Foods also agreed to furnish funds for the construction of the Finger Bay facilities and, in addition, to provide the personnel to run AAP's general business affairs.<sup>34</sup> Market Place agreed to coordinate relations between AAP and NGK and

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22. *Hikita*, 713 P.2d at 1198.

23. See Purchasers' Agreement § 6(b), reprinted in Brief for Appellant exhibit 1 at 33, *Hikita*, 713 P.2d 1197 (No. S-0494); see also *Hikita*, 713 P.2d 1197, 1198 n.3 [hereinafter Purchasers' Agreement].

24. Purchasers' Agreement, *supra* note 23, §§ 4, 6(a).

25. Shareholders' Agreement, reprinted in Brief for Appellant exhibit 1 at 1-7, *Hikita*, 713 P.2d 1197 (No. S-0494) [hereinafter Shareholders' Agreement].

26. 645 P.2d 191 (Alaska 1982).

27. 713 P.2d 1197 (Alaska 1986).

28. Shareholders' Agreement, *supra* note 25, § 1.

29. *Id.* § 2.

30. *Id.* § 3.

31. *Id.* § 4.

32. *Id.* § 6.

33. *Id.* § 6(a).

34. *Id.* § 6(b).

Alaska Foods, and to serve as liaison between AAP and the federal and state governments.<sup>35</sup>

The processing plant was completed under NGK's direction in 1973, but its total cost came to \$3.2 million, compared to an original estimate of \$700,000. The first fishing season was unprofitable because construction delays resulted in a late start, and NGK completely abandoned the AAP venture in January 1975, a few days into the next season.<sup>36</sup> A flurry of suits followed.

In April 1975, Norman sued NGK for the balance of the funds owed to him under the stock purchase agreement.<sup>37</sup> In June 1975, Nichiro Pacific, Ltd. ("NPL"), a wholly owned subsidiary of NGK incorporated in Washington,<sup>38</sup> brought an action against AAP for repayment of working capital loans. AAP counterclaimed, alleging mismanagement and abandonment.<sup>39</sup> Also, in June 1975, AAP filed suit in Alaska Federal District Court against NGK and NPL for mismanagement and abandonment.<sup>40</sup> In August 1975, the Bank of California, which had foreclosed against Alaska Foods and acquired notes executed by AAP as security for loans from Alaska Foods, brought suit against AAP and NPL. AAP cross-claimed against NPL, asserting mismanagement and abandonment, and NPL cross-claimed against AAP to foreclose its working capital loans.<sup>41</sup> In August 1977, Norman sought to amend his complaint, adding NPL as a defendant and asserting additional claims for breach of the shareholders' agreement and tortious interference by NGK and NPL with Norman's employment contract with AAP.<sup>42</sup> Finally, in October 1977, Takehiro Hikita and Alaska Foods filed suit against NGK and NPL for breach of the shareholders' agreement and a series of tort claims.<sup>43</sup>

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35. *Id.* § 6(c).

36. See Brief for Appellee at 7, *Norman v. Nichiro Gyogyo Kaisha, Ltd.*, 645 P.2d 191 (Alaska 1982) (No. 5254).

37. *Norman*, 645 P.2d at 193.

38. Brief for Appellee at 3, *Hikita v. Nichiro Gyogyo Kaisha, Ltd.*, 713 P.2d 1197 (Alaska 1986) (No. S-0494).

39. *Nichiro Pacific, Ltd. v. Adak Aleutian Processors*, Civ. No. 75-4074[G], slip op. (Alaska Super. Ct. July 13, 1976) (Nichiro Pacific, Ltd. awarded summary judgment against Adak Aleutian Processors on a claim of failure to repay loans).

40. *Adak Aleutian Processors v. Nichiro Gyogyo Kaisha, Ltd.*, No. A-75-153 Civ., slip op. (D. Alaska May 3, 1976) (dismissed by stipulation without findings of fact).

41. *Bank of California v. Adak Aleutian Processors*, No. A-75-182 Civ., slip op. (D. Alaska Aug. 15, 1975) (decree of foreclosure granted to Bank of California and Nichiro Pacific, Ltd. against Adak Aleutian Processors; Adak Aleutian Processors' cross-claim against Nichiro Pacific, Ltd. dismissed with prejudice for failure to comply with discovery).

42. *Norman v. Nichiro Gyogyo Kaisha, Ltd.*, 645 P.2d 191, 193 (Alaska 1982).

43. Brief for Appellee at 12, *Norman*, 645 P.2d 191 (No. 5254).

No party in any of these suits questioned the validity of the shareholders' agreement; they raised, instead, the narrower issue of who was the proper party to enforce it.<sup>44</sup> The validity of such an agreement, however, had been open to question in Alaska before the AAP litigation.<sup>45</sup> In particular, the designation of the corporate officers in section 2 of the agreement and of the distribution and marketing rights in section 4 of the agreement conflicted with the statutory norms set out in the Alaska Business Corporation Act. The Act specifically requires that the officers of a corporation be elected by the board of directors<sup>46</sup> and that the board manage the business and affairs of a corporation.<sup>47</sup> The Alaska Supreme Court's adjudication in *Norman* and *Hikita* of the issue of who was the proper party to sue for a breach of the shareholders' agreement required implicit acceptance of the agreement's validity and the adoption of a flexible attitude to the legislative norms. The extent of this acceptance is emphasized by the court's language and analysis in the opinions.<sup>48</sup>

In *Norman*, the court relied extensively on *E.K. Buck Retail Stores v. Harkert*<sup>49</sup> in which the Nebraska Supreme Court upheld a shareholders' agreement in which the majority shareholders agreed that each would nominate two of a corporation's four directors.<sup>50</sup> The Alaska Supreme Court cited with approval the Nebraska court's analysis that "the only reason the agreement was valid was that it was for the benefit of the corporation and all shareholders alike."<sup>51</sup> The Alaska court then proceeded to apply the same analysis to the AAP agreement. It stated that "a reading of the shareholders' agreement in the instant case shows that it, like the agreement in *E.K. Buck*, was intended to benefit the corporation and all shareholders alike."<sup>52</sup> Although *Hikita* overruled portions of the *Norman* opinion,<sup>53</sup> it also

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44. See, e.g., Brief for Appellant at 12-13, *Hikita v. Nichiro Gyogyo Kaisha, Ltd.*, 713 P.2d 1197 (Alaska 1986) (No. S-0494).

45. See Note, *supra* note 14, at 167.

46. ALASKA STAT. § 10.05.228 (1985).

47. *Id.* § 10.05.174.

48. The court did not suggest in either opinion that the agreement itself was invalid. In fact, the court quoted the agreement extensively in *Norman*, 645 P.2d at 196, and held that Alaska Foods could recover damages for a breach of the agreement in *Hikita*, 713 P.2d at 1201.

49. 157 Neb. 867, 62 N.W.2d 288 (1954).

50. *Id.* at 871, 62 N.W.2d at 293.

51. *Norman*, 645 P.2d at 196 (citing *E.K. Buck*, 157 Neb. at 899, 62 N.W.2d at 307). The Alaska court chose to completely ignore the *E.K. Buck* court's suggestion that agreements which created "dummy" boards of directors or impinged upon the board of directors' powers were void as being against public policy. See 157 Neb. at 890, 62 N.W.2d at 303.

52. *Norman*, 645 P.2d at 196.

53. *Hikita*, 713 P.2d at 1200-01.

accepted this "benefit to the corporation" test of the validity of shareholder's agreements and stated that "[a] shareholder's agreement for the benefit of a corporation does create a duty running to both the corporation and the promisee."<sup>54</sup>

The position adopted by the court in the NGK litigation allows one to draw certain conclusions about shareholders' agreements in Alaska. First, the strongest evidence that an agreement is for the benefit of the corporation and all shareholders alike is that all of the shareholders have signed it. In the absence of any intent to defraud creditors or the public, an agreement made by all the shareholders of an Alaska corporation should be presumed valid.<sup>55</sup> The agreement in *E.K. Buck*, however, shows that, under this "benefit to all the shareholders" test, even agreements made by a mere majority of the shareholders may be considered valid if they can be shown to benefit all shareholders equally.<sup>56</sup> A showing of a direct benefit to the company would be strong evidence of this type of agreement.<sup>57</sup> A prudent attorney, however, would be well advised to beware of suggesting that clients enter into such agreements, the validity of which would be a question of legal fact and dependent upon the interpretation of the courts. A court could easily conclude that an agreement among less than a majority of the shareholders benefits only the signers. The agreement would then fail this test for validity even though it did not harm the non-signers.<sup>58</sup>

A second conclusion which follows from the NGK litigation is that the Alaska Supreme Court appears to have endorsed the use of shareholders' agreements to depart from statutory norms. How far this departure can go is a matter of speculation. For example, although the agreement among the AAP shareholders infringed on the

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54. *Id.* at 1200.

55. Although there is no Alaska case on this point, this conclusion is the one reached by the majority of states. See F.H. O'NEAL & R. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 5.25 (3d ed. 1987).

56. The agreement in *E.K. Buck* was signed by less than a majority of the shareholders. 157 Neb. at 872, 62 N.W.2d at 294.

57. The control agreement in *E.K. Buck* was part of an effort to obtain financing. One of the company's creditors cancelled the debt owed him by the company and invested an additional \$50,000 in exchange for 40% of the company's stock and the control agreement, which gave him veto power over company policy through his election of two of the four directors. *Id.* at 881, 62 N.W.2d at 298.

58. The type of situation in which this doctrine can create problems is illustrated by *Odman v. Oleson*, 319 Mass. 24, 64 N.E.2d 439 (1946). One shareholder was not a party to an agreement entered into by all the other shareholders, but he sold his shares to one of the signing shareholders shortly after the agreement was executed. There was no evidence of harm to the noncontracting shareholder. Nevertheless, in a suit between parties to the agreement seeking to have it enforced, the court held that it was invalid as against public policy since a contract signed by less than all the shareholders created a possibility of harm to the minority. *Id.* at 25, 64 N.E.2d at 440.

powers of the directors by designating the distribution and marketing rights, it survived the Alaska Supreme Court's scrutiny. Would a clause which sought to prevent the company from entering any new business or transaction without a minority shareholder's consent also be upheld? There is precedent from other states for accepting such agreements,<sup>59</sup> and an agreement could be drafted to include such an explicit clause, along with other clauses<sup>60</sup> designed to allow a client to achieve the same objective if the validity of the explicit clause was ever cast into doubt.

Unfortunately, the Alaska Supreme Court's decisions in *Norman*<sup>61</sup> and *Hikita*,<sup>62</sup> while they endorsed the validity of shareholders' agreements, created problems of enforceability. This issue will be discussed in the next section.

### III. THE ALASKA SUPREME COURT'S ANALYSIS OF A SHAREHOLDER'S STANDING TO SUE ON A SHAREHOLDERS' AGREEMENT

The most important issue before the Alaska Supreme Court in *Norman v. Nichiro Gyogyo Kaisha, Ltd.*<sup>63</sup> was whether a shareholders' agreement could be enforced directly by a shareholder who had signed the agreement, or whether the action had to be brought through a derivative suit on behalf of the corporation.<sup>64</sup> It has long been accepted that an individual shareholder cannot bring a direct action for a wrong to the corporation, but must bring an action derivatively on the corporation's behalf.<sup>65</sup> To do this, the shareholder must first attempt to obtain a remedy through the corporation's internal procedures.<sup>66</sup>

59. See, e.g., *Zion v. Kurtz*, 50 N.Y.2d 92, 405 N.E.2d 681, 428 N.Y.S.2d 199 (1980). See also *supra* notes 8-12 and accompanying text.

60. For example, the drafters could include a veto position on the board by creating separate classes of stock, each able to vote for a limited number of directors. This designation is valid under Alaska law. ALASKA STAT. § 10.05.060 (1985). Alternatively, they could require a supermajority vote for board meetings. *Id.* § 10.05.192. However, problems arise if a director dies or resigns. See *id.* § 10.05.189 (vacancies on the board of directors must be filled by a vote of the remaining directors); *id.* § 10.05.135 (bylaws must be determined by the board of directors unless this power has been reserved to the shareholders).

61. 645 P.2d 191 (Alaska 1982).

62. 713 P.2d 1197 (Alaska 1986).

63. 645 P.2d 191.

64. See 12B W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5911 (rev. perm. ed. 1984); 2 MODEL BUSINESS CORPORATION ACT ANN. § 7.40 annot. (3d ed. 1984).

65. See W. FLETCHER, *supra* note 64, § 5911.

66. This rule has its origins in the English case of *Foss v. Harbottle*, 2 Hare 461, 67 Eng. Rep. 189 (1843); see also Wedderburn, *Shareholders' Rights and the Rule in Foss v. Harbottle*, 1957 CAMBRIDGE L.J. 194. This case still states the law in England. See 2 F. GORE-BROWNE, GORE-BROWNE ON COMPANIES § 28.20 (A. Boyle &



This requirement has been incorporated into both the Federal Rules of Civil Procedure<sup>67</sup> and the Alaska Rules of Civil Procedure.<sup>68</sup> Under the business judgment rule, the refusal of the board of directors to sue will be respected by a court and a derivative suit will be dismissed unless either the directors improperly refused to act,<sup>69</sup> or resort to the corporation's internal procedures had been excused.<sup>70</sup> Even then, a shareholder bringing a derivative action on behalf of the corporation must show he is a fair and adequate representative of similarly situated shareholders.<sup>71</sup> There are several policies behind the requirement that corporate injuries must be redressed through a derivative action. Any other result would ignore the corporation as a legal entity,<sup>72</sup> and

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R. Sykes 44th ed. 1986). For a discussion of the history of the derivative suit in America, see J. MOORE & J. KENNEDY, *MOORE'S FEDERAL PRACTICE* § 23.1.15 (2d ed. 1987). In *Hawes v. Oakland*, 104 U.S. 450, 461 (1881), the Supreme Court first required that the complaint in a derivative suit brought in a federal court must allege with particularity the efforts made to seek relief from the directors (and, if time permitted, from the shareholders if the directors refused) or else show why it could not be done, or it was not reasonable to require it to be done.

67. The holding of *Hawes v. Oakland*, 104 U.S. 450 (1881), was incorporated into Federal Rule of Equity 94, 104 U.S. IX (1882), which was slightly modified by subsequent Federal Rule of Equity 27, 226 U.S. Appendix (1912). This was incorporated into the old Federal Rule of Civil Procedure 23(b), 28 U.S.C. app. (1964), which the modern Federal Rule of Civil Procedure 23.1 substantially restates. See J. MOORE & J. KENNEDY, *MOORE'S FEDERAL PRACTICE* §§ 23.1.01, 23.1.15 (2d ed. 1987).

68. ALASKA R. CIV. P. 23.1. The language of this rule almost exactly parallels Federal Rule of Civil Procedure 23.1.

69. "In a demand required case . . . courts will defer to the director's business judgment to forego litigation, absent some challenge to their investigative procedures or independence and good faith." *Woodward & Lothrop, Inc. v. Schnabel*, 593 F. Supp. 1385, 1399 (D.D.C. 1984).

70. See, e.g., *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1071 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985): "[T]o excuse demand . . . the complaint must allege specific facts which demonstrate that the primary purpose of management was to retain control. . . . [T]he plaintiffs' complaint . . . sufficiently pleads a primary purpose to retain control, and thus casts a reasonable doubt as to the disinterestedness and independence of the board of this stage of the proceedings." *Id.* For collected cases, see Annotation, *Negligence, Nonfeasance, or Ratification of Wrongdoing as Excusing Demand on Directors as Prerequisites to Bringing of Stockholders' Derivative Suit on Behalf of the Corporation*, 99 A.L.R. 3d 1034 (1980); Annotation, *Circumstances Excusing Demand Upon Other Shareholders as a Prerequisite to Bringing of Stockholder's Derivative Suit on Behalf of Corporation*, 48 A.L.R. 3d 595 (1973).

71. ALASKA R. CIV. P. 23.1. See *Davis v. Comed*, 619 F.2d 588 (6th Cir. 1980) (lists six factors to be considered in determining whether a shareholder meets the fair representative requirements of Federal Rule of Civil Procedure 23.1); see also Annotation, *Requirement of Rule 23.1 of Federal Rules of Civil Procedure that Plaintiff in Shareholder Derivative Action "Fairly and Adequately Represent" Shareholder's Interest in Enforcing Corporation's Right*, 15 A.L.R. FED. 954 (1973).

72. "In law the corporation and the aggregate members of the corporation are not the same thing . . ." *Foss v. Harbottle*, 2 Hare 461, 490, 67 Eng. Rep. 189, 202 (1843).

would result in a multiplicity of suits.<sup>73</sup> Furthermore, to allow a shareholder to recover damages directly could injure the creditors of the corporation or the taxing authorities,<sup>74</sup> and would interfere with the directors' prerogative to decide how the corporate funds that had been recovered should be used.<sup>75</sup>

There are two widely recognized exceptions to the general rule that corporate injuries must be redressed through a derivative suit: when the injury also resulted in a breach of some special duty to the shareholder, and when the shareholder has suffered an injury which is separate and distinct from that suffered by other shareholders, the shareholder may sue directly.<sup>76</sup> An example of the former type of injury is one which results in damage to a shareholder's contractual right, such as a voting right.<sup>77</sup> An example of the latter is where a fraud has been perpetrated on the shareholder alone,<sup>78</sup> or the shareholder has personally guaranteed the corporation's debts.<sup>79</sup> Norman argued that he fell within this second exception to the general rule. He argued that the shareholders' agreement gave rise to a contractual relationship between himself and NGK and NPL.<sup>80</sup> Thus, although the contract was made for the benefit of AAP, when read in combination with the stock purchase agreement and employment agreement it also gave rise to a duty running from NGK directly to Norman.<sup>81</sup> Norman sought to recover damages for the loss and destruction of his stock which he claimed to be a result of NGK's breach of the shareholders' agreement.<sup>82</sup>

The Alaska Supreme Court held that the destruction of the value of Norman's stock was an injury suffered in common with the other shareholders, and thus could only be redressed through a derivative

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73. *Sutter v. General Petroleum Corp.*, 28 Cal. 2d 525, 530, 170 P.2d 898, 901 (1946) (en banc); *Wells v. Dane*, 101 Me. 67, 70, 63 A. 324, 325 (1905).

74. *E.K. Buck Retail Stores v. Harkert*, 157 Neb. 867, 900, 62 N.W.2d 288, 307 (1954).

75. *Commonwealth of Massachusetts v. Davis*, 140 Tex. 398, 407, 168 S.W.2d 216, 221 (1943).

76. See *W. FLETCHER*, *supra* note 64, § 5921.

77. See, e.g., *Lipton v. News International, P.L.C.*, 514 A.2d 1075, 1078 (Del. 1986); *Condec Corp. v. Lunkenheimer Co.*, 43 Del. Ch. 353, 366, 230 A.2d 769, 777 (1967) (right to vote is a right the shareholder possesses independently of any right of the company).

78. See, e.g., *Ritchie v. McMullen*, 79 F. 522 (6th Cir.), *cert. denied*, 168 U.S. 710 (1897); *Sutter v. General Petroleum Corp.*, 28 Cal. 2d 525, 170 P.2d 898 (1946).

79. See *Buschmann v. Professional Men's Ass'n*, 405 F.2d 659 (7th Cir. 1969).

80. *Norman v. Nichiro Gyogyo Kaisha, Ltd.*, 645 P.2d 191, 196 (Alaska 1982).

81. *Id.* at 196-97.

82. *Norman*, 645 P.2d at 195. "[He] measured this damage as 20 percent (his stock ownership interest) of the minimum book value of the stock assuming defendants had not breached." *Id.*

action on behalf of AAP.<sup>83</sup> The court also refused to accept Norman's argument that the stock purchase, employment, and shareholders' agreements formed a single contract, and chose to analyze each agreement separately.<sup>84</sup> The Alaska Supreme Court denied Norman any right to sue under the shareholders' agreement.

The Alaska Supreme Court, holding that Norman could not recover for the destruction of the value of his stock through a direct action, relied heavily for precedent on the Nebraska Supreme Court's decision in *E.K. Buck Retail Stores v. Harkert*.<sup>85</sup> However, while the Nebraska Supreme Court in *E.K. Buck* had applied the same "benefit to the corporation" test for the validity of a shareholders' agreement,<sup>86</sup> and had come to the same conclusion that a shareholder must bring a derivative action to recover damages if the agreement is breached,<sup>87</sup> the *E.K. Buck* court's analysis of the issue rested on a premise which the Norman court failed to follow.

The Nebraska Supreme Court in *E.K. Buck* recognized a single exception to the general rule that a shareholder may only recover for a wrong to the corporation through a derivative action. This exception arises "when he has sustained a loss separate and distinct from that of other shareholders."<sup>88</sup> In other words, unlike the Alaska Supreme Court in *Norman*, the Nebraska court declined to follow those cases holding that a breach of a special duty, such as a contractual duty,<sup>89</sup> also gives rise to a direct cause of action. This holding was crucial to the Nebraska court's analysis of why the plaintiff in *E.K. Buck* could not recover, through a direct action, damages in proportion to his shareholdings, for the losses inflicted on the company as a result of the breach of the shareholders' agreement.

The *E.K. Buck* court decided to uphold the shareholders' agreement because it was for the benefit of the corporation and all shareholders alike, and thus made the finding that all shareholders had suffered the same injury by its breach a logical necessity. This finding required the conclusion that the plaintiff, because his injury was identical to that suffered by the other shareholders, could only recover for his losses through a derivative action.<sup>90</sup> The *E.K. Buck* court accepted

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83. *Id.* at 195-96.

84. *Id.* at 197.

85. 157 Neb. 867, 62 N.W.2d 288 (1954).

86. *Id.* at 894-95, 62 N.W.2d at 305; *cf. Norman*, 645 P.2d at 196 (applying the "benefit to the corporation" test). *See also supra* notes 49-54 and accompanying text.

87. The plaintiff in *Buck* sought to recover 40% of the losses sustained by the company as a result of the breach of the shareholders agreement in accordance with his 40% of the company's shares. *E.K. Buck*, 157 Neb. at 894-95, 62 N.W.2d at 305.

88. *Id.* at 899, 62 N.W.2d at 307.

89. *See supra* notes 76-78 and accompanying text.

90. *E.K. Buck*, 157 Neb. at 899, 62 N.W.2d at 307.

that this conclusion presented the plaintiff with a dilemma: If the plaintiff, in order to bring a direct action, argued that he had suffered a separate and distinct injury because of a breach of the agreement, then the agreement would not have benefited all shareholders alike and thus would have been held invalid.<sup>91</sup>

Paradoxically, the *E.K. Buck* court appears, despite the above analysis, to have upheld the lower court's grant of injunctive relief in a direct action brought by the plaintiff shareholder.<sup>92</sup> *E.K. Buck* might thus be seen as authority for only the limited proposition that a shareholder cannot maintain a direct action to recover damages for injuries received by the corporation, and not for the wider proposition that all actions on a shareholders' agreement must be brought by the corporation or through a derivative suit.<sup>93</sup> Either way, the *E.K. Buck* court's holding was based on a premise that the Alaska Supreme Court failed to follow when it adopted the majority view that a breach of a special duty also gives rise to a direct cause of action.<sup>94</sup>

The Alaska Supreme Court was thus correct in citing *E.K. Buck* to support its argument that, since the loss and destruction of his stock<sup>95</sup> was the major element in Norman's claim for damages, he had not suffered an injury that was separate and distinct from that suffered by the other shareholders.<sup>96</sup> Its analysis, however, was flawed when it again cited *E.K. Buck* to support its argument that NGK owed Norman no special duty.<sup>97</sup> The Alaska Supreme Court claimed that *E.K. Buck* stood for the proposition that because the validity of the shareholders' agreement rested on the fact that it was made for the benefit of all shareholders, "any duties owed under the agreement were owed primarily to the corporation and its shareholders."<sup>98</sup> In fact, the passage that the Alaska court cited in *E.K. Buck* merely recites the argument that the mutuality of benefit required for the shareholders' agreement to be valid precludes any argument that the shareholder suffered any special injury.<sup>99</sup>

The Alaska Supreme Court went on to argue that because NGK's duties under the agreement were owed primarily to AAP, any benefit

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91. *Id.* at 900, 62 N.W.2d at 307.

92. *Id.* at 894, 62 N.W.2d at 304.

93. This holding would be consistent with the general theory concerning third party contract beneficiaries. See *infra* notes 100-101 and accompanying text.

94. Norman v. Nichiro Gyogyo Kaisha, Ltd., 645 P.2d 191, 195 n.9 (Alaska 1982).

95. *Id.* at 195.

96. *Id.* at 197.

97. *Id.* at 196.

98. *Id.*

99. *E.K. Buck Retail Stores v. Harkert*, 157 Neb. 867, 898-99, 62 N.W.2d 305, 307 (1954). See *supra* notes 86-88 and accompanying text.

Norman would derive from the agreement would be solely in his capacity as a shareholder. The court argued that this showed that Norman was only an incidental beneficiary of the contract and that, since "Norman's right to have the parties perform their obligations under the shareholders' agreement [was] derived solely from that agreement,"<sup>100</sup> then Norman's right to enforce the agreement was only incidental, and "that right [to enforce the agreement] belonged directly to the corporation."<sup>101</sup>

The obvious problem with the argument that only the direct beneficiary, AAP, could enforce the shareholders' agreement was that AAP had never signed the agreement.<sup>102</sup> Indeed, under traditional Anglo-American contract theory, AAP, as a third party beneficiary, would have had no right to enforce the agreement,<sup>103</sup> and would have been dependent on Norman and the other promisees to defend any rights it had under the agreement.<sup>104</sup> Even under the modern view, both the promisee and the third party beneficiary would have a right to enforce the contract.<sup>105</sup> The *Norman* court thus succeeded in standing traditional contract theory on its head.

Justice Matthews, in a vigorous dissent, in which Chief Justice Rabinowitz concurred, accepted Norman's argument that the shareholders' agreement should not be viewed in isolation. He argued that Norman had agreed to transfer the AAP stock to NGK in exchange for NGK's promises in the shareholders' agreements,<sup>106</sup> and that,

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100. *Norman*, 645 P.2d at 197.

101. *Id.*

102. The court cited the following language in *Green v. Victor Talking Mach. Co.*, 24 F.2d 378, 382 (2d Cir. 1928), in support of this point: "[D]espite the fact that [the contract] was made with a shareholder, not with the corporation, nevertheless a breach of duty would give a right of action to the corporation, not to its shareholders." *Norman*, 645 P.2d at 197 n.11. This case is weak precedent for this proposition for two reasons: First, the plaintiff in *Green* was suing in tort and had expressly declined to sue on the contract. Thus, the court's remarks are clearly dicta. Second, the quoted passage speaks of a contract with a *shareholder*, yet a right of action in the *shareholders*. The contract in *Green* was between the plaintiff's dead husband, the *shareholder* in question, and the defendants. The plaintiff in *Green* was thus not a party to the contract and, unlike Norman, would have been unable to sue as a promisee.

103. See, e.g., *Merchants' Union Trust Co. v. New Philadelphia Graphite Co.*, 10 Del. Ch. 18, 83 A. 520 (1912); *Furnas v. Durgin*, 119 Mass. 500 (1876). See also *Dunlop Pneumatic Tyre Co. v. Selfridge & Co.*, [1915] App. Cas. 847, 853 ("[I]n the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it.").

104. *Dunlop*, [1915] App. Cas. at 853. But see, e.g., RESTATEMENT (SECOND) OF CONTRACTS §§ 302-315 (1979) (shows the modern American rule that donees and creditors, but not incidental beneficiaries, have a right to enforce a contract as third party beneficiaries).

105. RESTATEMENT (SECOND) OF CONTRACTS § 305 (1979).

106. *Norman*, 645 P.2d at 199 (Matthews, J., dissenting).

under the *Restatement (Second) of Contracts*,<sup>107</sup> this agreement created a duty in NGK running to both AAP, the beneficiary, and Norman, the promisee.<sup>108</sup> Justice Matthews argued that the duty NGK owed Norman to contribute money to the corporation under the shareholders' agreement was precisely the type of duty which could give rise to a direct cause of action under the exception to the general rule that an injury to the corporation must be redressed through a derivative suit.<sup>109</sup> In Justice Matthews' view, the depreciation in the value of Norman's stock was a result of NGK's breach of this duty. Justice Matthews cited a series of New York cases to support his argument that Norman should have been allowed to recover from NGK for the loss in the value of his stock.<sup>110</sup>

In *Hikita v. Nichiro Gyogyo Kaisha, Ltd.*,<sup>111</sup> an opinion that was delivered almost four years after *Norman*, the Alaska Supreme Court overruled those portions of the *Norman* decision in which it had discussed the shareholder standing issue.<sup>112</sup> The appellants in *Hikita* were Alaska Foods, one of the parties to the AAP shareholders' agreement, and Takehiro Hikita, the majority shareholder of Alaska Shokai, Japanese parent company of Alaska Foods.<sup>113</sup> Alaska Foods and Hikita had filed suit against NGK and NPL in October 1977, over two years after the latter had abandoned AAP, claiming that NGK had breached the shareholders' agreement and that NGK had committed various torts against Hikita and Alaska Foods.<sup>114</sup> NPL was joined as a defendant on the theory that it was the alter ego of NGK and the two companies had acted as though they were a single entity.<sup>115</sup>

The superior court granted NGK's motion for summary judgment.<sup>116</sup> It gave two reasons for its dismissal of the breach of contract

107. RESTATEMENT (SECOND) OF CONTRACTS § 305(1) (1979) (providing that: "A promise in a contract creates a duty in the promisor to the promisee to perform even though he has a similar duty to an intended beneficiary.").

108. *Norman*, 645 P.2d at 199 (Matthews, J., dissenting).

109. *Id.*

110. *Norman*, 645 P.2d at 200 (Matthews, J., dissenting) (quoting *Higgins v. Applebaum*, 186 A.D. 682, 686-87, 174 N.Y.S. 807, 810 (1919)).

Where . . . the value of [a shareholder's] stock has been depreciated by the failure of his cocontractor to furnish moneys needed by the corporation which he has stipulated with plaintiff to advance, then the damage is directly traceable to his breach of contract and for that damage he may be held individually liable.

*Id.* See also cases cited *infra* note 149.

111. *Hikita v. Nichiro Gyogyo Kaisha, Ltd.*, 713 P.2d 1197 (Alaska 1986).

112. *Id.* at 1200.

113. *Id.* at 1198.

114. *Id.* at 1199 n.4.

115. *Id.* at 1198 n.1.

116. *Id.* at 1199.

claims. First, it held that the *Norman* decision barred a direct action.<sup>117</sup> Second, it held that the prior litigation between AAP and NGK and NPL barred Alaska Foods' suit under section 56 of the *Restatement (Second) of Judgments*.<sup>118</sup> The superior court dismissed the tort claims on the ground that they were brought after the expiration of the two year statute of limitations.<sup>119</sup>

Chief Justice Rabinowitz's opinion for the court in *Hikita* paralleled the arguments of Justice Matthews' dissent in *Norman*.<sup>120</sup> The *Hikita* court accepted that, in general, a shareholder can only recover for wrongs suffered by a corporation through a derivative suit on the corporation's behalf.<sup>121</sup> The court felt, however, that Alaska Foods fell within the exception to the general rule, because NGK had breached a special duty it owed Alaska Foods. The court stated that "[a] shareholders' agreement for the benefit of a corporation does create a duty running to both the corporation and the promisee."<sup>122</sup> The breach of this contractual duty gave rise to a direct cause of action "even if [the shareholder] had not suffered an injury separate and distinct from that suffered by other shareholders."<sup>123</sup>

The *Hikita* court concluded that if Alaska Foods could show that NGK had breached the shareholders' agreement, then it could recover "all proximate damages that can be proved with reasonable certainty."<sup>124</sup> Whether "all proximate damages" would include damages for the lost value of the AAP stock is open to question. In *Norman*, however, Chief Justice Rabinowitz joined in a dissent which had expressly approved Norman's claim for the loss in the value of his stock.<sup>125</sup> The court in *Hikita* did state that it would allow a direct

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117. *Id.* at 1199 n.4.

118. *Id.* RESTATEMENT (SECOND) OF JUDGMENTS § 56 (1980) (states that judgment against a third party beneficiary to a contract also terminates the promisor's obligation to the promisee).

119. *Hikita*, 713 P.2d at 1199 n.4.

120. Not only had Chief Justice Rabinowitz joined Justice Matthews' dissent in *Norman*, but Matthews joined with the majority in *Hikita*.

121. *Hikita*, 713 P.2d at 1199.

122. *Id.* at 1200.

123. *Id.*

124. *Hikita*, 713 P.2d at 1201. The court upheld the superior court's dismissal of *Hikita's* contract claims on the ground that since he was neither a promisee nor a beneficiary he had no rights to enforce. *Id.* at 1201 n.11. The court also concluded that the RESTATEMENT (SECOND) OF JUDGMENTS § 56 (1980) did not bar Alaska Foods' action, since none of the prior suits had made a determination of whether Nichiro Gyogyo Kaisha, Ltd. had breached its duty to Adak Aleutian Processors under the shareholders' agreement. The court upheld the superior court's dismissal of *Hikita's* and Alaska Foods' tort claims. *Hikita*, 713 P.2d at 1202.

125. *See supra* notes 108-09 and accompanying text.

action even where the shareholder had not suffered a separate and distinct injury.<sup>126</sup> The *Hikita* court also noted that Norman's claim for loss of stock value had been dismissed because the loss was an injury suffered in common with other shareholders and, therefore, neither separate nor distinct.<sup>127</sup> Thus, there is a clear implication that the court would uphold damages based on the loss in value of stock.

#### IV. A REVIEW OF THE PROBLEMS WITH THE ALASKA SUPREME COURT'S APPROACH AND A SUGGESTION FOR AN ALTERNATIVE

The decision in *Norman v. Nichiro Gyogyo Kaisha, Ltd.*,<sup>128</sup> while conclusively settling the issue of the legality of shareholders' agreements in Alaska, also succeeded in making them virtually useless as a control device. The major purpose of a shareholders' agreement is to protect minority shareholders from the dangers inherent in the majoritarian concepts that are the basic norms which govern the corporate statutes. The *Norman* court's denial of a direct action to the parties to a shareholders' agreement left the aggrieved minority shareholder in an unenviable position if the majority breached a shareholders' agreement. The requirements of a derivative action are both the product of, and an enforcement device for, those very corporate norms that the shareholders' agreement was designed to guard against.

The procedures for a derivative action are set out in Alaska Rule of Civil Procedure 23.1.<sup>129</sup> This rule has never been construed by a court of record in Alaska, but it is almost identical to Federal Rule of

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126. *Hikita*, 713 P.2d at 1200.

127. *Id.* at 1199-1200.

128. *Norman v. Nichiro Gyogyo Kaisha, Ltd.*, 645 P.2d 191 (Alaska 1982).

129. Alaska Rule of Civil Procedure 23.1 states:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.



Civil Procedure 23.1,<sup>130</sup> and an Alaska court would undoubtedly follow federal precedent when interpreting its provisions. Rule 23.1 requires the plaintiff's complaint to allege that he owned shares in the corporation at the time of the injury complained of and to plead with particularity the efforts he has made to persuade the corporation itself to act by obtaining a directors' or shareholders' vote endorsing the suit.<sup>131</sup> Federal courts have developed this rule so that it represents more than just a formality of pleading. In all but a few circumstances, courts will not allow a suit unless there has been a demand on the directors.<sup>132</sup> The rationale behind this demand requirement is that a shareholder should exhaust his intra-corporate remedies before resorting to the courts.<sup>133</sup>

Once a demand on the directors has been made, federal courts have applied the business judgment rule. Under the business judgment rule, courts will not second-guess a director's decision if it was made in good faith and pursuant to a legitimate business purpose. Thus, a derivative action cannot be brought where the directors, acting in good faith, have refused to sue.<sup>134</sup>

If, as the *Norman* court suggested, a minority shareholder must bring a derivative action to enforce a shareholders' agreement, he will thus face a double barrier of the demand requirement and the business judgment rule. To succeed, he must show either that demand on the directors should be excused<sup>135</sup> or that the directors' refusal to act on the demand was in bad faith.<sup>136</sup> Not only is this requirement a tedious prerequisite, but, if Alaska follows the standards applied by the courts in other states, it will also be onerous. In most jurisdictions demand will only be excused where the directors are accused of wrongdoing or

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130. See FED. R. CIV. P. 23.1. The major difference between the federal rule and the Alaska rule is the jurisdictional requirement under the federal rule that the complaint must allege that the action is not a collusive one. Compare *id.* with ALASKA R. CIV. P. 23.1.

131. ALASKA R. CIV. P. 23.1.

132. See, e.g., *Galef v. Alexander*, 615 F.2d 51 (2d Cir. 1980); *In re Kauffman Mutual Fund Actions*, 479 F.2d 257 (1st Cir.), *cert. denied*, 414 U.S. 857 (1973). For a brief history of the demand requirement, see *supra* note 66.

133. See, e.g., *Evangelist v. Fidelity Management & Research Co.*, 554 F. Supp. 87 (D. Mass. 1982); see also Note, *The Demand and Standing Requirements in Shareholder Derivative Actions*, 44 U. CHI. L. REV. 168 (1976).

134. See, e.g., *United Copper Securities Co. v. Amalgamated Copper Co.*, 244 U.S. 261 (1917); *Abramowitz v. Posner*, 672 F.2d 1025 (2d Cir. 1982); Note, *Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit*, 73 HARV. L. REV. 746 (1960). For criticism of this doctrine, see Note *The Propriety of Judicial Deference to Corporate Boards of Directors*, 96 HARV. L. REV. 1894 (1983).

135. See *supra* note 70.

136. See, e.g., *Lewis v. Curtis*, 671 F.2d 779, 786 (3d Cir.), *cert. denied*, 459 U.S. 880 (1982).

violating their duty of care.<sup>137</sup> In some jurisdictions, such as Delaware, this requirement has been extended and the allegation must contain particularized facts to support the accusation of director misconduct.<sup>138</sup> The enormity of the business judgment rule as an obstacle to plaintiffs is seen in the recent trend to extend judicial deference to the decisions of a minority of the board of directors acting with the full board's authority in a special litigation committee.<sup>139</sup>

While the decision to form a special litigation committee is unlikely to occur in the close corporation setting because of the expense involved, the decision to breach a corporate contract, like the decision to abstain from night baseball games,<sup>140</sup> is just the type of decision to which courts have applied the business judgment rule and refused to review the directors' actions. Even if the decision were not subject to the business judgment rule, the ratification of the directors' decision by the majority shareholders would preclude a challenge unless the minority shareholder could show fraud.<sup>141</sup> Thus, under the *Norman* rule, the minority shareholder is left with an unenforceable piece of paper in place of the protections of the shareholders' agreement.

The decision of the Alaska Supreme Court in *Hikita v. Nichiro Gyogyo Kaisha, Ltd.*<sup>142</sup> to overrule *Norman* may have ended the minority shareholders' problems with derivative suits, but it may have created more problems than it solved. *Hikita* represents a dangerous extension of liability for majority shareholders through its erosion of

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137. *Id.*; see also *Barr v. Wackman*, 36 N.Y.2d 371, 377, 329 N.E.2d 180, 185, 368 N.Y.S.2d 497, 504 (1975).

138. *Pogostin v. Rice*, 480 A.2d 619, 624-25 (Del. 1984); *Aronson v. Lewis*, 473 A.2d 805, 814-16 (Del. 1984).

139. For three cases showing the spectrum of judicial approval of special litigation committees, see *Joy v. North*, 692 F.2d 880 (2d Cir. 1982), *cert. denied*, 460 U.S. 1051 (1983); *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981); *Auerbach v. Benett*, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979). *Contra* *Abella v. Universal Leaf Tobacco Co.*, 495 F. Supp. 713 (E.D. Va. 1980); *Miller v. Register & Tribune Syndicate*, 336 N.W.2d 709 (Iowa 1983).

For an interesting critique of the special litigation committee, see *Cox & Munsinger, Bias in the Boardroom: Psychological Foundation and Legal Implications of Corporate Cohesion*, 47 LAW & CONTEMP. PROBS. 83 (1985). For collected cases see, Annotation, *Propriety of Termination of Properly Initiated Derivative Action by Independent Directors by "Independent Committee" Appointed by Board of Directors Whose Actions (or Inaction) are Under Attack*, 22 A.L.R. 4TH 1206 (1983).

140. See *Shlensky v. Wrigley*, 95 Ill. App 2d 173, 237 N.E.2d 776 (1968) (holding that the decision not to install lights at Chicago's Wrigley Field was subject to the business judgment rule).

141. See, e.g., *Smith v. Brown-Borhek Co.*, 414 Pa. 325, 200 A.2d 398 (1964) (ratification by shareholders of directors' lack of due care will bar a derivative suit, but this rule will not apply when the allegation involves fraud, self dealing or waste by the directors). *Contra* *Claman v. Robertson*, 164 Ohio St. 61, 128 N.E.2d 429 (1955) (majority of shareholders can ratify fraud).

142. 713 P.2d 1197 (Alaska 1986).

the business judgment rule's protection of directors from the fear that all their decisions may be subject to subsequent critical review by a court, which has the benefit of hindsight. *Hikita* also involves a rejection of the traditional protection of creditors that is embodied in the requirements of the derivative suit.

If *Hikita* really does stand for the proposition that a minority shareholder may recover damages from the breaching shareholder for the loss in stock value that occurs as a result of a breach of a shareholders' agreement,<sup>143</sup> then a majority or managing shareholder should be careful how that agreement is drafted. A simple clause requiring a shareholder to exert his best efforts on behalf of the corporation could result in the total elimination of the business judgment rule's protection of directors' action from judicial scrutiny.<sup>144</sup> The managing shareholder of an Alaska corporation who makes unguarded predictions as to future returns or makes vague promises could, under *Hikita*, find himself insuring the other shareholders against all risks of loss.

While it seems logical that a breach of a shareholders' agreement should, like the breach of any other contract, leave the breaching party subject to the entire range of contract remedies, there is always a second contract at issue in corporate litigation. The corporation itself could be said to represent a contract with the state as well as a contract among the shareholders. The state gives to the corporation the benefit of limited liability,<sup>145</sup> but in exchange imposes certain obligations for the protection of creditors.<sup>146</sup> One of these obligations is that shareholders, as well as creditors, respect the legal status of the corporation as an entity. The rule that corporate injuries be redressed through a derivative suit is part of this obligation. The shareholders are not the corporation, but rather are its owners and most junior creditors.<sup>147</sup> The derivative suit protects the interests of those with more senior claims than the shareholders.<sup>148</sup> The *Hikita* court, by allowing a shareholder to recover for the loss in the value of his stock through a direct action, has allowed minority shareholders to bypass the senior creditors' claims and freeze senior creditors out of any recovery for mismanagement.

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143. See *supra* notes 121-23 and accompanying text.

144. Alaska Foods' claim in *Hikita* was based on precisely this type of "best efforts" clause. *Hikita*, 713 P.2d at 1199.

145. ALASKA STAT. § 10.05.126 (1985).

146. See, e.g., *id.* § 10.05.543 (1985) (providing for action by creditor for liquidation).

147. *Id.* § 10.05.561 (1985) (upon liquidation remaining assets are to be distributed to shareholders "according to their respective rights and interests").

148. See *supra* notes 63-72 and accompanying text.

While the *Hikita* court's decision to allow a direct action that imposes liability on a breaching shareholder for losses in the value of other shareholders' stock is not without precedent,<sup>149</sup> it is the product of flawed thinking. Although the analysis of the rights of parties to a shareholders' agreement is conceptually difficult, this author suggests an alternate approach based on the merger of two distinct bodies of law — corporate and contract. This approach requires a resolution of the conflicts that necessarily arise between these bodies of law, a resolution which can be achieved only by focusing on which rights are peculiar to each of them.

The parties to a shareholders' agreement are in a unique position because they have rights based on two distinct roles. They are both the promisees in a contract for the benefit of a third party, the corporation, and the ultimate beneficiaries of that contract, since they are shareholders in the corporation. While it is true that under contract theory both the parties to the agreement and the corporation, as a donor beneficiary, have a right to enforce the agreement,<sup>150</sup> in the event of a breach of the agreement only the intended beneficiary, the corporation, will suffer any real damage. The parties to the agreement will also be injured, but mainly in their role as shareholders, as a result of the harm done to the corporation. In their role as promisees their injury is nominal.

With this conceptual outline as a foundation, this author suggests that it is possible to allow shareholders to maintain both direct and derivative actions for breach of a shareholders' agreement and to achieve the desired middle ground between the extremes of the *Norman* and *Hikita* decisions. The shareholders, as promisees, should have a right to a direct action for a breach of the shareholders' agreement,<sup>151</sup> but, because they will suffer only nominal injuries as promisees, they should not be able to recover damages through this direct action. However, nominal damages represent an inadequate remedy at law and thus they would have the right to demand equitable relief and its remedies of specific performance and injunction.<sup>152</sup> These equitable remedies should be sufficient to protect minority shareholders from the majority when the latter is determined to renege on a shareholders' agreement. The availability of this direct action means that the minority shareholder can seek the court's protection with relative ease and rapidity. This approach thus avoids the pitfalls of the *Norman* decision.

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149. See, e.g., *Eden v. Miller*, 37 F.2d 8 (2d Cir. 1930) (following New York law). See also *Higgins v. Applebaum*, 186 A.D. 682, 174 N.Y.S. 807 (1919); *Meyerson v. Franklin Knitting Mills*, 185 A.D. 458, 172 N.Y.S. 773 (1918).

150. See RESTATEMENT (SECOND) OF CONTRACTS § 305 (1981).

151. *Id.*

152. *Id.* § 307.

If the majority's actions have also harmed the corporation in the meantime, then a minority shareholder, as a shareholder, would have a right to bring a separate derivative action on the corporation's behalf to recover damages. The requirements for a derivative suit<sup>153</sup> would allow the majority shareholder some protection against a nuisance challenge to his managerial decisions. Furthermore, because any recovery would be by the corporation, creditors would be able to participate, and the danger of a creditor freeze-out, a potential hazard inherent in the *Hikita* decision, would be avoided.

## V. CONCLUSION

In the absence of any action by the legislature to provide for the special needs of Alaska close corporations, the Alaska Supreme Court's decision in *Hikita* is to be welcomed. It is to be hoped that it represents the start of a trend toward judicial flexibility with regard to the Alaska Business Corporation Act. *Hikita*, however, protects minority shareholders at the expense of the majority and the corporation's creditors. The adoption of the alternative approach suggested by this note would balance the interests of all three. Both *Norman* and *Hikita* are once again before the Alaska Supreme Court.<sup>154</sup> While they are being appealed on issues peripheral to the focus of this note, the cases provide the court with a perfect opportunity to clarify its earlier decisions.

*B. Neil S. Clarke*

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153. ALASKA R. CIV. P. 23.1. See *supra* notes 129-33 and accompanying text.

154. *Norman v. Nichiro Gyogyo Kaisha, Ltd.*, 645 P.2d 191 (Alaska 1982), *appeal docketed*, No. S-1968 (Alaska Jan. 5, 1987). The issue on appeal in *Norman* is whether the superior court should have reopened the case after final judgment, in light of the supreme court's decision in *Hikita v. Nichiro Gyogyo Kaisha, Ltd.*, 713 P.2d 1197 (Alaska 1986).

*Hikita*, 713 P.2d 1197, *appeal docketed sub nom. Alaska Foods, Inc. v. Nichiro Gyogyo Kaisha, Ltd.*, No. S-1933 (Alaska Dec. 9, 1986). The issues on appeal in *Alaska Foods* are whether the superior court was correct in holding that the litigation between Adak Aleutian Processors and Bank of California, *supra* note 41, and between Adak Aleutian Processors and Nichiro Pacific, Ltd., *supra* note 39, had a res judicata effect on Alaska Foods because Adak Aleutian Processors and Alaska Foods were in privity of contract.

