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LEGAL CONSIDERATIONS GOVERNING DIVIDEND PAYMENTS IN NORTH DAKOTA

I. INTRODUCTION

Every year money and other property is distributed in the form of dividends to the stockholders of North Dakota corporations. Such sums should increase with the anticipated business and industrial growth of this state. Since business corporations are organized for profit,¹ the payment of dividends is one of the most important corporate activities. In those states popular for incorporation of large industrial and business corporations substantial litigation has been concerned with the payment of illegal dividends. On the contrary, in North Dakota there has been no litigation on this subject. Questions concerning the legality of dividend distributions may soon be brought to the attention of the bench and bar in North Dakota because of the growing number of corporations in the state now being financed by public offerings of stocks and bonds. Groups of shareholders and bondholders who are strangers to the active management may instigate litigation on this subject. This should be the reason for more care in the fiscal affairs of corporations.

The most important factors that must be taken into account prior to the declaration of a dividend are considerations relative to long-range corporate policy and the current position of working capital. However, directors must also pay close attention to the legality of the proposed distribution in the light of pertinent statutes, court decisions and administrative regulations. It is with this latter consideration that this paper is to deal.²

A basic reason for development of the corporate form of business organization was to afford a means for its owners to secure the benefits to be derived from the business and to limit their liability to the investment therein. With this protective device available, creditors could look only to the assets of the firm for the satisfaction of their debts. In order to induce creditors to loan money to this form of business it be-

1. N.D. Cent. Code § 10-19-02 (1961).

2. For an excellent discussion of the early history of dividend regu-

came necessary to afford security from losses resulting from intentional managerial policies. Such a safeguard must insure that the corporation maintain a certain degree of financial responsibility. To accomplish this objective was the primary intent underlying practically all of the statutes restricting dividend payments.³ The reason for the restrictions is that it would perpetrate a fraud on the creditors of a corporation, who extend credit to it on the faith of its capital, to permit that capital to be diverted by a distribution among the stockholders as dividends.⁴

II. MODERN DIVIDEND STATUTES

In general there are three basic types of statutes operating to limit the payment of dividends. They are (1) the insolvency test, (2) the impairment of capital or balance sheet test, and (3) the earned surplus or net profits test.

The insolvency test prohibits the declaration and/or payment of a dividend when there is insolvency or when the payment would render the corporation insolvent.⁵ When the term "insolvent" is not defined by statute the question arises whether the legislature meant to use the word in the bankruptcy sense of balancing the assets against liabilities or in the equity sense of the inability to meet obligations and debts as they mature.⁶ Often a statute will incorporate the insolvency test as an additional check on either the balance sheet surplus test or the net profits test.⁷ In this situation, the equity definition of "insolvency" should always be adopted as it provides an additional limitation on the payment of dividends.⁸

The impairment of capital or balance sheet surplus test

lation, see Kehl, *The Origin and Early Development of American Dividend Law*, 53 Harv. L. Rev. 36 (1939).

3. Comment, 23 Tenn. L. Rev. 769, 770 (1955).

4. See *American Steel & Wire Co. v. Eddy*, 130 Mich. 266, 89 N.W. 952 (1902).

5. E.g., Tex. Bus. Corp. Act, art. 2.38 (Vernon 1956); N.D. Cent. Code § 10-19-44 (1961).

6. 30 Stat. 544 (1898), 11 U.S.C. § 1(19) (1958) states: "A person shall be deemed insolvent within the provisions of this title whenever the aggregate of his property . . . shall not . . . be sufficient in amount to pay his debts." The Model Bus. Corp. Act § 2(n) states: "'insolvent' means inability of a corporation to pay its debts as they become due in the usual course of its business."

7. Tex. Bus. Corp. Act, art. 2.38 (Vernon 1956); N.D. Cent. Code § 10-19-44 (1961).

8. In the case of an excess of liabilities over assets the presence of an earned surplus is an accounting impossibility.

forbids the payment of a dividend unless the value of the assets exceeds the aggregate amount of the debts and liabilities including capital stock.⁹ To determine the legality of dividends by using this test, the balance sheet must be examined. From the total of all asset items are subtracted all items listed as liabilities plus the capital stock. The application of this test requires a determination of what items are assets and at what figure they are to be listed in the balance sheet. It further requires an understanding of what is meant by "capital" or "capital stock." This writer does not intend to make a complete analysis of the balance sheet surplus test. Exhaustive material on the subject is readily available.¹⁰ The important understanding for purposes here is that the balance sheet surplus test requires the use of the balance sheet in deciding whether or not dividends are available. Furthermore all surplus items are free for dividends, and those items are derived by subtracting the capital from the net assets.¹¹

The third type of dividend statute carries with it the net profits test, sometimes described by statute in terms of "earned surplus."¹² Since the North Dakota test is of this type, a complete discussion will be included in the examination of the North Dakota law.

It is often stated that the balance sheet surplus test and the net profits test are one and the same.¹³ However, there is also support for the view that the two tests are separate and distinct.¹⁴ The New Jersey statute provides for the payment of dividends from either a balance sheet surplus or the net profit.¹⁵ The Supreme Court of that state has held that these two sources are not redundant, but rather alternative.¹⁶ A

9. E.g., N.Y. Stock Corp. Law § 58 (McKinney 1951); N.J. Rev. Stat. § 14-8-19 (1937).

10. See Ballantine and Hills, *Corporate Capital and Restrictions Upon Dividends Under Modern Corporation Laws*, 23 Calif. L. Rev. 229 (1935).

11. For an application of the capital impairment test see *Randall v. Bailey*, 288 N.Y. 280, 43 N.E.2d 43 (1942).

12. E.g., N.D. Cent. Code § 10-19-44 (1961); N.J. Rev. Stat. § 14-8-20 (1937).

13. BALLANTINE, *CORPORATIONS* 575 (Rev. ed. 1946); Weiner & Bonbright, *Theory of Anglo-American Dividend Law; Surplus and Profits*, 30 Colum. L. Rev. 330, 331 (1930).

14. See Rain, *The Fund Available For Corporate Dividends*, 26 Tex. L. Rev. 273 (1948).

15. N.J. Rev. Stat. § 14:8-19 (1937).

16. *Goodnow v. American Writing Paper Co.*, 72 N.J. Eq. 645, 66 Atl. 607, *aff'd*, 73 N.J. Eq. 692, 69 Atl. 1014 (1908).

17. Mason, *Profits and Surplus Available for Dividends*, 7 *Accounting Review* 61 (1932).

reasonable interpretation of the term "profits" or "earned surplus" can be made and, when followed, leads to results contrary to the results obtained under a pure balance sheet surplus test. As one accountant has expressed it, "all profits result in an increase in surplus, but not all increases in surplus would ordinarily be called profits."¹⁷ This writer wishes to lend his support to the view that the balance sheet surplus test and the net profit test are independent and that the balance sheet surplus does not necessarily equal the net profit.

III. AN EXAMINATION AND EVALUATION OF NORTH DAKOTA STATUTES

Section 10-19-44¹⁸ sets forth the restrictions on dividend payments in North Dakota.

"DIVIDENDS—The board of directors of a corporation may, from time to time, declare and the corporation may pay dividends on its outstanding shares in cash, property, or its own shares, except when the corporation is insolvent or when the payment thereof would render the corporation insolvent or when the declaration or payment thereof would be contrary to any restrictions contained in the articles of incorporation, subject to the following provisions.

1. Dividends may be declared and paid in cash or property only out of the unreserved and unrestricted earned surplus of the corporation, except as otherwise provided in this section."

Examination of this portion of the statute reveals two important restrictions. The first paragraph prohibits the payment of a dividend when the corporation is insolvent or when the payment thereof would render the corporation insolvent. Section one limits the payments of cash or property dividends to earned surplus.

A. THE INSOLVENCY LIMITATION

Insolvency, in North Dakota, for the purpose of dividend restriction has been defined as the inability to meet debts and obligations as they mature.¹⁹ At first glance this restric-

18. N.D. Cent. Code (1961).

19. N.D. Cent. Code § 10-19-02(14) (1961).

tion may appear to be surplusage. In other words, the insolvency limitation will attach considerably later than does the earned surplus restriction. However, this may not be the case. It is possible that a corporation may become insolvent in the equity sense when it has an earned surplus. Since the equity sense of insolvency has been adopted in North Dakota, the statute has been given real vitality¹ for it operates as an additional check upon the payment of dividends.

B. THE EARNED SURPLUS LIMITATION

"Earned surplus" is defined by Paton as "the resultant of all realized gains and losses, including non-operating and extraordinary items, with the possible exception of adjustments due to retirement or conversion of outstanding securities."²⁰ A more detailed definition is given by the American Institute of Accountants.²¹ Earned surplus as used in the North Dakota statute should be determined directly from the profit and loss statement along with the necessary adjustments for items of realized gain and loss not universally reflected in the annual profit and loss statement. It should not be determined by the value of the assets of the business or the amount of capital. The sole source of earned surplus is profits, but this is not meant to be restricted to operating profits alone. Earned surplus as the source for dividends has the approval of almost the entire accounting profession,²² and is prescribed by the Securities and Exchange Commission.²³

Does "earned surplus" in the North Dakota statute mean the net profit for the current fiscal year? An affirmative answer to this question would mean the profit and loss statement for the current year would be consulted, and the net profit shown would be available for immediate dividend distribution. Prior activities of the corporation would be ignored. Such a construction of the North Dakota statute seems unlikely. Earned surplus, without specifying some particular

20. PATON, *ADVANCED ACCOUNTING* 566 (6th ed. 1950).

21. Earned surplus is defined as "The balance of net profits, income, gains and losses of a corporation from the date of incorporation (or from the latest date when a deficit was eliminated in a quasi-reorganization) after deducting distributions therefrom of shareholders and transfers therefrom to capital stock or capital surplus accounts." *ACCOUNTING TERMINOLOGY BULLETINS* No. 1 at 16 (1953).

22. PATON, *ADVANCED ACCOUNTING* 566 (6th ed. 1950).

23. C.F.R. § 210.6-07(b) (1949).

period, has not been considered to mean current profits.²⁴ To the accountant, earned surplus is not restricted in meaning to current profits.²⁵ Only by rare statutory authority can current profits be distributed without regard to the past history of the business.²⁶ Considering these facts, "earned surplus" in the North Dakota statute will most likely be construed to mean the accumulated profits and losses from the date of organization of the corporation. This construction prevents the consideration of current earnings or profits except in their relation to past profits or losses. The consideration of profits on an annual or other periodic basis has no sound foundation in the realities of business activity.

After establishing that dividends are limited in North Dakota to earned surplus, the next problem is to determine what and how certain transactions affect that account. Basically, any determination should be founded upon good accounting principles. However, the courts have not always applied this rule.²⁷

C. REALIZED CAPITAL GAINS AND LOSSES

A profit realized upon the sale or disposition of a fixed capital asset should operate to increase earned surplus, as it is a genuine business profit.²⁸ The same rule applies to losses

24. *BALLANTINE, CORPORATIONS* 575 (Rev. ed. 1946); *National Newark & Essex Banking Co. v. Durant Motor Co.*, 124 N.J. Eq. 213, 1 A.2d 316 (1938).

25. *ACCOUNTING TERMINOLOGY BULLETINS* No. 1 at 16 (1953).

26. Cal. Corp. Code § 1500; Del. Code Ann. tit. 8 § 170 (1953).

27. In *Mobile & O.R.R. v. Tennessee*, 153 U.S. 486, 497 (1894) the court stated: "The term 'profits' out of which dividends alone can properly be declared, denotes what remains after defraying every expense, including loans falling due. . . ."; The court in *George E. Warren Co. v. United States*, 76 F. Supp. 587 (D. Mass. 1948) said: "Profit means an excess of assets over liabilities and the par value of the capital stock." In *Roberts v. Roberts-Wicks Co.*, 184 N.Y. 257, 77 N.E. 13, 16 (1906) the court stated: "When the property of a corporation has accumulated in excess of its chartered capital, the excess may be regarded and dealt with as constituting a surplus of profits." The definition of "net profit" or "surplus profits" advanced in *Cannon v. Wiscasset Mills Co.*, 195 N.C. 119, 141 S.E. 344, 348 (1928) is of extraordinary interest. In that case the court said:

"Manifestly, for the purpose of determining the amount to be declared and paid as a dividend, it is necessary that the true value of the assets, in cash, and not the mere book value, should be ascertained, for no dividend can lawfully be declared and paid except from the surplus or net profits of the business. . . . The terms 'net profits' or 'surplus profits' have been defined as what remains after deducting from the present value of the assets of a corporation the amount of all the liabilities including the capital stock."

The following cases have also arrived at "profits" using an asset-valuation test. *Bank of Morgan v. Reid*, 27 Ga. App. 123, 107 S.E. 555 (1921); *Peters v. U.S. Mortgage Co.* 13 Del. Ch. 11, 114 Atl. 598 (1921).

28. *PATON, ADVANCED ACCOUNTING* 451 (6th ed. 1950).

realized upon sale or disposition of capital assets.²⁹ These losses operate to reduce earned surplus, either directly, or by first being carried as debits to profit and loss. Such losses may include unusual casualties from fire, tornado, or other natural elements.³⁰ The important element here is to understand that in accounting for profits and for dividend purposes, realized gains and losses, relating to fixed assets, must be recognized as determinants upon the fund available for dividends.

D. UNREALIZED GAINS AND LOSSES

Often a general change in the price level will cause the directors of a corporation to revalue their fixed capital assets. The credit entry to offset such write-ups in the case of a rising price level is usually represented by a new surplus account³¹ which may be termed "appreciation surplus." It has been held that such a surplus is available for dividend distribution when applying the "balance-sheet-surplus" test.³² It is submitted that such cases should not be used as a guide for the courts in North Dakota. Appreciation write-ups should *never* be credited to earned surplus and modern accounting requires a strict separation of this type surplus from earned surplus.³³

The problem of unrealized diminution in the value of fixed assets is the converse of unrealized appreciation, and consistency would apparently require that it be ignored. However, there may be circumstances such as a general and major collapse in business of such magnitude as to threaten permanently the soundness of the cost value of fixed assets. Under such extreme circumstances, where diminution in value has become a reality everywhere except on the books of the corporation, proper accounting requires a write-down of

29. FINNEY & MILLER, PRINCIPLES OF ACCOUNTING 354 (5th ed. 1959).

30. *Id.* at 383.

31. PATON, ADVANCED ACCOUNTING 348 (6th ed. 1950).

32. *Randall v. Bailey*, 288 N.Y. 280, 43 N.E.2d 43 (1942).

Contra, *Berks Broadcasting Co. v. Craumer*, 356 Pa. 620, 52 A.2d 571 (1947); *Loftus v. Mason* 240 F.2d 428 (4th Cir. 1957). Mich. Comp. Laws § 450:22 (1948) and Wis. Stat. Ann. § 180:38(3) expressly permit the use of appreciation surplus for dividends. But see Ill. Stat. Ann. ch. 32, § 157(41)(c) (1954) which provides that no cash dividend is to be paid from this source.

33. FINNEY & MILLER, PRINCIPLES OF ACCOUNTING 125 (5th ed. 1959).

asset values.³⁴ To require a write-down, and not permit a write-up is not as inconsistent as it might appear. In the case of bringing the asset values down, it is admitting losses which will probably never be regained, while in the case of write-ups the rule merely requires a postponement of realization. The gain, if permanent, will accrue to the benefit of the corporation sooner or later. If such a write-down is made, a question arises as to whether the impact of such a loss should fall on earned surplus or capital. This problem is especially acute in North Dakota where only earned surplus is available for dividends. The accounting profession speaks almost as one in saying that such losses must fall against earned surplus, to the point of extinguishment if necessary.³⁵ The writer lends his support to this view so long as it is applied only in those instances where the loss is of such magnitude as to endanger the capital foundation of the corporation. Fixed assets are not held for the purpose of resale, but rather for the production of revenue.³⁶ In the writer's opinion, if the fixed asset devaluation only effects the resale value and does not decrease the revenue producing ability, the loss should not be reflected as a decrease in earned surplus. The effect of these decreases in asset values is to make the corporation a smaller one and capital should be adjusted to recognize that fact. If there is no reason to expect that fixed asset losses will affect the earning power of the corporation the loss should fall against capital, either by utilizing an existing capital surplus, or by creating a reduction surplus from capital stock. Any other result would be inconsistent with the North Dakota theory that only earnings and profits realized are distributable as dividends.

Although the contrary rule exists in England,³⁷ it is clear that in our country normal depreciation of corporate assets must be taken into consideration in the process of establishing whether a dividend is permissible.³⁸ Numerous deprecia-

34. *Id.* at 251.

35. MONTGOMERY, AUDITING THEORY AND PRACTICE 372 (6th ed. 1940).

36. "Fixed assets are assets of a relatively permanent nature used in the operation of the business and not intended for sale." FINNEY & MILLER, PRINCIPLES OF ACCOUNTING 328 (5th ed. 1959).

37. *Verner v. General and Commercial Investment Trust*, 2 Ch. 239 (1894).

38. See *Dealers' Granite Corp. v. Faubion*, 18 S.W.2d 737 (Tex. Civ. App. 1929) where depreciation was deducted before arriving at net profit. But see *Eyster v. Centennial Board of Finance*, 94 U.S. 500 (1876) where depreciation was held not a reduction of profits.

tion methods are used in modern accounting.³⁹ Although no judicial support has been given many of them it may be assumed that any method approved as good accounting practice should be condoned by the courts.

E. PAID-IN-SURPLUS

The premium received on the sale of par value stock, or in the case of no-par stock the amount of consideration received which has been designated by the directors as not being capital, is generally called paid-in-surplus.⁴⁰ Under pure balance sheet surplus statutes, such amounts are available for dividends since they are in excess of capital.⁴¹ However, when applying the "earned surplus" test, the availability of paid-in-surplus as a source of dividends may become filled with pitfalls and subtleties which are beyond the comprehension of those not possessing a thorough understanding of corporate finance. In the event original shareholders pay more than stated or par value for their stock, there seems no justification for allowing it as a source of dividends.⁴² In this case, even though it may be called surplus it is in reality a part of the capital of the business. In any event it is certainly not earned surplus. But suppose a subsequent issue of stock is sold when the corporation has an existing earned surplus. Is not paid-in-surplus then actually paid so that prior shareholders will retain their equity in the earned surplus account? Courts faced with this situation have without exception answered the question in the affirmative.⁴³ On the surface their theory seems to present a satisfactory result. However, it is this writer's opinion that the aforementioned holdings are not supported by realistic thinking. The cost of an investment is determined by capitalizing anticipated future earnings and not because of a desire to preserve prior stock-

39. For the methods allowable for income tax purposes, see INT. REV. CODE OF 1954, § 167(b).

40. FINNEY & MILLER, PRINCIPLES OF ACCOUNTING 125 (5th ed. 1959).

41. See Del. Code Ann. tit. 8 § 170 (1953); N.Y. Stock Corp. Law § 58 (McKinney 1951); Mich. Comp. Laws § 450:22 (1948); Wis. Stat. Ann § 180:38(3) (1957); N.C. Gen Stat. § 55-50(a)(3) (1960).

42. For a complete discussion of this problem see Note, 31 Colum. L. Rev. 844 (1931).

43. *Smith v. Cotting*, 231 Mass. 42, 120 N.E. 177, 181 (1918); *Equitable Life Assur. Society v. Union Pac. R.R.*, 212 N.Y. 360, 106 N.E. 92 (1914); See also *In re Hoare & Co. Ltd.*, 2 Ch. 208, 213 (1904); Note, 31 Colum. L. Rev. 844 (1931) supports the position taken by these cases.

holders equity.⁴⁴ After digesting this elementary concept of finance it should follow that even this type of paid-in-surplus is more closely related to permanent capital than to earned surplus. Only in the rare situation where paid-in-surplus was *actually* created so that prior stockholders would retain their equity in the earned surplus account could a court logically consider permitting a dividend from this source.

IV. REQUIREMENTS IN SPECIFIC SITUATIONS

A. QUASI-REORGANIZATIONS

A simple procedure commonly known as quasi-reorganization may create a surplus variously known as dated surplus, reorganization surplus or reduction surplus.⁴⁵ This is nothing more than a reclassification of a portion of the original legal capital into a so-called surplus category. In this case, nothing of value has come into the corporation that was not already there. For instance, the ABC corporation decides to reduce the par value of its stock. It follows the provisions of Section 10-19-70⁴⁶ and reduces its par stock from \$60,000 to \$45,000 (600 shares @ \$100 reduced to 600 shares @ \$75). The remaining \$15,000 is allocated to reduction surplus. The surplus thus created is not earned surplus but a partial liquidation of investment. In no sense does this surplus represent profits or earning. However, by statutory authority⁴⁷ a reduction surplus may be created under certain circumstances to take up a deficit incurred through operating losses in order to give the corporation a fresh start. If the corporation then has a profitable year, it may declare a dividend from the earned surplus created since the reorganization without the normal necessity of applying the earnings from the current year to the deficit of previous years. However, if it is supposed that preferred shareholders exist when a stated capital reduction has been made of capital represented by common shares, the foregoing procedure has the effect of reducing the cushion of protection upon which the senior shareholders are entitled to rely. Particularly vicious is the ef-

44. JOHNSON, FINANCIAL MANAGEMENT 522 (1959).

45. For a discussion of the mechanics behind this process, see FINNEY & MILLER, PRINCIPALS OF ACCOUNTING 587 (5th ed. 1959).

46. N.D. Cent. Code (1961).

47. N.D. Cent. Code § 10-19-71 (1961).

fect where the preferred shares carry a preference upon dissolution. The North Dakota statute⁴⁸ protects the senior shareholders by providing that no reduction of stated capital is to be made which would reduce the amount of the aggregate stated capital of the corporation to an amount less than the preferential amounts payable upon dissolution.

B. WATERED STOCK

If inflated values have been assigned to assets transferred to the corporation for stock, a distortion results, which has dangerous possibilities if not corrected prior to a dividend declaration. This situation is commonly termed "watered stock."⁴⁹ The issue presented is this: Must the first profits of the business be applied against the water, or would North Dakota permit a declaration of dividends? In states using the profits test, the majority rule has been that earned surplus need not be offset against original water in stock prior to the declaration of a dividend.⁵⁰ It is conceded that theoretically the majority has the stronger argument. However, it is urged that if North Dakota is faced with this question they should join ranks with the minority. The practice of placing inflated values on property which is then exchanged for stock should be discouraged whenever possible.

C. WASTING ASSET CORPORATIONS

When a corporation is organized to exploit a specific asset such as a mine, an oil field, a piece of land, or a patent, with no intention of continuing in business after such exploitation, the corporation is usually described as a wasting asset corporation.⁵¹ As in the case of other corporations, the various assets used to accomplish this task such as buildings, machinery, tools, etc., are subject to charges of depreciation, depletion and other accounting procedures. But deductions for depletion or amortization of the asset or assets of the wasting type are considered not legally necessary for the purpose of

48. N.D. Cent. Code § 10-19-70 (1961).

49. BALLANTINE, CORPORATIONS 802 (Rev. ed. 1946).

50. *Goodnow v. American Writing Paper Co.* 62 N.J. Eq. 645, 66 Atl. 607 (1907) *aff'd* 73 N.J. Eq. 692, 69 Atl. 1014 (1908); *United Light & Power Co. v. Grand Rapids Trust Co.*, 85 F.2d 331 (6th Cir. 1936); but see *Northwestern Electric Co. v. Federal Power Commission*, 321 U.S. 119 (1944).

51. 11 FLETCHER, CYCLOPEDIA CORPORATIONS § 5347 (1958).

52. N.D. Cent. Code § 10-19-44(2) (1961).

determining funds available for dividends.⁵² In North Dakota a provision is required in the articles of incorporation authorizing dividends in cash "out of depletion reserves", if such dividends are to be paid from this source; the privilege is confined to corporations engaged in exploiting natural resources.⁵³ Shareholders must be informed of the source of such dividends.⁵⁴

D. LIQUIDATING DIVIDENDS

North Dakota makes a provision for the payment of a cash dividend in partial liquidation.⁵⁵ A liquidating payment is not truly a dividend, but rather a return to the stockholders of part of the capital. This dividend may be paid out of "stated capital" or "capital surplus" of the corporation.⁵⁶ A distribution of this nature may not be made unless the articles of incorporation so provide and unless such a distribution is authorized by the affirmative vote of the holders of at least two-thirds of the outstanding shares of each class of stock.⁵⁷

V. CONCLUSION

From the foregoing discussion it is obvious that this area is and has been in a state of uncertainty. It is possible to draw several conclusions as to what the law should be but only a few conclusions as to what the law is. The most pressing problem from the point of view of the attorney is the fact that the legislature has not adequately defined the term "earned surplus." Section 10-19-02⁵⁸ states:

"'Earned surplus' means the portion of the surplus of a corporation equal to the balance of its net profits, income, gains and losses from the date of incorporation, or from the latest date when a deficit was eliminated. . . ."

The legislature has apparently left the meaning of "net profits, income, gains and losses" to judicial interpretation. The North Dakota courts have not had the opportunity to interpret these words, and courts of other jurisdictions have

53. *Ibid.*

54. *Ibid.*

55. N.D. Cent. Code § 10-19-45 (1961).

56. *Ibid.*

57. *Ibid.*

58. N.D. Cent. Code (1961).

given them a variety of meanings. To clarify this perplexing situation, I would recommend the adoption of the following statute⁵⁹ in North Dakota.

“Except where provisions of this chapter specifically require a standard or impose additional limitations, the assets of a corporation may, for the purposes of determining the lawfulness of dividends or of distributions and withdrawals of corporate assets to or for the shareholders, be carried on the books in accordance with generally accepted principles of sound accounting practices applicable to the kind of business conducted by the corporation.”

The term “unrestricted earned surplus” has a well-defined accounting meaning which may be relied upon by those concerned with its interpretation.

The importance of being certain that a dividend distribution is condoned by the legislature should not be underestimated. Section 10-19-47⁶⁰ places liability upon any director who votes for, or assents to, the declaration of a dividend which is contrary to the restrictions contained in the articles of incorporation or to restrictions imposed by law.

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59. N.C. Gen. Stat. § 55-49(b) (1960).

60. N.D. Cent. Code (1961).