October 20, 1948

Mr. Raymond Vernon
Assistant Chief
International Resources Division
Department of State
Washington 25, D. C.

Dear Mr. Vernon:

This will refer to your letter of September 29, 1948 forwarding a proposed corporation law for the Republic of Liberia and requesting, on behalf of the Department, our views.

It is my understanding that this law was drafted by an American controlled corporation known as the Liberia Company which is interested in the economic and cultural development of that country. The Liberia Company proposes to develop the country and seeks to form as many subsidiary companies as are necessary, in each of which it will grant an equity interest to the Liberian government, to operate the projects it undertakes. The method of financing these corporations, however, is still uncertain.

Insofar as the proposed law performs the traditional function of a corporation law and provides a procedure for the formation of corporations and the regulation of the relationships between the participants in the business enterprises initiated by the new corporations I have made a number of observations which stem from the daily experience of the Commission with such statutes. This experience is concerned largely with the protection of investors in this country to whom corporate securities are offered for sale. However, if the corporations to be formed are to be financed exclusively by other corporate enterprises together with the interests in control of the Liberia Company my observations will have little relevance, for the law should then be considered chiefly as a possible regulatory measure to protect the interests of Liberian labor and industry. An extended analysis based upon a detailed study of the country, its needs, and its resources would then be necessary, and in these fields I do not believe I have any special competence.

The proposed law seems to have been adopted from the State of Delaware's general corporation law. However, in many instances, the proposed law imposes less restrictions upon management than those compelled by the Delaware statute. The major differences arise in those provisions dealing with the consolidation of two or more corporations and in those which specify the contents of the stock certificates. Section 34

of the proposed law provides that a majority of the voting power of each of two or more corporations may compel a consolidation. Under the Delaware law, which I believe imposes a minimum requirement, it is necessary for at least a two- thirds majority of the shares representing all the capital stock of the corporation to vote in favor of the proposal to authorize a merger or consolidation. Thus, it is possible, under the proposed law, for a bare majority of the voting stock in a corporation to effect a consolidation which may (1) radically change the nature of a corporation's business, (2) alter or eliminate arrearages upon preferred stock which may not have even had an opportunity to express an opinion upon the merger, and (3) completely alter the capital structure of the enterprise. The dangers to the public inherent in easily accomplished mergers were clearly expressed by Mr. Robert O'Brien of the Securities and Exchange Commission staff in his testimony before a sub-committee of the United States Senate which was conducting hearings upon a bill providing for the federal licensing of corporations in 1938. I should like to refer you to that testimony which appears at pp. 360 to 376 of the hearings on S. 10 and S. 3072, 75th Congress, 3d Session. Under the Public Utility Holding Company Act, where the Commission has a relatively broad discretion to insist upon protective provisions, its practice is to require in the event of a preferred stock issue that preferred stockholders have minimum voting rights which would require at least a majority vote of each class to approve a merger or consolidation. See the Commission's Thirteenth Annual Report, p. 90.

Moreover, I believe Section 43 of the Liberian law, which provides for the appraisal of the interests of dissenting stockholders in a merger is unrealistic. It requires any stockholder who dissents from the proposed consolidation and wishes to have his stock appraised and redeemed by the corporation to declare his objection to the consolidation in writing prior to the taking of the vote and then, within sixty days after he has noted his objection, to apply to "a court of competent jurisdiction" for the appointment of appraisers to value the stock. It is at least arguable that only a Liberian court would fulfil the definition of a court of competent jurisdiction. If so, it would be difficult for stockholders in this country to take advantage of the appraisal provision. Under the corresponding provision of the Delaware law a dissenting stockholder may demand payment of his stock "within twenty days after the date on which the agreement of consolidation of merger has been filed." This has the advantage of not requiring action on the part of the stockholder before steps have been taken to make the consolidation or merger effective. If, however, the minority stockholder objecting were an American investor, it might be difficult for him to obtain information as to when the agreement was filed in Liberia, and, of course, to take action within a twenty day period thereafter.

It should also be noted that the proposed law does not follow the Delaware statute in its provisions concerning the disclosure necessary on stock certificates. The Delaware law, like that of most states, provides that whenever "any corporation shall be authorized to issue more than one class of stock or more than one series of any stock, the designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of

such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate." As a matter of fact, shares cannot be listed on the New York Stock Exchange unless "certificates of every class recite the preferences of all classes." No such provision appears in the proposed Liberian law. Thus, it may be difficult or at least inconvenient for a stockholder to discover exactly what rights his certificate of stock confers.

There are a number of other minor distinctions between the proposed law and the Delaware statute. In each instance it appears that the rather broad standards imposed by the Delaware law, which grant a great deal of freedom to the corporate managers, are made broader. Thus, although Delaware requires that the certificate of incorporation include a statement of the "nature of the business" the proposed law merely requires that the certificate of incorporation state only the "general nature of the business." (Section 38) The Delaware law limits proxies to three years; there is no limitation upon the length of time within which proxies may be enforced under the proposed law. We note that Section 46 of the Act authorizes a private organization, the "International Trust Company of Liberia," to act as a resident business agent for all Liberian corporations.

Although the above comments indicate the nature of the differences between the proposed Liberian law and the Delaware law, they do not take into account those omissions from the proposed law which appear in other corporation laws as an aid to full disclosure of the corporate affairs. For instance, statutes of a majority of the states require some form of periodic public report of the financial condition of the corporation for the information of shareholders, creditors and other members of the investment public. Some such provision would seem to be desirable in this Act but it is impossible, without an understanding of the local conditions in Liberia, to prescribe the form of such reports. I believe, however, that some reporting requirement should be included in the Act so that the Liberian government may have an opportunity to publish the financial reports of the companies granted a preferred status. It would also appear desirable, in order to protect senior security holders, to impose some restriction upon the payment of dividends other than that contained in Section 21 of the proposed law. This section would make it possible for the common stock interest to continue to receive dividends in spite of a depletion of capital below that which would represent senior securities.

I have refrained from commenting upon Section 3K of the proposed law which provides for the indemnification of the management against expenses incurred in defense of stockholder suits for negligence or misconduct because I feel that these provisions may be necessary at this time in order that the corporation may attract officers and directors who would otherwise be reluctant to assume responsibility for activities in Liberia. However, it should be noted that although Section 3K prohibits indemnification when the suit results in a judgment against the officer or director it contains no such prohibition in the more common situation, when the liability of the corporate official is adjusted or settled and there is no adjudication of negligence or misconduct.

Mr. Raymond Vernon

At our conference you expressed an interest in provisions of the Model Business Corporation Act or the Federal Licensing of Corporations Bill (S. 10, 75th Cong.) which might be adapted to the problem now confronting the Republic of Liberia. The Model Business Corporation Act was originally proposed by the National Conference of Commissioners on Uniform State Law and has been adopted by the states Idaho, Louisiana, and Washington. The Federal Licensing of Corporations Bill was introduced by Senator O'Mahoney but was never enacted by the Congress of the United States. A number of its provisions went considerably beyond the typical state corporation laws in according protection to investors. For example, Section 201(3) provided that all stock should be voting stock; Section 201(4) provided that the stockholders of a corporation must approve all payments to officers of the corporation in excess of their regular salaries. In addition, Section 201(5) and 201(6) provided for certain restrictions upon the withholding of dividends and upon the issuance of stock in payment for services.

I should like to point out that the above-mentioned testimony of Robert O'Brien given at the hearings in that bill was limited to describing some of the corporate abuses which are possible under the more "liberal" state incorporation statutes and that no opinion was then expressed, or has since been expressed by or on behalf of the Commission, concerning the efficacy of dealing with such a problem through an incorporation statute as distinguished from more comprehensive as well as more flexible administrative controls such as are provided in a more limited area by the Public Utility Holding Company and Investment Company Acts. In the event that public offerings of securities of Liberia corporations should hereafter be made in the American security markets an even more difficult problem would be posed of protecting public investors. Some of these difficulties are inherent in any offering to private investors of a direct stock ownership in corporations incorporated in foreign countries in view of the necessity of resort to the courts in foreign countries to obtain protection against any abuse of position by the corporate managements. This difficulty might be the more aggravated in the case of securities of a Liberian corporation than in the case, for example, of a British or Dutch corporation, because, as I understand it, there is no class of private investors in Liberia. Thus, it is impossible to rely on fellow stockholders in the country of incorporation to afford a check through class suits against unfair action of corporate management. If, therefore, there should be future attempts to make public offerings in the United States of securities issued by corporations organized under the proposed Liberian law, there would be, in my opinion, a serious danger that those securities would be traps for the unwary even if the incorporation act was modeled upon those American statutes which have gone farthest in protecting the investors, and the fact that the present proposed incorporation act contains the minimum of protective provisions would seem to make such a problem all the more serious. As illustrated by Mr. O'Brien's testimony, the Commission's powers in connection with any such public offering in this country would be limited to requiring disclosure and it would not have the power to restrain such an offering. On the other hand, I understand that the immediate purpose of the statute is to attract investment in local industry on the part of American or perhaps other foreign corporations. Such corporate investors would stand in a very different position from

scattered private investors from the point of view of their own protection and would presumably prefer a minimum of restrictions on managerial discretion.

I trust that the foregoing comments, which are personal and necessarily limited in scope, will be of assistance to you.

Very truly yours,

Roger S. Foster
General Counsel