1972

Shareholders

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Available at: https://uknowledge.uky.edu/klj/vol61/iss1/7

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SHAREHOLDERS

This article is intended to serve as a roadmap to guide the practitioner through the unexplored shareholder provisions of the recently enacted Kentucky Business Corporation Act.¹ In achieving this objective, certain basic strains of analysis will be pursued. The prior corporate statute will be consulted to ascertain the extent of change and the continued viability of past statutory concepts and precedents.² In addition, a comparative analysis of prior Kentucky corporate law and the law as it exists under the newly established act will be made. Finally, the article will attempt to project the problem areas that may arise under the new legislation by examining the developing law in sister states which have adopted the Model Business Corporation Act.³ It is hoped that this analysis will supply the Kentucky practitioner with a working knowledge of the shareholder provisions of the new act. Such knowledge should enable him to anticipate and avoid problems that might otherwise arise as he becomes familiar with the new legislation.

I. SHAREHOLDER MANAGEMENT FUNCTIONS

A distinctive feature of the modern corporation is the wide separation of ownership and control.⁴ As a by-product of this separation, considerable litigation has developed over the conflict between management prerogatives and shareholder rights.⁵ A fundamental precept underlying the conflict is that the management of the corporation is

² It should be noted that there is not a large body of corporate case law in Kentucky. This fact served as an impetus for the passage of a statute very similar to the ABA-ALI MODEL BUS. CORP. ACT (rev. ed. 1969). The many jurisdictions which have adopted the Model Act should provide a body of case law to aid in interpreting the new Kentucky Act.
⁴ A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1933). The phenomenon of owners who do not manage and managers who do not own was discussed in this classic work. The authors labeled the divorce of control from ownership as a characteristic of the corporate system.
⁵ See Polk, The Model Act and South Carolina Corporation Law, 15 S.C.L. Rev. 275, 303 (1962).
vested in a board of directors who are chosen by the shareholders. Despite the broad managerial powers given to the board, certain specified powers are reserved to the shareholders. These powers comprise the shareholder management functions and mark an appropriate starting point for examination of the new law.

Shareholder management functions arise chiefly in the context of shareholder meetings and are inextricably tied to voting rights. They relate chiefly to election and removal of directors and officers; adoption, amendment, and repeal of by-laws; shareholder resolutions, including ratification of board of directors actions; and extraordinary corporate matters.

A. Election and Removal of Officers and Directors

The initial board of directors is usually named in the articles of incorporation or elected at an organizational meeting of the incorporators. Although this is the approach of the Model Act, under prior law election of the initial board was postponed until the first shareholder meeting. This procedure created a time gap in which corporate status was achieved without corporate directors. The problem of having no directors to hold liable for unauthorized corporate action is thus eradicated by adoption of the Model Act provision.

The recent enactment is similar to prior corporate legislation authorizing the election of directors. At the first annual meeting of

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0 It should be noted that KRSA § 271A.175 contains language that allows increased shareholder participation in management. Whereas the prior act stated unequivocally in KRS § 271.345 that "the business of every corporation shall be managed by the board," KRSA § 271A.175 adds the clause "except as may otherwise be provided in the articles of incorporation."  
1 H. Henn, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 361 (2d ed. 1970) [hereinafter cited as H. HENN, LAW OF CORPORATIONS].  
2 See text accompanying notes 107-152, infra.  
3 See text accompanying notes 153-284, infra.  
4 See H. HENN, LAW OF CORPORATIONS § 361.  
5 See H. HENN, LAW OF CORPORATIONS § 409.  
6 ABA-ALI MODEL BUS. CORP. ACT § 36 (rev. ed. 1969), which is identical to KRSA § 271A.180, states that: "[T]he names and addresses of the members of the first board of directors shall be stated in the articles of incorporation..."  
7 Ky. REV. STAT. § 271.345(2) (1971) [hereinafter cited as KRS] states: "After issuance of the certificate of incorporation, the first meeting of the shareholders shall be held... for the purpose of electing the directors..."  
8 Kentucky's previous corporation act was based largely upon the UNIFORM BUS. CORP. ACT. The procedure designating directors at the first meeting of the shareholders represented one of the former statute's few deviations from the Uniform Act which required the designation of directors in the articles. Because of this deviation, there was some question as to the liability on the part of those acting as directors and officers of the corporation before having been properly elected. See Tri-State Developers, Inc. v. Moore, 343 S.W.2d 812 (Ky. 1961).  
9 Compare KRS § 271.345 with KRSA § 271A.100. It should be noted that in statutory authority, shareholders have inherent power at common law to elect directors. See Bruum v. Cook, 273 N.W. 744 (Mich. 1937).
shareholders and at each annual meeting thereafter, the shareholders elect directors to serve until the next annual meeting,\(^{16}\) except where directors are divided into classes, in which case one class is elected each year.\(^ {17}\)

1. **Classification of Boards—Cumulative Voting Rights**

Closely tied to the election process, and specifically sanctioned by both the old and new statutes,\(^ {18}\) is the system of classifying the board of directors.\(^ {19}\) This is the process by which directors are classified by term of office with staggered terms so that only a portion of the board is elected annually. In theory, it assures continuity of management by providing holdover directors with experience in conducting affairs of the corporation. But in practice, the device is not necessary to assure continuity since it is normally achieved through customary year-to-year re-election.\(^ {20}\) The primary objections to classification are that shareholders cannot replace a majority of the board at any one annual meeting\(^ {21}\) and the effectiveness of cumulative voting, where it is statutorily or constitutionally sanctioned,\(^ {22}\) is impaired.

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\(^{16}\) See Mut. Tel. Co. v. Jarrell, 295 S.W. 865 (Ky. 1927), where the Court in construing KRS § 271.345 held that an election of directors must be held annually.


\(^{18}\) KRS § 271.345(4) and KRS § 271A.165.

\(^{19}\) See Adkins, *Corporate Democracy and Classified Directors*, 11 Bus. Law. 31 (Nov. 1955). See also note 22 infra.

\(^{20}\) MODEL BUS. CORP. ACT ANN. 2d § 87 §§ 2 (1971).

\(^{21}\) Id.

\(^{22}\) See Wolfson v. Avery, 126 N.E.2d 707 (Ill. 1955), where an Illinois statute substantially similar to KRS § 271A.185 was held unconstitutional as inconsistent with cumulative voting rights granted shareholders by the Illinois Constitution. Ill. Const. art. XI, § 3. The case is of particular importance in that Kentucky does constitutionally require cumulative voting. Ky. Const. § 207. Cf. Janney v. Philadelphia Transit Co., 128 A.2d 76 (Pa. 1956), which held that classification of directors with staggered terms was not inconsistent with the cumulative voting provision of the Pennsylvania Constitution. The court in effect said that cumulative voting, though constitutionally granted, was not guaranteed to be effective. It distinguished Wolfson v. Avery on the basis of language used in the constitutional provision. The court held that the Illinois Constitution was framed in terms of the number of directors to be elected, while the Pennsylvania provision was framed in terms of voting for one candidate or another. Thus, a representational proportion of directors was not guaranteed. The old Kentucky statute, KRS § 271.315(2), and the newly enacted KRS § 271A.165(4), both of which guarantee cumulative voting, speak of directors in the early part of the provision and candidates in the latter part thereof. The question of whether statutory provisions like KRS § 271A.185, which authorize classification of boards, are compatible with constitutional provisions calling for cumulative voting therefore remains open in Kentucky. In Comment, *Cumulative Voting-Removal, Reduction and Classification of Corporate Boards*, 22 Chi. L. Rev. 751, 757 (1955), the writer discusses the events at the convention which adopted the Kentucky con-

(Continued on next page)
The first of these objections may have had merit under the prior Kentucky statute, but not under the new act. The old act contained no provision for the removal of directors, but Kentucky Revised Statutes Annotated [hereinafter KRSA] § 271A.195 provides that “[a]ny director, or the entire board of directors may be removed, with or without cause, by a vote of the holders of a majority of shares then entitled to vote at an election of directors” (emphasis added). The power to remove the entire board, or at least a majority thereof, allows the shareholders to replace a majority of the board at a single annual meeting, despite a classified system of election. Thus the reason for this objection to classified boards, i.e., insulation of management from changed attitudes on the part of the shareholders, is eliminated.

The second objection, that classification of boards and cumulative voting are incompatible, is particularly relevant in Kentucky where cumulative voting is constitutionally protected. Both the prior and recently enacted statutes recognize the right of shareholders to vote cumulatively. Although the constitutionality of staggering the directors’ terms of office in order to elect different classes of directors in successive years has been litigated in other jurisdictions, Kentucky has not yet decided the issue. However, the constitutionality of classification is questionable. By reducing the number of directors elected at any one time the minority shareholders are deprived of the leverage given them through cumulative voting. A vivid example is Humphreys v. Winous Co., where the board was classified to prevent...
a 40% minority shareholder from electing one of three directors through his cumulative voting right.\textsuperscript{31} Under prior Kentucky law, such a classified board could be similarly structured to deny minority shareholder representation.\textsuperscript{32} The constitutional question was therefore particularly acute under prior law. The new corporation act, however, reduces the opportunity for the use of a staggered board as a tool for defeating cumulative voting, especially in the close corporation, by providing that the board consist of at least nine directors and that at least one-third of the board be elected at each election.\textsuperscript{33} By requiring the election of at least three directors at any one time, the minority shareholders are given a greater opportunity to combine their votes to achieve a proportionate representation on the board.

2. Filling of Vacancies

A topic closely related to election of directors is the power to fill vacancies. Vacancies on the board of directors are usually filled by the shareholders.\textsuperscript{34} But under prior Kentucky law, filling vacancies was a power clearly delegated to the board of directors.

Except as otherwise provided in the articles or by-laws . . . vacancies in the board of directors shall be filled by the remaining member or members of the board\textsuperscript{35} (emphasis added).

The new provision also vests the power to fill vacancies in the board of directors.\textsuperscript{36} But its language is permissive rather than mandatory, \textit{i.e.}, "[a]ny vacancy occurring in the board of directors may be filled by the affirmative vote of a majority of remaining directors. . . ."\textsuperscript{37} (emphasis added).

\textsuperscript{31} Ohio statutorily sanctioned cumulative voting and the classification was challenged on the basis of its effect upon the right. The Supreme Court of Ohio rejected the minority shareholder’s argument, holding that, although cumulative voting was granted by statute, its effectiveness was not thereby guaranteed. At the time of the decision it is important to note that the statute authorizing classification had been amended to provide that each class must consist of at least three directors.

\textsuperscript{32} KRS § 271.345(4).

\textsuperscript{33} KRSA § 271A.185.

\textsuperscript{34} See Campbell v. Loew’s, Inc., 134 A.2d 852 (Del. Ch. 1957) where it was held that shareholders have an inherent right to fill vacancies stemming from their power over the composition of the board. See also \textit{In re Union Ins. Co.}, 22 N.Y. (Wend) 591 (1840). The court held that shareholders may fill vacancies, however created, on the board of directors even though there is nothing in the charter or other statutes controlling the question, and further that the power of election is a necessary incident to a corporation for the purpose of perpetuating its succession.

\textsuperscript{35} KRS § 271.345(4).

\textsuperscript{36} KRSA § 271A.190.

\textsuperscript{37} Id.
This rather subtle distinction is important. In *Campbell v. Loew's, Inc.*, a provision substantially similar to KRSA § 271A.190 specifically empowered directors to fill vacancies which were created by an increase in the number of directors. It was argued that the provision precluded shareholders from exercising their inherent right to fill vacancies on the board, unless such power was reserved in the articles or by-laws. The court held that by using permissive rather than mandatory language, the legislature did not intend to infringe upon the shareholders' inherent right to fill vacancies. Kentucky's prior provision contained mandatory language clearly delegating to the board the power to fill vacancies. The new provision, however, provides that, "any directorship to be filled by reason of an increase in the number of directors may be filled by the board of directors. . . ." (emphasis added). Thus, any future litigants questioning the authority of shareholders to fill newly created directorships will have to overcome the persuasive interpretation of *Campbell v. Loew's, Inc.*

In concluding the discussion of election of directors and specifically the related problem of filling vacancies, it should be noted that conflict over the exercise of the power will rarely arise. Granting directors the authority to fill vacancies, a delegation sanctioned under both prior and new legislation, is justifiable since it enables a corporation to have a full board without the delay and expense incident to calling a special meeting of the shareholders. Usually only during a contest for corporate control will the power to fill vacancies become an acute issue.

3. Removal of Directors

Although election of directors is a crucial managerial function of the shareholder, the removal of directors is of equal importance in the ultimate control of management. Prior Kentucky law did not expressly authorize the removal of directors by the shareholders. Although the ability to remove directors was indirectly recognized by Kentucky Revised Statutes [hereinafter KRS] § 271.365, there was no provision directly granting shareholders the power of removal. It is therefore necessary to examine the common law attitude toward the removal

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38 134 A.2d 852 (Del. Ch. 1957).
40 134 A.2d 852 (Del. Ch. 1957).
41 KRS § 271.345(4).
42 KRSA § 271A.190.
44 KRS § 271.365 placed directors in a fiduciary relationship to the corporation and sanctioned removal for the breach of that relationship.
power in light of the new Kentucky provision which somewhat alters the common law.\footnote{KRSA § 271A.195.}

At common law, the power of removal was predicated upon the inherent right of shareholders to remove \textit{for cause}.\footnote{See Note, \textit{Removal of Directors For Cause}, 27 U. CHI. L. REV. 92 (1958).} Even delegation of the power to the directors through the articles could not serve to defeat this inherent power in the shareholders.\footnote{See \textit{Auer v. Dressel}, 306 N.Y. 427, 118 N.E.2d 590 (1954).} The common law, however, did not recognize a corresponding inherent right to remove \textit{without cause}.\footnote{Prior to the ABA-ALI Model Act, there was statutory authorization in some states for removal \textit{without cause} provided such power was specified in the articles. \textit{See N.Y. Bus. CORP. LAW § 706 (McKinney 1963). See also Travers, \textit{Removal of the Corporate Director During His Term of Office}, 53 IOWA L. REV. 389 (1967); Note, \textit{Validity of By-Law Permitting Removal of Directors Without Cause}, 59 MICH. L. REV. 640 (1961).} Nonrecognition of a right of removal \textit{without cause} might not have been such a problem had shareholders been able to remove for cause without affording the directors procedural due process of law. The procedural complexities of providing due process, where proxy machinery was involved, served as such a deterrent to the removal of directors \textit{for cause}, that the power was rendered meaningless to shareholders of a large corporation.\footnote{See \textit{Campbell v. Loew's, Inc.}, 134 A.2d 852 (Del. Ch. 1957).} In response, a growing number of jurisdictions enacted statutes recognizing the right of shareholders to remove directors \textit{with} or \textit{without cause}.\footnote{H. HENN, \textit{LAW OF CORPORATIONS}, § 205, at 413 n. 34. Section 39 of the Model Act follows this growing trend. \textit{See MODEL BUS. CORP. ACT ANN. 2d} § 39 ¶ 2 (1971), where the trend is rationalized as follows: More recent statutory provisions, as well as section 39 of the Model Act, are based upon the theory that since the shareholders are the owners of the corporation, they should have complete power to control management. Accordingly, the section grants to shareholders the right to remove any or all directors whether or not cause exists. Thus, the right of removal hinges not upon the propriety of a director's conduct, but upon the bare question of whether the shareholders desire to retain him as a representative on the board for whatever reason.} Kentucky has thus taken a progressive step in adopting KRSA § 271A.195(1), which sanctions removal \textit{with} or \textit{without cause}. However, there appear to be serious problems in reconciling the removal power with the constitutionally protected cumulative voting right.\footnote{See \textit{Laughlin v. Geer}, 121 ILL. App. 584 (1905) where an Illinois Court ruled unconstitutional the power of shareholders to remove directors \textit{for cause} because inconsistent with cumulative voting rights. The ability to remove \textit{without cause} only serves to enhance the constitutional question which Kentucky courts have yet to answer.}

If directors are removable \textit{without cause} by a simple majority vote of the shareholders, a director elected by a minority of shareholders cumulatively voting their shares could simply be removed by the majority. This could in effect reduce the cumulative voting right to a
nullity. In *Campbell v. Loew's, Inc.*, the inherent power of the majority shareholders to remove a director for cause was recognized despite cumulative voting. But, the court intimated that removal without cause might have been another matter. Under the prior Kentucky statute, with no provision to govern removal power, resolution of the conflict would have rested with the courts and *Campbell v. Loew's, Inc.* might have been used to define the scope of the power. The new Kentucky Corporation Act eliminates the problem by restricting the power of removal in order to protect cumulative and class voting rights. In the case of cumulative voting, if less than the entire board is to be removed, no one director may be removed if the votes cast against his removal would be sufficient to elect him if cumulatively voted at an election of an entire board.

Before exploring other basic managerial functions of the shareholder, the shareholder's relationship to the election and removal of officers should be examined. Most statutes provide for election of the principal corporate officers by the board of directors, although occasionally providing that other officers, agents, and employees may be elected or appointed by the board or as prescribed in the by-laws. It has been suggested that the modern trend is to permit officers to be elected by the shareholders. If the suggestion is accurate, Kentucky's prior corporate statute may have provided a more progressive approach to the election and removal of officers than the recently adopted Model Act provision. The prior provision assigned the function of appointing officers and agents primarily to the shareholders. However, it permitted placing the power with the board of directors if provided for in the by-laws. It provided that: "Such officers and agents as may be necessary for the business of the corporation may be appointed by the board of directors or in a manner provided in the by-laws" (emphasis added). The same permissive language does not exist under the new provision, at least not in connection with election of the president, secretary, and treasurer: "The officers of a corporation shall consist of

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52 See Comment, supra note 28. See also *In re Rogers Imports, Inc.*, 202 Misc. 761, 116 N.Y.S.2d 106 (Sup. Ct. 1952) (articles of incorporation amendment providing for cumulative voting held to invalidate pre-existing by-law provision for removal of directors without cause by majority of shareholders.)

53 134 A.2d 852 (Del. Ch. 1957).


55 KRS § 271A.195.

56 ABA-ALI MODEL BUS. CORP. ACT § 650 (rev. ed. 1969); N.Y. BUS. CORP. LAW § 715(a) (McKinney 1963).

57 H. HENN, LAW OF CORPORATIONS § 210, at 422 n. 4.

58 KRS § 271.355(1).
a president, a secretary, and a treasurer, each of whom shall be elected by the board of directors..."\(^{60}\) (emphasis added). The provision does retain some flexibility with respect to the appointment of other officers: "Such other officers and assistant officers and agents as may be deemed necessary may be elected or appointed by the board of directors or chosen in such other manner as may be prescribed by the by-laws"\(^{60}\) (emphasis added). The old and new acts are identical regarding removal of officers.\(^{61}\) It is within the discretion of the board to remove officers when in its judgment the best interest of the corporation will be served thereby.\(^{62}\)

B. By-Laws

By-laws are the rules made by a corporation to regulate its affairs and to define and determine the rights and duties of shareholders, directors, and officers.\(^{63}\) There are two facets to any statutory analysis of the law relating to by-laws. The first concerns the scope of the by-laws, i.e., defining what matters are properly included within them.\(^{64}\) Courts generally hold that by-laws must be reasonable, must be consistent with the articles of incorporation, applicable statutes, and constitutions, and must not violate public policy.\(^{65}\) Aside from the above restrictions, the content of by-laws has been left almost entirely within the discretion of those who have the power to adopt them. The old and new Kentucky statutes are identical in their response to the scope of by-laws, leaving open the various matters which by-laws may regulate, as long as not inconsistent with law or the articles of incorporation.\(^{66}\) The statutes are not identical in their response to the second consideration, i.e., who shall have the power to adopt, amend, or repeal the by-laws.

While there is total uniformity as to the importance of establishing rules and regulations for governing the internal affairs of a corpora-

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\(^{60}\) KRS § 271A.250.

\(^{61}\) Id.


\(^{63}\) KRS § 271.285; KRS § 271A.135.
uniformity is lacking in the statutes delineating the means of adopting, amending and repealing such rules and regulations. This divergence is immediately apparent when comparing the recently enacted by-law provision with the prior Kentucky statute.

The old act granted the power to adopt, amend, and repeal the by-laws in three provisions. There was no specific distinction between initial and subsequent by-laws as under the new act. The shareholders were delegated the power to adopt and alter all by-laws unless such power was expressly reserved to the directors by the articles of incorporation. The articles of incorporation could expressly vest the power to make by-laws in the board of directors but such power was always subject to the right of the shareholders to change or repeal the by-laws. A United States Supreme Court decision involving a similar statute recognized that despite any power delegated to the board of directors, the shareholders retained the inherent power to repeal by-laws and also to adopt new ones. Thus, under prior law, it can reasonably be assumed that the shareholders retained the ultimate control over adoption and alteration of by-laws.

67 See KRS § 271.125(7); KRSA § 271A.020. Both expressly recognize the making of by-laws as a basic power of the corporation.

68 H. Henn, Law of Corporations § 133, at 224, which points out that: "Formulation of the by-laws is a power variously enjoyed in different jurisdictions by the incorporators, shareholders and the board of directors." See, e.g., ABA-AI MO Corp. Act § 27 (rev. ed. 1969) (by-law making power in the board of directors unless specifically reserved to the shareholders in the articles of incorporation); DEL. CODE ANN. tit. 8, § 109 (1969) (by-law making power in the shareholders unless granted to the board of directors in the articles of incorporation); N.Y. Bus. Corp. LAW § 601 (McKinney 1971) (by-law making power in board or shareholders as provided in articles of incorporation). In some jurisdictions, the practice is to have the incorporators at their organizational meeting adopt the initial by-laws and to have the board of directors at its organizational meeting approve such by-laws.

69 KRS § 271.345(2) provided that: "After the issuance of the certificate of incorporation the first meeting of the shareholders shall be held . . . for the purpose of . . . making by-laws if the articles of incorporation do not provide for the making thereof by the directors . . . ." KRS § 271.285 expressly delegated the power to make and alter by-laws to the shareholders but provided that: "The authority to make by-laws may be expressly vested by the articles of incorporation in the board of directors subject to the power of the shareholders to change or repeal such by-laws." KRS § 271.125(7) gave the corporation the power "to make by-laws not inconsistent with law."

70 KRSA § 271A.135.

71 KRSA § 271.285.

72 Id.

73 In Rogers v. Hill, 289 U.S. 582 (1933), the Supreme Court, construing a New Jersey statute which provided that the power to make and alter by-laws was in the shareholders unless conferred on the directors in the articles of incorporation and that the by-laws made by the directors were subject to alteration or repeal by shareholders, held that a by-law adopted by shareholders authorizing executive bonuses was valid in spite of an earlier delegation of power to the directors. Cf. Auer v. Dressel, 308 N.Y. 427, 118 N.E.2d 550 (1954).
Under Kentucky's new provision, the initial by-laws are to be adopted by the board of directors rather than the shareholders. Accordingly, it is not necessary to delegate the power to the board of directors in the articles. Furthermore, the power to alter, amend or repeal the by-laws or adopt new ones subject to repeal or change by action of the shareholders, is vested in the board of directors unless reserved to the shareholders by the articles of incorporation. Thus, for the shareholders to maintain complete control over the by-laws, affirmative action expressly reserving the power is required. It is significant to note that prior to the 1969 Model Act amendments, the by-law provision contained in the new Kentucky Act completely precluded shareholder participation in the by-law making process absent express reservation in the articles. The wisdom of preserving ultimate control over the by-laws in the shareholders was recognized in 1969 and the "subject to repeal or change by action of shareholders" clause was inserted. As a result of this amendment the effect of the old and new provisions is essentially the same.

Entirely new is the provision concerning emergency by-laws. It empowers the board of directors to adopt emergency by-laws, subject to repeal or alteration by shareholders, to be operative notwithstanding contrary provisions elsewhere in the corporate statute or in the articles and by-laws, during any emergency in the conduct of the business of

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74 KRS § 271A.135.
75 Daubenspeck v. Day, 123 N.E. 402 (Ind. 1919) (a by-law adopted by the shareholders was held invalid because a statute gave the power to adopt by-laws to the board of directors. The court said where a statute gives the power to adopt by-laws to the board of directors, the shareholders may not interfere with the board's exercise so long as the by-laws are reasonable and not contrary to public policy or the established law of the land.)
76 See Note, Exclusive Control of the Adoption and Amendment of By-laws or Regulations by the Corporate Directors, 25 U. Cin. L. Rev. 362 (1956).
77 KRS § 271A.135.
78 There are occasions when a by-law might be upheld despite lack of express statutory authority. In Taylor's Adm'r v. Taylor, 301 S.W.2d 579 (Ky. 1957), a by-law providing that no transfer or sale of corporate shares could be made without first offering the shares to the remaining shareholders was held valid although no statute expressly permitted it and it was never formally adopted.
79 KENTUCKY LEGISLATIVE RESEARCH COMMISSION, INFORMATIONAL BULL. No. 76, CORPORATION LAW 23 (1969) [hereinafter cited as CORPORATION LAW].
80 Perhaps the best summary of the present statute is provided in the Model Bus. Corp. Act Ann. 2d § 27A ¶ 2 (1971) which reads:
Section 27 is a simple, direct and unequivocal statement of who has power to adopt, amend, or repeal the by-laws, both initially and subsequently, and is consistent with the modern tendency in corporation statutes. It delegates the power to the board of directors, subject to the right of shareholders to retain their common law authority in whole or in part by appropriate provisions in the articles of incorporation. At the same time, the content of by-laws is as flexible and unrestricted as the law permits.
81 KRS § 271A.135(2).
the corporation resulting from an attack on the United States or any nuclear or atomic disaster. It was suggested that the definition of an emergency in § 27A of the Model Act was too narrow and as a result language similar to that contained in § 110 of the Delaware Corporation Law was adopted.

C. Shareholder Approval of Extraordinary Corporate Matters

Shareholders invest in a corporate enterprise on the assumption that, for the most part, the board of directors will manage the corporation's ordinary business. But there are certain extraordinary transactions, involving organic or fundamental changes in the corporation, that are not considered ordinary business. Shareholders are thus required to approve such matters as amendments of the articles of incorporation, sale or lease of assets not in the regular course of business, merger, consolidation, and dissolution. Since fundamental corporate changes represent a separate area discussed elsewhere in this symposium, it is necessary only to provide a cursory examination of those sections of the statute dealing specifically with the shareholders' role in approving or consenting to extraordinary corporate matters.

1. Amendments of the Articles of Incorporation

The procedure for amending the articles of incorporation is contained in KRSA § 271A.295. It states that the directors must adopt a

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[1] the possibility of sudden annihilation of a substantial portion of the board of directors of a corporation in the event of a nuclear attack presents practical as well as legal problems as to the continuity of the corporate business and affairs during such emergency. The adoption of special by-laws effective during the emergency period as a recommended precaution was first provided in the Model Act in 1962, and has been adopted in whole or in part in a number of jurisdictions. Since such by-laws are at variance with the conventional standards of corporate practice, statutory authority for the adoption of emergency by-laws is proposed by section 27A.

83 Kentucky Legislative Research Commission, Informational Bull. No. 88, Legislative Hearing: Corporate Law 198 (1971) [hereinafter cited as Legislative Hearing].

84 Id. Del. Code Ann. tit. 8, § 110 (1969) entitled Emergency By-Laws and Other Powers in Emergency, provides that:
the board of directors of any corporation may adopt emergency by-laws subject to repeal or change by action of the shareholders, which shall not withstand any different provisions elsewhere in this Chapter or in the certificate of incorporation or by-laws to be operative during any emergency resulting from an attack on the United States, or on a locality in which the corporation conducts its business or customarily holds meetings of boards, directors, or shareholders, or during a nuclear or atomic disaster, or during the existence of any catastrophe or other similar emergency condition as a result of which a quorum of the board of directors or a standing committee thereof cannot readily be convened for action.
resolution setting forth the proposed amendment and, if shares have been issued, submit it to a shareholder's vote. Under the prior act,\(^8^5\) directors were not required to initiate amendments; such action was taken by the shareholders with execution of the articles of amendment by the president and secretary of the corporation. If no shares were issued, under the old statute the incorporators acted in place of the shareholders. Under the present act, the initial board of directors, named in the articles,\(^8^6\) acts in place of the shareholders. As to the adoption of proposed amendments the new provision requires a majority vote of the shareholders, except in the case of class voting where a majority vote is required of each class and of the total shares, while prior Kentucky law\(^8^7\) required two-thirds approval of each class affected thereby.\(^8^8\)

2. *Sale or Lease of Assets Not in the Regular Course of Business*

A provision in the new statute requires the approval of a majority of shareholders entitled to vote for the consummation of sales not in the regular course of business. If any class of shares is entitled to vote as a class, the authorization of sale must receive the affirmative vote of the holders of a majority of the shares of each class of shares entitled to vote as a class and of the total shares entitled to vote.\(^8^9\)

3. *Mergers and Consolidation*

Shareholder approval of both mergers and consolidations is necessary under the new act.\(^9^0\) It also requires that written notice be given to each shareholder of record, *whether or not entitled to vote*, not less than twenty days before the meetings.\(^9^1\) Furthermore, a copy or summary of the plan of merger or consolidation is to be included in such notice. Prior Kentucky corporate law did not impose the twenty day notice requirement. KRS § 271.295(4) provided that only shareholders entitled to vote be given at least ten days' notice, unless otherwise provided in the articles of incorporation or by-laws.\(^9^2\)

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\(^8^5\) See KRS § 271.445(2).
\(^8^6\) See notes 11, 12 and 13 supra.
\(^8^7\) KRS § 271.445(3).
\(^8^8\) See LEGISLATIVE HEARING, supra note 83, at 196, where the phrase "of the majority of the shares entitled to vote thereon," is discussed: "This phrase appears throughout the act, and in the acts of other states, wherever reference to class voting is required. The phrase is ambiguous and no one at the hearing was able to give a plausible or acceptable interpretation. We recommend that the phrase be rewritten in a more meaningful manner." (comment of Mr. Greenebaum).
\(^8^9\) KRS § 271A.395.
\(^9^0\) KRS § 271A.365.
\(^9^1\) KRS § 271A.365.
\(^9^2\) KRS § 271.295(4).
addition, there was no obligation that a summary or copy of the plan be delivered with the notice.

4. Dissolution and Liquidation

In the case of dissolution by written consent of the shareholders, the prior act only required written consent of shareholders with voting power. The new provision, however, requires the written consent of all shareholders, whether or not they have the right to vote. Under both acts, dissolution by act of the corporation requires a vote of the majority of shareholders entitled to vote unless otherwise provided in the articles.

5. The Rights of Dissenting Shareholders

When shareholder approval is required, shareholders who do not assent are given a right to dissent with respect to specified matters. If they follow the prescribed procedure, they have a right to have their shares appraised and purchased, usually by the corporation. The new provisions governing dissenters' rights parallel the old statute in many respects, permitting dissension in sales, mergers and consolidations. The new provisions permit the shareholder to dissent with respect to less than all shares registered in his name. If he does so, his rights are determined as if the shares with respect to which he has dissented and his other shares were registered in the name of different shareholders. This right could be disadvantageous to both the shareholders and the corporation. Corporate efficiency could be impaired if shareholders were tempted to dissent in part on more corporate actions. For this reason, it was suggested during the legislative hearings on the Kentucky Act that "the provision . . . permitting a shareholder to dissent as to less than all of the shares registered in his name be deleted."

There are certain circumstances in which shareholders do not have the right to dissent, including a sale of assets pursuant to a court order and a sale for cash on terms requiring the distribution of the net proceeds to the shareholders within one year after the date of sale. Furthermore, the right to dissent shall not apply to shareholders of the

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93 KRS § 271.500.
94 KRS § 271A.415; KRSA § 271A.420.
95 See H. Henn, Law of Corporations § 723.
96 KRS § 271A.400; KRSA § 271A.405.
97 KRS § 271.415(4); KRS § 271.490.
98 KRSA § 271A.400(2).
99 See LEGISLATIVE HEARING, supra note 83, at 200.
100 KRSA § 271A.400.
surviving corporation in a merger if a vote of the shareholders of such corporation is not necessary to authorize the merger.\footnote{101}{KRSA § 271A.400(1)(b).} Dissenters' rights are also denied to the holders of shares registered on a national securities exchange unless the articles of incorporation provide otherwise.\footnote{102}{KRSA § 271A.400(3).} It has been suggested that the section does not go far enough since it does not take cognizance of the fact that many publicly traded securities are not registered on security exchanges.\footnote{103}{See Legislative Hearing, supra note 83, at 200, where it was suggested that the scope of the restrictive provision be broadened to parallel Del. Code Ann. tit. 8, § 262K (Supp. 1968).}

The procedure by which dissenting shareholders enforce their rights and the definition of those rights have not been significantly changed by the recent act;\footnote{104}{See KRSA § 271A.405; cf. KRS § 271.414 and KRS § 271.490.} in fact, the overall pattern has remained much the same.\footnote{105}{The essence of both the old and new provisions requires that dissenting shareholders: a) make written objections before the vote, b) abstain from voting in favor of the proposal, c) demand payment for sale at fair market value, and d) if no agreement is reached, institute court action to determine fair market value. Id.} One difference worthy of mention concerns the right of a shareholder to bring suit to set aside corporate action objected to on certain enumerated grounds.\footnote{106}{KRSA § 271.415(4)(b).} Although the old act contained such a provision, the recent enactment does not.


At common law, corporate action could be taken only after the approval of shareholders at a duly constituted meeting. Such formality is no longer needed if all of the shareholders who are entitled to vote sign a written consent to the corporate action.\footnote{108}{See KRSA § 271A.405; cf. KRS § 271.414 and KRS § 271.490.} Although action by written consent eliminates the cumbersome process of holding a shareholders' meeting, in practice it is a device used solely by the small closely held corporation. Meetings are still required where the number of shareholders renders unanimous written consent impractical.\footnote{109}{See KRSA § 271A.665.}

\subsection{A. Annual Meetings}

Corporations are usually required by statute to hold annual share-
holders' meetings. At common law such meetings could not validly be held outside the state of incorporation because the entity had no legal existence beyond the state's boundaries. In recognition of the modern practice of holding meetings in convenient places, both the old and the new acts allow holding of meetings within or without the state. The only variation under the new statute is the added flexibility allowed in by-law determination of the meeting's location. Unlike the prior act, the new act does not require the meeting location to be specifically designated in the by-laws. The by-laws may delegate the function of selecting a meeting site to the board of directors or the president, or provide for selection in any other manner "fixed in accordance with the by-laws." Furthermore, while the prior law required the date of the annual meeting to be specified in the by-laws, the new act allows the time to be determined as the by-laws provide.

The only significant difference under the new provision dealing with annual shareholder meetings relates to the procedure to be followed when more than eighteen months have elapsed without holding a meeting. The prior statute permitted any shareholder to call an annual meeting when more than eighteen months had elapsed. The new statute provides that:

If an annual meeting is not held within any eighteen month period, the circuit court of the county where the registered office is located may, on the application of any shareholder, summarily order a meeting to be held (emphasis added).

This provision of the new act varies from the Model Act provision with respect to the increase of the time period from thirteen to

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111 KRS § 271A.140; KRS § 271.295. See also Handley v. Stutz, 139 U.S. 417 (1891). One of the objections raised to a resolution increasing the shares of the company was that the resolution was adopted at a meeting outside Kentucky, the state of incorporation. The Kentucky statute provided that all elections for directors should be held within the state. The Court held, since there was no statutory restriction on the place of holding other meetings, the action taken outside of Kentucky was effective.

112 KRS § 271A.140(1).

113 KRS § 271.295(1).

114 The time of shareholder meetings is usually set late in the spring. The date of the annual meeting should be set in order to allow for the financial audit and preparation of the annual report between the end of the fiscal year and such meeting. The most common months for shareholder meetings are April and May. See N. McLaren, Annual Reports for Shareholders (1947); Kelly, Preparing for Shareholder Meetings, 52 Ill. B.J. 926 (1964).

115 KRS § 271A.140.

116 KRS § 271.295(2).

117 KRS § 271A.140.
eighteen months. Thirteen months was thought to be too short a period of time to require the calling of an annual meeting.

B. Special Meetings

The calling of special meetings for purposes appropriate for shareholder action is usually authorized in the statute, articles or by-laws. The business transacted at special meetings is confined to the purposes set forth in the call. The most difficult problem pertaining to special meetings is the determination of who is authorized to call the meeting. Prior Kentucky law provided that a special meeting could be called by the board of directors, by any single director, or upon written request of any shareholder or shareholders holding, in the aggregate, one-fifth of the voting power. The new statute differs in two respects from prior law. First, the individuals expressly authorized to call a meeting are different. Although the board of directors may still call a special meeting, a single director is no longer given express authority to do so. In addition, shareholders may call a special meeting when they hold in the aggregate only one-tenth of the voting strength. A more significant change involves the inclusion of the phrase "or such other persons as may be authorized in the articles of incorporation or the by-laws." Unlike prior law, the present statute does not preclude an enlargement of authority by provision in the articles or by-laws.

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119 See LEGISLATIVE HEARING, supra note 83, at 43.
120 H. HENN, LAW OF CORPORATIONS § 371.
121 See Campbell v. Loew's, Inc., 134 A.2d (Del. Ch. 1957), and Auer v. Dressel, 306 N.Y. 427, 118 N.E.2d 590 (1954). Both cases discuss and render opinions on the propriety of special meetings in light of the purposes for which they are called. The principles that emerge are (1) the purpose of the meeting must involve matter appropriate for shareholder action, and (2) in determining the propriety of a special meeting a proposal on which shareholders can take direct effective action is not needed. A special meeting may be called for the sole purpose of adopting a shareholder resolution.
122 KRS § 271.295(2).
123 KRSA § 271A.140(3).
124 Id.
125 Id.
126 In Auer v. Dressel, 306 N.Y. 427, 118 N.E.2d 590 (1954), under a similar statutory provision, shareholders compelled the president to call a special meeting. The by-laws made it the duty of the president to call a meeting whenever it was requested in writing by shareholders owning a majority of shares entitled to vote at such a meeting. The court held that the president had no discretion as to calling a meeting when a demand was made by the owner of the required number of shares.
C. Notice of Shareholder Meetings

It has long been recognized that notice must be given to each person entitled to be present at a corporate meeting. If notice is not given the meeting is a nullity, absent waiver or estoppel. The obvious purpose of notice is to inform the shareholder of the time, place and purpose of a meeting to enable him to attend and present his views. Both the old and new statutes require written notice of every shareholder meeting and describe the content of the notice, and when notice is by mail it is regarded as delivered. Although similarly structured, the content of the old and new legislation differs in several respects.

The present provision allows a notice period of no more than fifty and no less than ten days before the date of the meeting. The prior provision required at least ten days' notice prior to the meeting unless otherwise provided in the articles of incorporation or by-laws. It placed no limitation on the maximum number of days prior to the meeting that notice could be given. In contrast to this open-ended provision, the ten to fifty day period specified under the new act is mandatory, completely precluding any variation in the articles or by-laws. Although one might assume that the restrictive nature of the new provision is undesirable, those reviewing the act at the legislative hearing were not concerned. In discussing the inability of the corporation to vary the time limits for notice within KRSA § 271A.145, one commentator stated that "this does not disturb us because KRSA § 271A.132 specifically permits waiver of notice in a smaller corporation, ..."

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127 This is the topic of KRSA § 271A.145. It should be considered in connection with certain other related sections, namely: KRSA § 271A.660 which permits any shareholder to waive notice either before or after a meeting; KRSA § 271A.665 which permits all shareholders to take action upon written consent without a meeting; KRSA § 271A.365 which requires a minimum twenty days notice for action on a plan of merger or consolidation; and KRSA § 271A.150 permitting shareholders entitled to vote at any meeting to vote at a meeting postponed by adjournment.


129 See Note, Notice and Quorum Requirements of Shareholder Meetings, 24 U. Cin. L. Rev. 578 (1955).

130 See, e.g., Stutz v. Handley, 41 F. 431 (6th Cir. 1890) (stockholders who consented to or ratified action at a stockholders meeting which increased the capital stock waived their right to object to lack of notice).

131 Both KRS § 271.295(4) and KRSA § 271A.145 require that the notice of the meeting contain such information.

132 Id. At common law, courts held that if the articles or by-laws fixed the time and place of the annual meeting, no further notice was required. If a special meeting was called, however, notice was generally required.

133 See KRS § 271.295(4) and KRSA § 271A.145.

134 KRSA § 271A.145.

135 KRS § 271.295(4).
and in a larger corporation where waiver is not effective a 10 day notice does not seem to be an undue hardship, and is a protection shareholders are entitled to.\textsuperscript{136}

Another significant departure appears in the content of the notice. The prior act did not differentiate between annual and special meetings, but merely stated that every notice should contain the purposes for which the particular meeting was called.\textsuperscript{137} KRSA § 271A.145 of the new statute, however, reflects the importance of characterizing a meeting as either annual or special:

Since the earliest days of corporate practice, the annual meeting has been regarded as a forum for free expression of shareholder views, whether or not sought by management. Thus the Model Act\textsuperscript{138} does not require that notice of an annual meeting state the purpose or purposes for which the meeting is called, though it does so require in the case of special meetings. Indeed, it could not properly require that notice of an annual meeting state the purpose for which the meeting is called in the sense of precluding consideration of any other matters, since that would limit the freedom of shareholders to discuss matters of interest to them and restrict them to matters designated by management.\textsuperscript{139}

Under the new statute, notice of the annual meeting is limited to designating the time and place thereof, but notice of a special meeting must still include the purposes for calling.

D. Waiver of Notice

At common law, the prevailing view was that shareholders could effectively waive the requirement of notice either before or after the meeting.\textsuperscript{140} This view, incorporated in the new as well as the prior act,\textsuperscript{141} simply provides that "whenever any notice is required to be given to any shareholder . . . a waiver thereof in writing signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be equivalent to the giving of such notice."\textsuperscript{142}

E. Action By Shareholders Without a Meeting

At common law, shareholder action could only be taken at a formally conducted shareholder meeting.\textsuperscript{143} With the increasing in-

\textsuperscript{136} \textit{Legislative Hearing, supra} note 83, at 44.

\textsuperscript{137} KRSA § 271.295(4).

\textsuperscript{138} ABA-ALI \textit{Model Bus. Corp. Act} § 629(1) (rev. ed. 1969) is identical to KRSA § 271A.145(4).

\textsuperscript{139} Model Bus. Corp. Act Ann. 2d § 29 ¶ 2 (1971).

\textsuperscript{140} H. HENN, \textit{Law of Corporations} § 369.

\textsuperscript{141} KRSA § 271.295(4).

\textsuperscript{142} KRSA § 271A.660.
corporation of small enterprises, it was required that the requirement of a formal meeting was a mere pretense that was usually ignored. Thus, statutory authority for shareholder action by written consent was gradually adopted.\footnote{Comment, Corporations—Close Corporations—Strictness of Requirements at Meetings of Shareholders and Directors, 14 S.C.L.Q. 408 (1962).} Under the new corporate statute any action required to be taken at a meeting of the shareholders may be taken without a meeting if consent in writing is obtained from all of the shareholders entitled to vote on the subject matter of such action.\footnote{H. Henn, Law of Corporations § 369.} Unlike the new statute,\footnote{Id.} the prior provision did not allow action without a meeting in cases of voluntary transfer of corporate assets\footnote{KRS § 271.415.} and merger and consolidation.\footnote{KRS § 271.470.}

The KRSA § 271A.665 requirement of unanimous consent of all shareholders entitled to vote on the subject matter of the action could possibly develop into a source of future litigation. A problem may arise as a result of more stringent consent requirements placed on dissolution by written consent of the shareholders.\footnote{KRS § 271A.665.} KRSA § 271A.415 requires unanimous consent of all shareholders \textit{whether or not} entitled to vote. Thus, KRSA § 271A.655 may have to be reconciled with KRSA § 271A.415 to the extent that consent of everyone, rather than just those shareholders having voting power, is called for.\footnote{Id.}

It should be remembered that the usefulness of shareholder action without a meeting, where unanimous consent is required, is usually limited to the close corporation. Such action serves as a recording device for informal agreements among a small group of owners of an incorporated enterprise.\footnote{KRS § 271.415.} The shareholder meeting is essential, however, to shareholder participation in the business of the large corporation; it serves as a forum for the exercise of corporate democracy through the assertion of shareholder voting rights.\footnote{Id.}

\section*{III. Shareholder Voting Rights}

Having discussed the law pertaining to shareholder meetings and the functions of such meetings, it is necessary to explore the \textit{methods} employed by the shareholder in exercising control over the corporation. This involves an examination of shareholder voting rights—a
broad topic of particular importance in an era of increasing corporate democracy.  

A. Determination of Who is Entitled to Vote—Closing Transfer Books and Fixing Record Date

At common law, the corporation was permitted to close its stock transfer books for a reasonable time in order to establish stock ownership and thereby determine those shareholders entitled to have notices sent to them to vote or otherwise participate in corporate control, and to receive dividends. As stock transfers became more numerous, closing the books became highly impractical and costly. Legislatures quickly responded to the need for an alternative method of determining stock ownership by authorizing corporations to fix record dates. Closing the transfer books, although still a recognized procedure, has been reduced to obsolescence by the record date procedure which permits continuous trading in securities without postponement of transfers and thereby considerably simplifies corporate operations.

The adoption of the new act has little effect on Kentucky law in this area. The new provision does reduce the maximum number of days that the transfer books may be closed in those rare instances when such a procedure is employed. Under the new section when a closing or record date is not selected, the date on which notice of the meeting is mailed, or the date the board declares a dividend, is statutorily adopted as the record date. Two variations from the Model Act and the reasons therefor should be noted. First, the language pertaining to the statutory establishment of a record date in lieu of fixing one has been changed from “the date on which notice is mailed” to the “first date on which notice . . . is mailed.” This substitution acknowledges that, in large corporations, the process of mailing a meeting notice to several thousand stockholders may take several days and recognizes the importance of having a fixed date as the record date.

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154 Id.
155 H. HENN, LAW OF CORPORATIONS § 176 at 328.
157 See KRS § 271.315(1), KRSA § 271A.150.
159 KRSA § 271A.150. The time fixed has been reduced from a maximum of 60 to 50 days under the new provision.
160 KRSA § 271A.150.
161 Id.
Second, the new provision expressly recognizes that shareholders entitled to vote at a meeting on the basis of record date shall also be entitled to vote at any adjourned meeting. Under prior law, it was not clear whether the record date remained effective with respect to an adjourned meeting held later than the 60 days maximum by which the record date could precede the original meeting. Under the new act, it is clear that the record date is still effective even though the adjourned meeting is more than the maximum number of days after the record date.

B. Voting Record-Production At Shareholders Meeting

Closing the transfer books and fixing the record date are the statutory means for determining shareholders entitled to receive notice of, and to vote at, a shareholders meeting. This information must be available at the meeting in order to determine such matters as attendance, the presence of a quorum, and the voting rights of proxies. Prior to the recent enactment, Kentucky was one of the few states without a statute providing for production of voting lists or records at the shareholder meeting. It did have a provision requiring domestic corporations to keep a share register at their registered office containing information similar to that required under the new voting record provision. It gave every shareholder the right to examine the register at any reasonable time for any "proper" corporate purpose.

Under the new act, the officer or agent in charge of the stock transfer book is required to produce at the meeting, subject to shareholder inspection, an alphabetical record of shareholders containing their addresses, and number of shares held. The 1969 Model Act amendment of this provision substituted a "record of shareholders" for a "list of shareholders." The change involved more than mere semantics. Underlying the new language was recognition of the growing practice of maintaining corporate records in forms other than a written list. When § 52 was revised to permit the keeping of records

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162 See Legislative Hearing, supra note 83, at 199.
163 KRSA § 271A.150.
164 KR § 271.315 and KRSA § 271A.150.
166 KRS § 271.395 required every domestic corporation to keep a share register or duplicate, giving the names of the shareholders in alphabetical order, their addresses, the number and classes of shares held by each, and the dates on which they acquired their shares. This information is identical to that required by KRSA § 271A.155 except that dates of acquisition are no longer necessary.
167 KRSA § 271A.155.
in any form capable of conversion to writing in a reasonable time,\footnote{See Freed, Providing by Statute for Inspection of Corporate Computer and Other Records not Legible Visually-A Case Study on Legislating For Computer Technology, 23 Bus. Law. 457 (1968).} § 31\footnote{ABA-ALI Model Bus. Corp. Act § 31 (rev. ed. 1969) is identical to KRSA § 271A.260.} had to conform by permitting any record of shareholders. The new provision also prescribes the penalty for failure to comply with the statutory mandate of producing the shareholder record\footnote{Model Bus. Corp. Act Ann. 2d § 31 ¶ 2 (1971).} at a meeting. Failure to comply does not affect the validity of action taken at the meeting, but exposes the officer or agent having charge of the stock transfer book to personal liability if any shareholder suffers damage on account of such failure.\footnote{KRSA § 271A.155(2). It should be noted that the shareholder may often be precluded from any recovery because of the difficulty in establishing damages.} By imposing personal liability, the provision acknowledges that compliance would not be adequately assured by imposition of specific relief.\footnote{Id.}

The Model Act approach to inspection rights entails two provisions: § 31 which calls for the production of a voting record at the shareholders meeting\footnote{ABA-ALI Model Bus. Corp. Act § 31 (rev. ed. 1969) is identical to KRSA § 271A.260.} and § 52 which extends a reasonable right to inspect the books and records at the corporation’s registered office or principal place of business.\footnote{ABA-ALI Model Bus. Corp. Act § 52 (rev. ed. 1969); KRSA § 271A.260.} It was suggested prior to enactment of these provisions in Kentucky that § 52 was adequate to protect any shareholder interest and that § 31 should be deleted in its entirety.\footnote{See Legislative Hearing, supra note 83, at 51, 52.}

The primary concern was that § 31’s mandate (preparation and production of a record of shareholders at the shareholders meeting) would be hard for large corporations to comply with and therefore would run contra to one of the principal objectives of the new legislation—making the Kentucky corporate atmosphere more hospitable to the large corporation. An attorney at the legislative hearings pointed out:

> It is often impractical, if not impossible for large corporations to have and make available at shareholder meetings their stock transfer books. . . . [M]any large corporations do not maintain stock transfer books as such but, instead, use continuous ledger or card systems or other similar devices which are not easily transportable and would be difficult to examine during the course of a meeting.\footnote{Id. at 199, 200.}

Despite the seeming appeal of this argument, the suggestion was ultimately dropped in favor of the Model Act approach.
Shareholder Inspection Rights

Any discussion of shareholder inspection rights should be prefaced by at least a cursory examination of the common law.\textsuperscript{179} The shareholder enjoys certain qualified common law rights to inspect the books and corporate records, provided there is a "proper" purpose for inspection.\textsuperscript{180} At common law the burden of proof was on the shareholder to establish the propriety of his purpose, but today the trend is to place the burden upon the corporation to defeat a demand to inspect.\textsuperscript{181} The common law inspection rights are still relevant since they have not been abrogated by creation of statutory rights to inspect.\textsuperscript{182} It is often stated that "the statute was intended to enlarge and not restrict common law rights."\textsuperscript{183} The statutes do not usually encompass all of the corporate books and records, thus making it necessary to rely on the shareholder's common law right of inspection in some instances.\textsuperscript{184}

Inspection rights under the old Kentucky statute have been both broadened and narrowed by the more comprehensive inspection right provision of the new act.\textsuperscript{185} The prior enactment did little more than grant the right to inspect corporate books and records.\textsuperscript{186} The new provision protects the corporation from vexatious demands, extends the right to holders of voting trust certificates, prescribes specific penalties for failure to respect a valid demand, and authorizes the judiciary to ignore the statutory guidelines in proper cases.\textsuperscript{187} In ad-

\textsuperscript{180} H. Henn, Law of Corporations § 199, at 396 lists examples of proper purposes: "... to ascertain the financial condition of the corporation, the propriety of dividends, the value of shares, the existence of mismanagement, information in the aid of legitimate litigation, and the names and addresses of other shareholders in order to communicate with them concerning corporate affairs. . . ."
\textsuperscript{182} See, e.g., Holdsworth v. Goodall-Sanford, Inc., 55 A.2d 130 (Me. 1957), where it was held that a statute which authorized inspection of certain books did not limit the petitioner's common law right to inspect other books and records at proper times for a proper purpose.
\textsuperscript{183} H. Henn, Law of Corporations § 199, at 397.
\textsuperscript{184} See Otis-Hidden Co. v. Scheirich, 219 S.W. 191 (Ky. 1920), where a minority shareholder was permitted to inspect correspondence involving internal affairs of the corporation which passed between its non-resident president, who was a majority shareholder, and an active manager. The Court held that the common law right to inspect included all documents, contracts and papers relating to the business affairs of the corporation. See also E.I.F.C., Inc. v. Atnis, 454 S.W.2d 351 (Ky. 1970), which held that Kentucky shareholders do not waive their rights to examine the corporate books by bringing an action to recover the fair market value of their shares.
\textsuperscript{185} Compare KRS § 271A.260 with KRS § 271.395.
\textsuperscript{186} See KRS § 271.395.
\textsuperscript{187} KRS § 271A.260.
dition, through the imposition of procedural prerequisites, it protects the corporation from expensive fishing expeditions. First, the shareholder seeking inspection must make *written* demand setting forth the purposes for which inspection is deemed necessary.\(^{188}\) Second, the written demand must be acted upon only when the shareholder making the demand holds at least five percent of the total outstanding shares or has been a shareholder of record for at least six months.\(^{189}\) Finally, the right to inspect extends only to those books and records "relevant" to the purpose of the search.\(^{190}\) Since the prior act lacked any specific limitations, these restrictions narrow the scope of the statutory inspection right.

Although limiting the right to this extent, the new provision extends the right in several other ways. The new provision confers inspection rights on holders of voting trust certificates\(^ {191}\) and imposes liability on "any officer or agent who, or corporation" which, refuses to comply with a proper demand for inspection.\(^ {192}\) Additionally, the new provision gives any court of competent jurisdiction the power to disregard the restrictive requirements of the act and to grant inspection without satisfaction of the share ownership or holding period requirements.\(^ {193}\) In these two respects, the recently enacted legislation is significantly broader than the prior act;\(^ {194}\) however, the most important expansion of shareholder inspection rights stems from the specification of penalties to be imposed in cases of wrongful disregard of the right.\(^ {195}\) Under the prior act, which did not specifically impose penalties, the corporation or its officers could refuse access and delay inspection until the case was actually litigated. The absence of personal liability left nothing to deter officers from using dilatory tactics which had the effect of reducing the right to a nullity. On the other hand, the penalty provision of the new act with the threat of personal liability, exerts pressure on the corporation to permit inspection in cases where the purpose is clearly proper and tempers judgment in borderline cases. The net result is a far greater freedom of access to corporate books and records.

The penalty provision clearly establishes the measure of damages

\(^{188}\) KRSA § 271A.260(2).

\(^{189}\) Id.

\(^{190}\) Id.

\(^{191}\) KRSA § 271A.260(2). See also Note, Rights of Equitable Owners of Corporate Shares, 99 Pa. L. Rev. 999 (1951).

\(^{192}\) KRSA § 271A.260(3).

\(^{193}\) KRSA § 271A.260(4).

\(^{194}\) See KRS § 271.395.

\(^{195}\) KRSA § 271A.260(8).
to be imposed and the defenses available. The corporation or any officer or agent denying inspection is liable to the shareholder for an amount equal to ten percent of the value of the shareholder's shares in addition to any other damages or remedies available. In Kentucky, deviating from the Model Act, KRSA § 271A.260(3) puts a $500 ceiling on the damages figure. In so doing, the new act undermines the deterrent value of the penalty provision.

The right to recover is qualified to the extent of certain specified defenses: (1) improper use of a list of shareholders or information secured in a prior inspection of any corporation by a shareholder during a previous specified period, (2) lack of good faith, and (3) improper purpose. These are affirmative defenses with the burden of proof falling upon the corporation or its agent or officer.

Worthy of mention is the body of federal law relating to inspection rights. Shareholders in those Kentucky corporations subject to the Securities and Exchange Act of 1934 may demand a list of security holders from the corporation after solicitation is initiated by management. The corporation may avail itself of the frequently exercised option of handling the mailing for the shareholder rather than disclosing the list. The existence of this federal remedy has been held not to affect inspection rights under state law.

C. Voting of Shares

The new provision dealing with voting of shares, although basically similar to the prior act, contains several major variations. Under the new act all shares have one vote unless otherwise provided in the articles or by-laws. However, the new section allows each share to have more than one vote and in this respect is identical to the prior law.

KRSA § 271A.165 is like the prior provision except that it specifically prohibits the voting of treasury shares. The prior act merely de-

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107 KRSA § 271A.260(3).
108 Id.
200 17 C.F.R. § 240.14(a)-7 (1947).
201 Id.
203 Compare KRSA § 271A.165 with KRS § 271.315.
205 KRSA § 271A.165(1).
206 Compare KRSA § 271A.165(2) with KRS § 271.315(6).
clared that no corporation could vote or count shares belonging to itself.207 The new section states:

Neither treasury shares, nor shares held by another corporation if a majority of the shares entitled to vote for the election of directors of such other corporation is held by the corporation, shall be voted at any meeting or counted in determining the total number of outstanding shares at any given time.208

The provision indicates that shares owned by a subsidiary of a corporation are not considered outstanding shares of the corporation.209 The policy supporting inclusion of the above provision is evident. If shares held by a subsidiary could be voted, those in working control of the corporation would stand in a position to effectively oppose any attempt to shift control or to change management.

KRSA § 271A.165(5) defines the authority to vote where shares of one corporation are owned by another corporation.210 The Kentucky Legislature varied from the Model Act in this respect and retained essentially the prior provision.211 The Model Act provides that shares in the name of another corporation may be voted by such officer, agent, or proxy as the by-laws may provide or in the absence thereof, as the directors of such other corporation may prescribe.212 The new Kentucky provision grants authority to vote to the president or his proxy unless the board appoints some other person in which case a certified copy of the resolution appointing him must be produced.213 In rejecting the Model Act provision, the legislature probably felt that the prior act provided a more explicit basis for determining who has the right to speak for the shareholders of the corporation.

The right to vote shares is generally conferred only upon shareholders of record.214 KRSA § 271A.165(6), (7) and (8) provide a statutory resolution of the conflict between this limitation and the voting rights of fiduciaries and agents accorded by judicial decision.215 No comparable provisions existed under the prior act. KRSA § 271A.165(6) indicates that shares held by an administrator or executor may be voted by him without transferring the shares into his name. A

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207 KRS § 271.315(6).
208 KRSA § 271A.165(2).
210 KRSA § 271A.165(5).
211 Compare KRSA § 271A.165(5) with KRS § 271.315(5).
213 KRSA § 271A.165(5).
214 MODEL BUS. CORP. ACT ANN. 2d § 33 § 2 (1971).
215 See Schmidt v. Mitchell, 41 S.W. 929 (Ky. 1897).
trustee, however, is entitled to vote only after shares have been so transferred. KRSA § 271A.165(7), which has no counterpart in the Model Act, preserves prior Kentucky law. It establishes a specific procedure for the voting of shares held by three or more fiduciaries declaring that in the absence of another procedure in the instrument appointing the fiduciaries, the majority controls the manner of voting. If there is deadlock among the fiduciaries, any one of them or any beneficiary may invoke the aid of the courts in order to have an additional person appointed to act with the fiduciaries in determining the manner in which the shares will be voted. KRSA § 271A.165(8) describes how shares standing in the name of a receiver are to be voted. A receiver may vote shares under his control without transferring the shares into his name if authorized to do so by an appropriate order of the court by which he was appointed. KRSA § 271A.165(9) is identical in substance to the prior corporation law. It establishes a specific procedure for the voting of shares held by three or more fiduciaries declaring that in the absence of another procedure in the instrument appointing the fiduciaries, the majority controls the manner of voting. If there is deadlock among the fiduciaries, any one of them or any beneficiary may invoke the aid of the courts in order to have an additional person appointed to act with the fiduciaries in determining the manner in which the shares will be voted. KRSA § 271A.165(8) describes how shares standing in the name of a receiver are to be voted. A receiver may vote shares under his control without transferring the shares into his name if authorized to do so by an appropriate order of the court by which he was appointed. KRSA § 271A.165(9) is identical in substance to the prior corporation law. It provides that a shareholder whose shares are pledged is entitled to vote such shares until the shares have been transferred into the name of the pledgee, and that thereafter the pledgee is entitled to the vote.

KRSA § 271A.165(10) prohibits voting of redeemable shares after notice of redemption has been mailed and a sum sufficient to redeem the shares has been deposited. A somewhat similar provision under the prior act prohibited both the voting of redeemable shares and the counting of such shares in calculation of total voting power. The present provision applies only to redemption of such shares. Redemption frequently occurs in conjunction with a corporate transaction where the vote of the shares being redeemed would be required, absent a provision such as KRSA § 271A.165(10). If shares are to be redeemed, it serves no useful purpose to secure the concurrence of the holders of such shares provided they are assured of receipt of the amount payable to them on redemption. The new provision gives the necessary assurance by stating that “a sum sufficient to redeem such shares [shall be] deposited with a bank or trust company with

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210 See Corporation Law, supra note 87, at 32.
211 Compare KRSA § 271A.165(9) with KRS § 271.315(4).
212 See generally Vascocu, Right of Pledges of Stock to Vote and Receive Dividends, 1 Tex. Law & Leg. 238 (1947); Note, Right to Vote Corporate Stock as Between Pledgor and Pledgee, 11 Tex. L.Q. 241 (1937).
213 KRS § 271.315(6) stated: “Shares of a corporation belonging to the corporation shall not be voted nor counted in calculating the total voting power of all shareholders of a corporation at any given time.”
214 KRSA § 271A.165(10).
irrevocable instruction and authority to pay the redemption price to
the holders upon surrender of the certificates." 221

Clearly the most important sections of the voting of shares pro-
visions are those pertaining to proxies and cumulative voting. Both
are subjects of considerable scope and are worthy of detailed examina-
tion. 222

1. Cumulative Voting

When each voting share has one vote and each candidate for whom
a shareholder votes receives an equal number of votes, the holders of
a majority of shares can elect all of the directors. Cumulative voting
was devised to prevent majority-dominated elections by providing a
method of voting which assures minority representation on the board
roughly proportionate to the minority's size. 223 Such representation is
made possible by permitting each shareholder to cast his total votes
for any number of candidates or for only one candidate. The total
number of votes is computed by multiplying the number of shares a
shareholder is entitled to vote by the number of directors to be
elected. 224

This device is particularly significant to Kentucky corporate law
because of a Kentucky constitutional provision guaranteeing cumulative
voting. 225 Although mandatory cumulative voting may be desirable
for the protection of minority interests, it creates rather complex
constitutional problems with respect to several devices which may
dilute the right. 226 Classification of directors, removal of directors,
and filling of vacancies have been discussed previously. 227 However,
there are several other areas which may conflict with cumulative
voting rights.

221 Id.
222 See H. Henn, Law of Corporations §§ 282-83, §§ 364-67; Herron, Proxy
Voting at Company Meetings, 28 Aust. L. Rev. 249 (1958); Hoban, Voting Con-
tral Methods, 1958 U. Ill. L.F. 110; Aranow & Einhorn, Corporate Proxy Contests:
Conduct of the Stockholders Meeting, 42 Va. L. Rev. 1049 (1956); Axe, Corporate
Proxies, 41 Mich. L. Rev. 38 (1942); Comment, Irrevocable Proxies 43 Tex. L.
Rev. 733 (1965).
224 Id. See also Schwartz v. State, 56 N.E. 201 (Ohio 1908); Chicago
Macaroni Mfg. Co. v. Boggiano, 67 N.E. 17 (Ill. 1908); In re Mathiason Mfg.
Co., 99 S.W. 502 (Mo. 1907). These are representative of the cases where a
minority of shares were voted in such a manner as to actually elect a majority of
the board.
225 Ky. Const. § 207. But see Schmidt v. Mitchell, 41 S.W. 929 (Ky. 1897),
which held that straight voting was valid when no shareholder claimed the right to
vote cumulatively or objected to the right of anyone to cast straight ballots.
227 See text accompanying note 11-42 supra.
First, exercise of the right to reduce the number of directors on the board dilutes the right to vote cumulatively. As the number of directors to be elected decreases so does the voting power of the minority. Under the prior statute the problem was unsettled.\textsuperscript{228} KRSA § 271A.180 while recognizing the right to \textit{increase} the number of directors by amendment to the articles, or in a manner provided for in the articles or by-laws, provides that "no decrease shall have the effect of shortening the term of any incumbent director."\textsuperscript{229}

Another means of diluting cumulative voting rights is majority delegation of board functions to an executive committee. Minority representation on the board based on cumulative voting at the election does not assure the appointment of minority members to the executive committee. The prior act authorized the majority of the board to appoint the members of an executive committee, without any recognition of the effect upon cumulative voting rights.\textsuperscript{230} The new act requires that such power of appointment be specified in the articles and by-laws.\textsuperscript{231} In addition, it enumerates certain matters for board action which are non-delegable.\textsuperscript{232}

A final method which may nullify minority representation is the use of non-voting stock. Although non-voting stock has been held unconstitutional in some jurisdictions,\textsuperscript{233} the Court of Appeals has held that it does not offend the Kentucky Constitution.\textsuperscript{234} Language in the Constitution and statute providing that "each shareholder shall have as many votes in the aggregate as he shall be entitled to vote under the corporation's article of incorporation"\textsuperscript{235} may be subject to the interpretation that a shareholder may hold shares to which cumulative voting is inapplicable. The Model Act cumulative voting provisions were deemed unsuitable for Kentucky since they were not designed for states in which cumulative voting is constitutionally protected.\textsuperscript{236} Consequently, the legislature chose not to deviate from the language of the Constitution which not only provides for cumulative voting but also specifically states that directors \textit{shall not be elected in any other manner}.\textsuperscript{237}

\textsuperscript{228} See KRSA § 271.345(4).
\textsuperscript{229} KRSA § 271A.180.
\textsuperscript{230} KRSA § 271.345(4)(d).
\textsuperscript{231} KRSA § 271A.210.
\textsuperscript{232} Id.
\textsuperscript{233} Watseka Tel. Co. v. Emerson, 134 N.E. 707 (Ill. 1922); Dewey Portland Cement Co. v. O'Brien, 96 S.E.2d 171 (W. Va. 1957).
\textsuperscript{234} Williams v. Davis, 180 S.W.2d 874 (Ky. 1944).
\textsuperscript{235} KRSA § 271.315(2); KY. CONST. § 207.
\textsuperscript{237} KY. CONST. § 207.
2. Proxies

Voting by proxy is an outgrowth of the large public issue corporation. It was not recognized at common law. But as corporations increased in size and number of shareholders, as a matter of practicality, early reluctance to permit proxy voting yielded to statutory recognition of the right. In addition to express recognition and regulation in every state, there now exists a large body of federal law designed to regulate proxy solicitation and voting.

The new proxy provision in the Kentucky Act is identical to the old provision, except for adoption of the first sentence of the Model Act. The first sentence changes prior law to the extent that a proxy may now be executed in writing not only by a shareholder but also by his duly authorized attorney. Part of the Model Act provision which was rejected provided that no proxy was to be valid after 11 months from the date of its execution unless otherwise provided in the proxy. The effect of this 11 month limitation is to limit the continuation to one annual meeting. In deviating from the Model Act, KRS § 271A.165(3) limits the effective duration of proxies to three years, unless they are coupled with an interest. The duration of proxies under the new proxy authorizing provision thus lacks that degree of certainty that exists under the Model Act. Duration will depend upon judicial determination of the kinds of interests that are sufficient to render the proxy irrevocable.

In addition, the Model Act makes no provision for the manner of revocation of a proxy or the effective date thereof. Although the recently enacted Kentucky provision does not specify how to revoke a proxy, it does provide that a revocation is not effective until the secretary of the corporation has received written notice thereof.

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239 MODEL BUS. CORP. ACT ANN. 2D § 33 ¶ 2 (1971).
241 Compare KRS § 271A.165(3) with KRS § 271A.165(3) and MODEL BUS. CORP. ACT § 33(3) (rev. ed. 1969).
242 Compare KRS § 271A.165(3) with KRS § 271.315(3).
244 MODEL BUS. CORP. ACT ANN. 2D § 33 ¶ 2 (1971).
245 KRS § 271A.165(3).
D. Voting Trusts

A voting trust is created by the transfer of voting shares to a trustee or trustees, to hold and vote until the purpose of the trust is achieved. It is a device designed to concentrate shareholder control in a few persons who through election of directors can control corporate affairs. At early common law voting trusts were held illegal, irrespective of purpose, on the ground that separation of voting power from ownership was repugnant to the concept of corporation law. Gradually, it was recognized that shareholders have a right to combine and concentrate their voting strength by means of a voting trust provided the purposes of the trust are proper and not detrimental to the interests of non-participating shareholders. Statutes were enacted primarily to remove the stigma attached to such trusts and to place time limits on their duration. In addition, these statutes provided rather technical requirements and procedures to be complied with when creating a voting trust.

The new voting trust provision is a much condensed version of the earlier act. It authorizes the creation of voting trusts durating no longer than ten years provided there is a written voting trust agreement deposited with the corporation at its registered office and open to shareholder inspection. The 1969 amendment to the Model Act required the trustees of a voting trust to keep a record of the holders of voting trust certificates to be deposited with the corporation at its registered office and to be kept open for shareholder inspection. Section 52 of the Model Act was concurrently amended to extend the right of inspection to holders of voting trust certificates. To this extent the new provision on voting trusts goes beyond the requirements imposed under prior law.

248 See, e.g., Shepaug Voting Trust Cases, 24 A. 32 (Conn. 1890); Bridgers v. First Nat'l Bank, 67 S.E. 770 (N.C. 1910); Luthy v. Ream, 110 N.E. 373 (Ill. 1915). But see Ecker v. Kentucky Ref. Co., 138 S.W. 264 (Ky. 1911) where the Kentucky Court of Appeals held a voting trust valid when established for a lawful purpose.
251 Compare KRS § 271A.170; KRS § 271.325.
252 Compare KRS § 271A.170 with KRS § 271.325.
253 Compare KRS § 271A.170.
255 Id.
256 Compare KRS § 271A.170 with KRS § 271.325.
Although the law pertaining to voting trusts has not been greatly altered, the new act does significantly affect the law relating to shareholder agreements.\textsuperscript{257} The prior act recognized voting trusts, irrevocable proxies, and classification of stock as means of pooling voting strength but was silent as to shareholder agreements.\textsuperscript{258} Lack of statutory authority, coupled with language from the Court of Appeals decision in \textit{Haldeman v. Haldeman},\textsuperscript{259} left the validity of voting agreements in Kentucky extremely doubtful.\textsuperscript{260} With adoption of the new act, Kentucky recognizes the fundamental distinction between a voting trust and a voting agreement and specifically authorizes enforcement of contracts among shareholders regarding the voting of their shares.\textsuperscript{261} In addition, such agreements are segregated from the strict requirements regarding voting trusts.\textsuperscript{262}

Prior to adoption, the shareholder agreement section was criticized as conflicting with other statutes dealing with proxies and with prior court decisions holding shareholder agreements to be nothing more than voting trusts.\textsuperscript{263} It was argued that “[I]f left in the act, they [the provisions pertaining to shareholder agreements] would effectively nullify the remaining provisions of Section 34 [of the Model Act] with reference to voting trusts. (Why call something a voting trust and subject it to all of the detailed requirements contained in section 34 when you can merely call it an agreement among shareholders and subject it to none of them?)”\textsuperscript{264}

These arguments, although rejected, are not without merit. If the policy behind voting trust requirements is to prevent secret arrangements, why not apply such requirements to other secret pooling arrangements equally capable of skewing the vote? The answer, and reason for adoption of the shareholder agreement provision, lies in

\textsuperscript{257} See generally Elson, Shareholders Agreements, A Shield for Minority Shareholders of Close Corporations, 22 Bus. L\textsuperscript{\textregistered}w. 449 (1967); Note, Corporations-Specific Enforcement of Shareholder Agreements, 45 N.C.L. Rev. 228 (1965).
\textsuperscript{258} See KRS § 271.325.
\textsuperscript{259} 197 S.W. 376 (Ky. 1917).
\textsuperscript{260} In Haldeman v. Haldeman, 197 S.W. 376, 382 (Ky. 1917), the Court of Appeals took a dim view of such agreements: “Although a stockholder may vote as he pleases, public policy forbids the enforcement of a contract by which a shareholder undertakes to bargain away his right to vote for directors according to his best judgment and in the interest of the corporation. He has no right to disable himself by contract from performing his duty.” In light of this direct statement by the Court of Appeals that the shareholder must never tie his hands by contract, substantial doubt arose regarding the status of shareholder agreements.
\textsuperscript{262} KRS § 271A.170(2).
\textsuperscript{263} LEGISLATIVE HEARING, supra note 83, at 102.
\textsuperscript{264} Id. at 207.
the practical use of such a device. Voting agreements are almost exclusively used by shareholders in closely held corporations, where the need for strict statutory requirements simply does not exist. Voting trusts, on the other hand, are devices particularly appropriate for use in connection with large public issue corporations where the need for awareness of corporate control and protection of the investor is of greater concern. Thus, shareholders in the closely held Kentucky corporation who want to make use of a voting agreement may now do so without the burden of compliance with technical voting trust requirements or doubts as to its enforceability.

E. Quorum of Shareholders

The presence of a quorum is essential to holding valid meetings and taking shareholder action. The recent enactment specifies that unless provided for in the articles of incorporation, a majority of shares entitled to vote, represented in person or by proxy, constitutes a quorum at a meeting of the shareholders. The new provision is like the prior statute except for the limitation placed upon what may be provided for in the articles. The prior act was perhaps more liberal in its quorum requirements, placing no limit upon the percentage of outstanding shares needed to constitute a quorum. Under the new act, the articles may not lower the quorum requirement to less than one-third of the outstanding shares. The obvious policy behind this restriction is the prevention of any major corporate action without the approval of at least one-sixth of the shareholders.

The recent enactment also provides that if a quorum is present, the affirmative vote of a majority of shares represented at the meeting and entitled to vote on the subject matter constitutes the act of the shareholders unless the vote of a greater number, or voting by class, is required by the corporate statutes or the articles or by-laws. It is important to note that the majority in question is a majority of the voting shares represented at the meeting, rather than a majority of

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267 See generally H. HENN, LAW OF CORPORATIONS §§ 374, 525-27; Blewer, Quorum and Voting Requirements, 6 PRAC. LAW. 79 (1960).
268 KRS § 271A.160; KRS § 271.335.
269 KRS § 271.335.
270 KRS § 271A.160.
271 See MODEL BUS. CORP. ACT AN. 2d § 32 § 2 (1971).
272 KRS § 271A.160.
the voting shares outstanding.Kentucky was previously without such a provision.

The new quorum provision differs from the Model Act but conforms to the prior law in providing that a quorum once obtained cannot be lost. A shareholder can continue to transact business at a meeting notwithstanding the withdrawal of enough shareholders to leave less than a quorum. An interesting facet of the prior quorum provision has been deleted in the recent enactment. Previously, if a quorum was not present at a meeting called for the purpose of electing directors, the meeting was adjourned for one day; at the second meeting, those present were considered a quorum for the purpose of electing directors.

**Greater Voting Requirements**

The quorum provision of the new act, KRSA § 271A.160, provides that the articles or by-laws may require more than a majority vote. Greater voting requirements for shareholder action are frequently desired in close corporations to provide minority shareholders protection against adverse joint action by other shareholders. High-vote requirements in effect enable minority shareholders to veto action at the shareholder level. In addition to enhancing probability of deadlock and paralysis at the shareholder level, such requirements are also inconsistent with majority rule and would probably be invalid in the absence of statutory sanction.

The prior act permitted the articles or by-laws to fix the vote required for a specific act at either more or less than the usual majority vote. The new act provides that the articles may require the vote or concurrence of a larger percentage of the shares than the prescribed

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273 Matters for which the new act requires the affirmative vote of a percentage of shares based on outstanding shares rather than shares represented at a meeting, together with a like vote of outstanding shares of each class entitled to vote thereon as a class, are:

1. amendments to the articles (KRSA § 271A.295),
2. mergers or consolidations (KRSA § 271A.365),
3. sales not in the regular course of business (KRSA § 271A.395),
4. voluntary dissolution (KRSA § 271A.420), and
5. revocation of voluntary dissolution proceedings (KRSA § 271A.445).

274 KRSA § 271A.160.
276 KRSA § 271A.160.
277 KRS § 271.335.
279 See MODEL Bus. CORP. ACT ANN. 2D § 143 ff 2 (1971).
280 KRS § 271.315(7).
majority but does not contemplate provision for a lower percentage. \[281\]
Limiting changes in voting requirements to those which increase requirements is entirely consistent with the more restrictive scheme of the recent legislation. The new act requires a quorum of shareholders to be not less than one-third, whereas the prior act permitted any quorum percentage. \[282\] Where prior law allowed adjustment of voting requirements upward or downward, the new act only permits the former. \[283\] The scheme reflects a philosophy of protection and although less flexible, it is probably preferable to the previous corporate statute.

IV. PROCEDURES RELATING TO ACTIONS BY SHAREHOLDERS—THE SHAREHOLDER DERIVATIVE SUIT

The derivative action developed in equity to empower a shareholder to derivatively or secondarily enforce a corporate right where those in control of the corporation refuse to initiate the action on behalf of the corporation directly. \[285\] Ordinarily, it is the function of management to determine whether a cause of action which the corporation processes should be prosecuted. If management exercises its discretion not to assert a corporate right, the shareholder is deprived of standing to object unless he contends that the decision was the result of a conflict of interest which motivated the directors to prevent the corporation from prosecuting the claim. In such a case, the shareholder may be required to make demand on the board of directors and possibly even on the shareholders before initiating the action himself on behalf of or in the right of the corporation. \[286\] The plaintiff-shareholder in effect sues as guardian ad litem for the corporation, deriving his right from the corporation which is being prevented by management from prosecuting the claim. \[287\] By the very nature of the suit, the corporation is a necessary party to the action. It owns the cause of action and any recovery stemming from litigation is paid to the corporation. \[288\]

Although the derivative action serves a useful purpose in protecting the shareholders from abuse on the part of management, it can become detrimental when shareholders act out of self-interest rather than in

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281 KRSA § 271A.655.
282 KRSA § 271A.160; KRS § 271.335.
283 Compare KRS § 271.315(7) with KRSA § 271A.655.
284 See LEGISLATIVE HEARING, supra note 83, at 103.
285 See generally H. HENN, LAW OF CORPORATIONS §§ 358-84; 19 AM. JUR. 2D CORPORATIONS §§ 524-29 (1965); 18 C.J.S. CORPORATIONS §§ 55-76 (1939).
286 See MODEL BUS. CORP. ACT ANN. 2D § 49 ¶ 2 (1971).
287 H. HENN, LAW OF CORPORATIONS § 358.
288 Id.
the best interests of the corporation. The so-called “strike suit” is a device used by small shareholders to “blackmail by litigation” in the hope of gaining private settlements, the benefits of which accrue not to the corporation but to the shareholder initiating the action.\(^{289}\) Spurious actions which are not settled or prove unsuccessful are often expensive to the corporation, which must retain counsel and usually indemnify the defendant directors and officers for their expenses.\(^{290}\)

Each shareholder suffers a diminution in the value of his shares as a result of a bad faith derivative action. Such misuse of the derivative remedy has led to statutory procedural restrictions and an increased judicial awareness of the fiduciary relationship between the shareholder bringing the action and the corporation in whose behalf it is brought.\(^ {291}\)

Although the shareholder derivative suit is strictly a matter of procedural rather than substantive corporate law,\(^{292}\) the prior statutory provision was not included in the Kentucky Rules of Civil Procedure but rather appeared in the general corporation statute.\(^{293}\) It was modeled after Rule 23 (B) of the Federal Rules of Civil Procedure with one serious omission: it failed to include language within the Federal Rules which required approval by the court and notice to shareholders of any proposed settlement or compromise.\(^{294}\) The provision, therefore, did not fully protect the corporation and shareholders against unfounded “strike suits” and attempts at self-enrichment through private settlements.

The prior act also required a demand on shareholders, \(i.e.,\) an effort to secure the desired action from the directors, and if necessary the shareholders, before initiating a derivative suit.\(^{295}\) The “demand on shareholders” requirement was taken directly from Federal Rule 23 (B) and remains part of the new provision despite deletion from the Model Act.\(^ {296}\) The legislature probably retained the requirement in the hope of averting needless derivative suits. A final aspect of the prior provision warrants discussion. Contrary to the usually accepted procedure of naming the corporation as a nominal party defendant, the prior act named the corporation as a plaintiff.\(^ {297}\) Under the new act,

\(^{291}\) H. Henn, \textit{Law of Corporations} § 358.
\(^{293}\) See KRS § 271.605.
\(^{294}\) See Fed. R. Civ. P. 23(C).
\(^{295}\) KRS § 271.605; KRSA § 271A.245.
\(^{296}\) Id.
\(^{297}\) Id.
however, the corporation is a defendant in all derivative actions. As a defendant it is able to interpose defenses to the suit. This change creates a problem, viz., to what extent is the corporate treasury accessible to director defendants in defending on their own behalf.

The new statutory provision on shareholder derivative actions is a hybrid of § 49 of the Model Act and present Federal Rule 23.1. It is built into the substantive corporate law in order to prevent a gap in the procedural rules concerning such actions. Although it may be argued that such actions could be more appropriately handled as a matter of procedural law, the gap created by repeal of the prior provision and lack of judicial action to adopt such a rule necessitated the drafting of a section relating to procedures in shareholder actions.

Section 49 of the Model Act, however, did not meet Kentucky's corporate needs. It contains rather restrictive provisions on responsibility and security for costs that are more appropriate to the New York corporate climate in which they originated. Additionally, the Model Act assumes that the settlement problem is handled in the civil rules and therefore contains no such provision.

Federal Rule 23.1 places restrictions on time of ownership, required efforts, and control of settlement without subjecting the shareholder to responsibility or security for costs. This rule was thought preferable and was adopted as KRSA § 271A.245. It requires that a shareholder be an owner of shares at the time of the transaction of which he complains, and that he allege with particularity the efforts to obtain the desired action from the directors or, if necessary, the shareholders, before bringing the action. The most significant change from the prior act is the necessity of court approval and shareholder notification of any settlement or compromise agreement. The insertion of this requirement deprives the self-interested shareholder of the opportunity to acquire private settlements by nuisance suits. Although the new provision was primarily structured after the Federal Rule, the Model Act was not completely ignored. It recognizes that equitable ownership carries with it the right to initiate derivative actions whereas the prior act and the Federal Rule did not.

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298 See KRSA § 271A.245.
300 KRSA § 271A.245.
301 See MODEL BUS. CORP. ACT ANN. 2D § 49 ¶ 2 (1971).
302 Id.
303 FED. R. CIV. P. 23.1.
304 See ABA-ALI MODEL BUS. CORP. ACT § 49 (rev. ed. 1969); KRS § 271.605; FED. R. CIV. P. 23.1.
this approach and therefore permits holders of voting trust certificates to exercise the same rights as other shareholders.\textsuperscript{305}

A close examination of the new provision reveals that the drafters followed practically verbatim the first sentence of the Model Act. Thereafter, the Federal Rule was consulted, with only a few deletions relating to special problems of federal jurisdiction. This hybrid of the Model Act and Federal Rule provides Kentucky with a well structured provision which properly balances the conflicting policies of assuring shareholders the right to initiate derivative actions and protecting the corporation against abuses of that right.

\textbf{Conclusion—The End of the Road}

It is hoped that this guided tour through the newly enacted shareholder provisions has provided the Kentucky attorney with a better understanding of the new Kentucky corporate law. It should be apparent that there are no drastic changes in the corporate law pertaining to shareholders, but the changes and variations which do appear would seem in combination to produce a more complete statutory framework. If the policy underlying the new legislation is to so improve the corporate climate that large corporations are necessarily attracted to Kentucky, the new shareholder provisions alone may not be enough to accomplish this purpose. However, they do at least place Kentucky in a competitive position with other jurisdictions.

\textit{Clyde Kuehn}

\textsuperscript{305} \textit{KRSA § 271A.245.}