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A Survey of Kentucky Corporation Cases Since 1946

By WILLBURT D. HAM*

The 1946 Revised Corporation Law of Kentucky became effective on July 1, 1946.¹ Since that time the General Assembly has passed several amendments and made several additions to this new corporation statute. All of this accords with the trend throughout the country to modernize and improve existing state statutes dealing with the law of private corporations. However, despite the presence in each state of a comprehensive statute dealing with the creation, existence, and functioning of the private corporation, much of corporation law still rests in the judicial opinions which construe and apply the provisions of the corporation statute or which deal with matters not specifically covered by the terms of such statute. It is the purpose of this survey to determine what aspects of corporation law the Court of Appeals of Kentucky has been called upon to review in the years which have elapsed since 1946 and the extent to which the presence of a new corporation statute has increased the number of corporation cases during these years.

A review of the cases considered by the Court during this period reveals decisions covering a rather wide range of corporate activities, but surprisingly few cases which called for a construction and application of the provisions of the 1946 corporation statute. In the resumé of these cases which follows, no attempt will be made to refer to all cases in which corporations were involved, but only to selected cases in which the principles of corporation law were more or less in the foreground.

I

FINANCE

Recapitalization. No doubt two of the most important decisions which were handed down during this period were those

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¹ Ky. Acts 1946, c. 141.
dealing with the recapitalization of the old Louisville Railway Company. In the first of these cases, *Donohue v. Heuser,*³ the validity of the recapitalization plan as it affected the interests of the preferred stockholders of Railway came up for review. The recapitalization had taken the form of a consolidation of Railway with the Capital Transit Company of Frankfort, and the organization of a new company to be known as the Louisville Transit Co. Under the proposed plan of consolidation, each preferred stockholder of Railway was to receive, in return for each share of his present five percent $100 par value preferred stock, $2.50 in cash, and one share of Louisville Transit Co. $80 par value five percent preferred stock. Accumulated arrearages of $100 per share in dividends on the old preferred stock were to be eliminated. A group of minority preferred stockholders, holding nine percent of the preferred stock, voted against the consolidation and brought suit to enjoin the consummation of the plan on the ground that it destroyed valuable rights of the preferred stockholders. The Court, however, upheld the decree of the Chancellor dismissing the petition. The Court was unable to find that the elimination of the accrued dividends, or the other changes effected, violated any vested rights of the preferred stockholders in view of the fact that their stock was held subject to the power of the corporation to consolidate and that a change in the preferential rights of the stockholders could be considered as one of the natural incidents flowing from a consolidation. The Court also found no reason to question the fairness of the plan, despite its severe treatment of the preferred stockholders in eliminating some twenty years of accrued dividends, since, in addition to providing the preferred stockholders with an immediate cash payment of $2.50 per share, the plan put Railway on a sound operating basis, enabling the resumption of dividend payments on the preferred as well as the common stock. The Court pointed to the significance of testimony by prominent bankers, public officials, and businessmen that the plan was fair to the preferred stockholders, and the presence in the suit of a brief filed by a group of the preferred stockholders themselves urging approval of the plan.

³239 S.W. 2d 238 (Ky. 1951).
This decision is of interest, not only because of its importance in the development of the local law on the subject, but also because the problem it presents, that of elimination of accrued dividends on preferred stock through recapitalization plans, is one which has arisen in a number of other jurisdictions as well and has thus assumed a national importance.

Where the plan of recapitalization takes the form of a consolidation or merger, there has been little, if any, dissent as to its validity and enforceability. Constitutional attack is usually precluded because of long standing provisions in most corporation statutes authorizing consolidation and merger of one corporation with another. Stock is thus deemed to be purchased subject to this possible type of corporate action and there results no impairment of contract rights or deprivation of any vested rights. Where, however, the plan takes the form of a direct amendment of the corporate charter, sharp conflict exists as to the enforceability of such a plan. Here constitutional attack has sometimes been successful, based on the concept of the preferred stockholder's right to accrued dividends as in the nature of a vested right of property which cannot be impaired by provisions in a corporation statute authorizing elimination of such dividends, particularly if the empowering statute was enacted after the date the stock was first issued. On the other hand, strong and convincing arguments have been made for upholding the constitutionality of such statutory provisions. It is reasoned that the right of the preferred stockholder to accrued dividends, while an important and valuable preferential right, is in no sense a vested right of property, since until the dividends are actually declared the stockholder can make no claim to them as a debt owing by the corporation to him.  

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4 See Keller v. Wilson & Co., 21 Del. Ch. 391, 190 Atl. 115 (1936); Wheatley v. A. I. Root Co., 147 Ohio St. 127, 69 N.E. 2d 187 (1946). Aside from the constitutional question, lack of corporate power under the existing corporation statute may also prove to be a bar to the validity of such a plan. Compare Davison v. Parke, Austin & Lipscomb, Inc., 285 N.Y. 500, 35 N.E. 2d 618 (1941), with Sherman v. Pepin Pickling Co., 230 Minn. 87, 41 N.W. 2d 571 (1950). Some states have sought to meet this objection by including in their corporation statute provisions specifically authorizing amendments which eliminate accrued dividends. See, e.g., N.Y. STOCK CORP. LAW, sec. 35 sub-par. 3; OHIO REVISED CODE ANN., sec. 1701.17(1) (Page, 1954).
Furthermore, under the "reserved power" of the Legislature to alter, amend, or repeal corporate charters, the preferred stockholders's contract is deemed to be at all times subject to such changes as may be prescribed or authorized by the Legislature. The opinion of the Court in Donohue v. Heuser indicates agreement with this line of reasoning, and, while the Court was careful to distinguish the cases involving elimination of accrued dividends through direct charter amendment, the inference seems possible that the Kentucky Court might find no constitutional objection to elimination of accrued dividends even by this method.

In view of this, any effective judicial control over recapitalization plans of this nature in the future may well have to rest in many jurisdictions, including Kentucky, on considerations of the fairness of such plans, an area which as yet has not been explored to any great extent by the courts. As a matter of fact, in commenting on the Louisville Railway recapitalization plan, one writer went so far as to say:

The height of disregard of fairness was probably achieved in the Louisville Railway recapitalization where the preferred's dividend was reduced from $5 to $4, about $100 of arrearages were wiped out and, in return for all this sacrifice, the preferred was given $2.50 in cash. One is startled to find a banker testifying in that case, as the court reports, that 'the preferred shareholders will receive the equitable equivalent of what they previously had.' To the writer, this appears to be a caricature of the substantial equivalence doctrine as we know it in reorganizations.

Surplus. The second decision growing out of the Louisville Railway situation was that of Graham v. Louisville Transit Co., concerning the right of the new corporation to declare dividends out of a surplus of almost $3,000,000, which had come into existence as a result of the consolidation and recapitalization. The preferred stockholders of Transit, who were given a preference in the distribution of assets on dissolution, urged that this newly created surplus was a "paid-in" surplus and that there should be set aside and preserved out of it an amount equal to the total par
value of the preferred stock before any of it was used to pay dividends on the common stock. The Court, however, rejected this contention and held that the surplus was available for dividends on the same basis as if it had been earned by the new corporation.

Two approaches were used in arriving at this result. First, the Court looked behind the organization of the new corporation and noted that during the time the capital of the old Louisville Railway Company was impaired, the company had earned almost $4,000,000. From this it was reasoned that, when the capital was reduced, and a surplus was thereby created, this was an "earned surplus", composed of the earnings of the old company which had thereby been freed and made available for dividends. The surplus, therefore, acquired by the new corporation was an "earned surplus." Secondly, the Court took the position that, if one did not look behind the organization of the new corporation, then the surplus would be in the nature of a paid-in surplus resulting from a payment in excess of the par value of the stock on the organization of the company, and available, just as any other surplus, under the Kentucky dividend statute, for payment of dividends.\(^9\)

It seems fair to say of the first approach that it appears somewhat misleading in that the surplus created was really composed of contributions made by the stockholders (both preferred and common) out of their capital as a result of the reduction in capital effected under the consolidation. It would seem, therefore, that instead of there being an earned surplus, there was in reality only a "reduction surplus." However, since under the Kentucky dividend statute all kinds of surplus appear to be available for dividend purposes, the result of the case would not seem affected. Whether one calls the surplus, "reduction surplus", "paid-in surplus", "capital surplus", or by some other name, makes no difference. In other jurisdictions, however, where sharper distinctions are drawn as to the source of funds available for dividend purposes, the label attached could make a great deal of difference. As far as the interests of the preferred stockholder are concerned, if they need protection, it appears likely that such will have to

come through carefully drawn restrictions on the distribution of the different types of surplus imposed in the dividend statutes themselves.\(^\text{10}\)

*Stock Dividends.* The problem of allocation of a corporate stock dividend as between a life tenant and remaindermen sometimes confronts a trustee or executor in the administration of a trust estate. Since this is a matter which is traditionally treated in discussions of the law of trusts, no attempt will be made here to review recent Kentucky developments with reference to this problem. However, one case, that of *Ball’s Ex’r v. Woodford Bank & Trust Co.*,\(^\text{11}\) deserves mention because of its direct concern with an important question in the law of corporations, namely, the time at which a dividend, once declared, creates an enforceable right in the stockholders. Leon Ball was the beneficiary of a bequest left in trust under the will of a relative whereby he was to receive the net income of the trust during his lifetime and at his death the principal was to go to sisters of the testator. Part of the corpus of the trust consisted of capital stock in the Woodford Bank & Trust Company. The directors of the bank adopted a resolution on November 26, declaring a stock dividend out of surplus in favor of each shareholder of record on December 10, consisting of one additional share of stock for each share held, subject to approval of the stockholders at a meeting to be held on December 10. Ball died on December 3. On December 10, the stockholders met, approved the declaration of the dividend, and authorized the required amendment to the articles of incorporation for an increase in the capital stock. Action was brought by the executor of Ball’s estate for a declaratory judgment to determine the proper disposition of this stock dividend, the executor contending that the dividend should go to the life tenant as representing income realized by the corporation during his lifetime. The Court held, however, that this stock dividend could not be considered as representing income to the life tenant, since the earnings of the corporation would not constitute “income” to the stockholders until declared payable to them in the form of a dividend and the

\(^{10}\) See, e.g., CAL. CORP. CODE ANN., sec. 1500 (Deering, 1953), which provides that dividends out of surplus arising from a reduction of stated capital, or out of paid-in surplus, shall be declared only upon shares entitled to preferential dividends.

\(^{11}\) 311 Ky. 474, 224 S.W. 2d 678 (1949).
Recent Kentucky Corporation Cases

Declaration here involved could not be considered as effective for such purpose until December 10 when the stockholders met and gave their approval. Only then could the declaration be considered as a complete and final act creating in the stockholders an enforceable right against the corporation. At that time the life tenant's interest in the trust estate had terminated.  

One of the contentions made by the executor was that the "declaration date" determines who is entitled to a dividend regardless of the "record date" and the "payment date." Since under the circumstances the declaration date was the record date, the Court did not have to determine this question. But the Court did say by way of dictum that other jurisdictions had recognized "that where a resolution declares a dividend payable to stockholders as of a certain date, the earnings are not segregated for the benefit of any except those owning the stock on the record date, and the latter would control."  

Unclaimed Dividends. In Potter-Matlock Trust Co. v. Myers, suit was brought by a bondholder on behalf of himself and other bondholders similarly situated against the trustee for the bondholders of the insolvent Diamond Rock Asphalt Co. and all unknown persons holding bonds of that company, asking for a declaration that certain unclaimed dividends declared by the trustee in the liquidation of the company be distributed to the remaining known bondholders. The requested relief was denied by the Court. It was reasoned that the petitioning bondholders had received what they were justly entitled to in the liquidation, and the fact that the fund due to the unknown bondholders might

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12 Under the "Kentucky rule" then applicable, an extraordinary stock dividend, such as here involved, declared during the term of the life estate would have constituted "income" to the life tenant in the absence of an expressed intention of the creator of the trust to the contrary. See Laurent v. Randolph, 306 Ky. 134, 206 S.W. 2d 480 (1947). This former "Kentucky rule" was rejected and the "Massachusetts rule" adopted by the Court in the recent case of Bowles v. Stilley's Ex'r., 267 S.W. 2d 707 (Ky. 1954). Also, in 1950 the General Assembly adopted a statute on the subject. See Ky. Rev. Stat. sec. 386.020(4) (1953). The Bowles case and this statute are discussed in a note written by Charles Richard Doyle appearing in 43 Ky. L.J. 447 (1955).

13 311 Ky. at 477, 224 S.W. 2d at 679. This statement accords with what appears to be the general rule on the subject, despite some judicial authority in support of the declaration date as the controlling date. See Note, 130 A.L.R. 492, 495 (1941). It is settled that as between the "declaration date" and the "payment date," it is the declaration date which controls. See BALLANTINE, CORPORATIONS sec. 240 (Rev. Ed. 1946); Note, 60 A.L.R. 703 (1929).

14 239 S.W. 2d 949 (Ky. 1950).
eventually escheat to the state was considered no loss to the petitioning bondholders. The loss would not be to them but to the unknown bondholders. The Court held that the petitioning bondholders could invoke neither the doctrine of laches nor the statute of limitations against the unknown bondholders in support of their claim to the fund. In reply to the suggestion that an analogy be drawn to the theory of a lapsed legacy in the disposition of the assets of an estate, the Court said:

The lapsed legacy or devise is one which never vests because the legatee dies before the testator or before his interest vests under the will. There is no similar provision in corporation law which would permit a dividend declared in favor of one or more bondholders to fall back into a fund for the benefit of other bondholders because an unknown or unlocated bondholder did not claim his dividend.\(^5\)

II

**Corporate Existence**

*Corporate Entity.* The concept of corporate entity and its disregard received attention in several cases during this period. No doubt the most interesting individual case was that of *Veterans Service Club v. Sweeney*,\(^6\) in which a father, along with his son and daughter, organized the Veterans Service Club ostensibly as a nonprofit corporation to extend help and assistance to ex-service men, but which in reality was conducted primarily as a gambling establishment. Plaintiff's wife lost sums of money while gambling there, and plaintiff brought action against the corporation and the individual organizers under the Kentucky treble damage statute.\(^7\) The individual defendants set up the existence of the corporation as a defense to their individual liability, but the Court agreed with the Chancellor that this defense should be rejected on the familiar principle of law that the corporate device may not be used as a shield for the carrying on of an illegal activity and that in such case the legal fiction of the separate corporate existence will be swept aside to reach the individuals responsible for the performance of the illegal acts.

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\(^5\) Id. at 952.
\(^6\) 252 S.W. 2d 25 (Ky. 1952).
Another familiar situation in which the corporate existence is sometimes disregarded was illustrated by *Martin v. Ratliff Furniture Co.*,18 in which a stockholder in a closely held corporation sold his stock to the corporation and agreed not to engage in the same business, either directly or indirectly, for a period of five years within the same county. He proceeded, however, to organize a new corporation, with himself as the president and general manager and owner of eighty percent of its capital stock, for the purpose of engaging in a like business in the same locality. The Court held that it could properly enjoin both the stockholder and the new corporation from engaging in the competing business.

Frequently, in the small corporation, the fact of corporate existence and the formalities which accompany such existence are ignored by the members themselves or those dealing with them, and as a result complications occasionally develop which lead to litigation, particularly if the corporation suffers financial reverses. The Court was called upon recently to pass upon a situation of this nature in *William Brown v. John W. Gray's Executrix*.19 Gray, who owned all of the stock of the Art Metals Company, sold the business to three men, executing a bill of sale of the assets to the purchasers who, in turn, executed a chattel mortgage in favor of the company (instead of to Gray) to secure a note given Gray for the purchase price. On the subsequent insolvency of the company, Gray brought suit on the note and sought to have the mortgage reformed so as to run to him. The trial court reasoned that, since the bill of sale was not properly authorized by a corporate resolution, it was a nullity, and it followed that the chattel mortgage must likewise be considered a nullity since the purchasers had nothing to mortgage. Reformation, therefore, would be a useless procedure. The court, however, did award Gray's estate (Gray having died while the action was pending) a prior equitable lien on the assets of the company, which was approved on appeal. The Court of Appeals remarked:

The situation is somewhat confusing and complicated, principally because the parties paid little regard to the fact that the Art Metals Company was a corporation.20

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18 264 S.W. 2d 273 (Ky. 1954).
19 276 S.W. 2d 672 (Ky. 1955).
20 Id. at 673.
Sometimes, where the members of a corporation have conducted the corporate affairs informally, the courts, as a means of arriving at justice in the particular case, have ignored the need for adherence to the formalities of corporate existence. The Kentucky Court adopted this approach in *Slater v. Bright*;21 which involved the question as to whether, in the case of two corporations with an interlocking membership, one of the corporations, the Bartlett Corporation, should be treated as a mere volunteer in paying debts of the other corporation, the U. S. 60 Wood Manufacturing Company, whose property had been taken over by the Bartlett Corporation without any formal transfer of assets and without any formal agreement between the two corporations as to payment of the debts. In support of its position that the Bartlett Corporation was not a mere volunteer, the Court said:

> Throughout the very nebulous record runs the thread of a nonchalant informality in the conduct of the affairs of the two corporations. Apparently all involved acted almost exclusively as individuals in transacting the various phases of business and never considered the corporations as entities. Meetings were not held regularly and minutes were rarely kept so that there is no reliable record as to what actually transpired regarding the payment of $5,223 by the Bartlett Corporation, on the indebtedness of U. S. 60. Therefore, in the light of past activities by the officers and stockholders of the corporations, the question of whether the Bartlett Corporation acted purely as a volunteer must be decided, not by adherence to strict formality, but by the nature and effect of all agreements, actual or implied, which can be deduced from the conduct of the parties.22

In an earlier case of *Hoagland v. Liter*;23 the entity issue centered around the availability to defendant of certain credits on a note which was being sued upon by plaintiff. The credits arose out of business dealings between the two parties entered into after the execution of the note and were ruled in a previous appeal of the same action to be available as a setoff against the amount due on the note even though outlawed by the statute of limitations.24 Plaintiff contended in his new appeal that the busi-

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21 248 S.W. 2d 915 (Ky. 1952).
22 *Id.* at 917.
23 308 Ky. 680, 215 S.W. 2d 583 (1948).
ness dealings involved were with a corporation of which defendant was the principal stockholder and any credits against the note were due the corporation and not the defendant. The Court held, however, that since the plaintiff had continued to deal with the defendant as if no corporation existed and no claims of corporate creditors were involved, the Court would "look through the type of business organization in analyzing the true nature of the transactions between the parties."25

In the area of intercorporate affairs, the Court had the opportunity in Big Four Mills, Limited v. Commercial Credit Co.,26 to apply the now established principle of corporation law that the mere allegation of ownership of all of the capital stock of one corporation by another corporation does not create such an identity of corporate interest as to call for ignoring the existence of the two corporations as separate entities.

**Corporate Name.** The importance of an accurate designation of the corporate name in a complaint or petition was illustrated in two cases. While in neither case did the plaintiff lose his case because of misnomer of the corporate defendant, nevertheless the misnomer made his case vulnerable. For example, in George H. Rommel Company v. Frank Greenwell,27 the Court held that a misnomer of the corporate defendant in an application for a workmen's compensation award could be disregarded as immaterial since there was no showing that the corporate defendant was misled or prejudiced by the misnomer.28 It was further held that an amended application, filed to correct the error, would be considered to relate back to and become a part of the original application, thus preventing the claim from being barred under the one-year period prescribed by the applicable statute of limitations.

In Carnation Co. v. Devore,29 the corporate defendant, the Carnation Milk Company was sued in five separate actions under

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25 308 Ky. at 682, 215 S.W. 2d at 584.
26 307 Ky. 612, 211 S.W. 2d 831 (1948).
27 273 S.W. 2d 46 (Ky. 1954).
28 The Court applied the provisions of Section 134 of the former Civil Code of Practice, in effect at the time the case was tried, directing courts to disregard errors or defects in proceedings which did not affect the substantial rights of the adverse party and authorizing courts to permit amendments of pleadings to correct a mistake in the name of a party. See Rules 15.01 and 61.01 for similar provisions under the new Kentucky Rules of Civil Procedure.
29 252 S.W. 2d 860 (Ky. 1952).
the name Carnation Company for damages growing out of an accident involving one of its trucks. Judgments were rendered against the company in each of the actions, which were consolidated for purposes of trial, and the company appealed these judgments. The company contended, among other things, that the petitions were defective on demurrer because of the misnomer of the defendant's corporate name. To this contention, the Court gave the following answer:

An objection that a defendant is not sued in its correct corporate name cannot properly be interposed by a demurrer, but should be presented by an answer or affidavit in the nature of a plea in abatement, setting forth the misnomer and disclosing the defendant's true name, and where the defendant makes defense in the trial court on the merits and it is apparent that it was the corporation to be sued, it is estopped to complain that judgment was not rendered against it in its true corporate name, though it was sued under another name.30

In a third case, Burnside Veneer Corp. v. New Burnside Veneer Co.,31 the similarity of corporate names came before the Court and focused attention on the provision contained in the 1946 Revised Corporation Law which states that the corporate name adopted by a newly formed corporation shall not be the same as, nor deceptively similar to, the name of any other domestic corporation.32 The Burnside Veneer Corporation, which was incorporated in 1948, sought to enjoin The New Burnside Veneer Company, which was incorporated in 1949, from the use of that name. The Court, however, refused to grant the injunction, applying the common law rule which refuses to recognize an exclusive right in a geographic name. In referring to the statute the Court said that "to construe it in a manner which would create exclusive rights in geographic or generic terms would lead to absurd results, results of such scope that it can fairly be presumed they would have been expressly mentioned in the statute had the Legislature intended them."33

30 Id. at 862.
31 247 S.W. 2d 524 (Ky. 1952).
33 247 S.W. 2d at 526.
Dissolution. Two recent decisions illustrate the practical problem presented as to the right of a legally dissolved corporation to maintain suits after its dissolution in the winding up of its affairs. In *Leiserson & Adler, Inc. v. Keam,*\(^3\) the plaintiff, a New York corporation, had instituted action for $2,000 on a guaranty contract against the defendant, Keam, on February 5, 1935. The corporation was successful in obtaining a judgment on December 27, 1935, and issued an execution on the judgment on March 6, 1936, which was levied on certain property of Keam. Later, on December 9, 1948, a second execution was issued on the judgment and this execution was levied on property of Keam that had not been discovered until that time. Then on January 18, 1949, the corporation filed the present suit to enforce the execution liens. Defendants objected to the maintenance of this latter suit on the ground that the corporation had been legally dissolved on December 16, 1935, by appropriate action taken by the Secretary of State of New York for nonpayment of franchise taxes, and that all proceedings taken by the corporation after that date, including the judgment rendered in its favor on December 27, 1935, were therefore null and void. Plaintiff corporation sought to sustain its position by reference to Section 29 of the General Corporation Law of New York, which provides in broad terms for the continued existence of a dissolved corporation for the purpose of winding up its affairs (including the right to sue and be sued in its corporate name), and an amendment to the tax laws of New York under date of 1941 extending the provisions of Section 29 to any corporation theretofore or thereafter dissolved under the provisions pertaining to nonpayment of franchise taxes.\(^3\) The Kentucky Court of Appeals, however, refused to concede the applicability of these statutory provisions to the enforcement of a judgment which was void when rendered. "It is beyond the power of the Legislature", said the Court, "to revive an action which has abated prior to the passage of the statute."\(^3\)

\(^{34}\) 266 S.W. 2d 355 (Ky. 1954).

\(^{35}\) Prior to this amendment, the Court of Appeals of New York had upheld a decision of the Supreme Court of that state that the provisions of Section 29 of the General Corporation Law did not apply to a corporation dissolved for failure to pay its franchise tax. See Application of S. M. & J. Eisenstadt, Inc. (*In re Hef- ferman*), 256 App. Div. 488, 10 N.Y.S. 2d 868 (Sup. Ct. 1939), *aff'd per curiam*, 283 N.Y. 578, 27 N.E. 2d 439 (1940).

\(^{36}\) 266 S.W. 2d at 355.
The Court alluded to the possibility of a new suit being brought on the original claim, but pointed out that, if such an action were to be considered as filed on January 18, 1949, the cause of action would still be barred because it was filed more than two years after 1941, and under Kentucky law, which determines the time within which a cause of action may be enforced in this state, proceedings by a dissolved corporation must be commenced within two years after its dissolution. However, just a year previously, in Blackerby v. Monarch Equipment, the Court had ruled in favor of the right of a corporation which had been dissolved in 1940, to maintain a suit in 1948 to set aside a conveyance executed in 1943 which operated to defeat a lien the corporation had obtained in 1937. The Court felt that, under the circumstances, the suit was brought within a reasonable time and emphasized that, while in the Ewald case, two years was indicated as being ample time within which to close the corporate affairs, later decisions of the Court had distinguished the Ewald case and limited it to cases involving taxation.

In view of the specific two-year limitation period now set out in the 1946 Revised Corporation Law, the flexibility which might have been available under the former "reasonable time" test would no longer appear to be available as to those corporations dissolved under the provisions of the 1946 Act. There remains, however, the question as to whether the provisions of this Act are to be construed as applicable to those corporations dissolved before the effective date of the Act. In answer to this question, the Blackerby and Keam cases do not seem entirely consistent, the one applying the flexible "reasonable time" test, with no mention of the new Act, the other approving the flat two-year test both as a statutory and judicial mandate.

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*The Court here referred to the two-year period as prescribed under the new corporation statute (Ky. Rev. Stat. sec. 271.585), and to Ewald Iron Company v. Commonwealth, 140 Ky. 692, 131 S.W. 774 (1910), which had held that, under a former statute which did not refer to any specific time to close up the corporate affairs, a reasonable time was meant and two years would be considered as a reasonable time ordinarily for this purpose.*

*See note 87 supra.*
III

Management

Fiduciary Relation. One of the most frequent subjects of litigation in corporation law in recent years has been that concerned with the fiduciary position occupied by the directors and officers of a corporation. One of the fundamental requirements of this fiduciary relation has been that a director or officer must not take for his own personal benefit a business opportunity which rightfully belongs to the corporation. In 1949 the Kentucky Court was called upon to consider the “corporate opportunity" doctrine in the case of Urban J. Alexander Co. v. Trinkle, which involved a suit by the corporation against a former officer and employee to recover profits made by him in a business transaction which it was alleged should have been consummated for the corporation's benefit. The Court held, however, that there had been no usurpation of a corporate business opportunity since the corporation had neither the legal capacity (due to a debt limit in its charter) nor the financial ability (due to its weak credit position) to have availed itself of the particular transaction. This decision accords with the principle, generally recognized by the courts, that the corporate opportunity rule does not apply where the corporation is unable or unwilling to avail itself of the business transaction.

An example of breach of trust by the officers of a corporation, who were also for all practical purposes its sole stockholders (two qualifying shares being held by their attorney), will be found in Stephens v. Allied Bldg. Credits, Inc. Plaintiff, Allied Building Credits, Inc., had obtained a default judgment on a note executed by the corporation and on return of execution "no property found" obtained an attachment of funds owed its judgment debtor by certain fire insurance companies. In the meantime, just a week before the order of attachment was issued, the two officers and stockholders had secured, through formal corporate action, the assignment to them of the corporation's claims against the insurance companies, and they claimed the right to the money owed as against the attachment of the plaintiff. The Court, however,

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40 311 Ky. 635, 224 S.W. 2d 923 (1949).
42 265 S.W. 2d 60 (Ky. 1954).
refused to recognize the validity of the assignment, and held that
the attempted transfer of the right to the insurance proceeds to
the stockholders as individuals constituted a fraud on the corpora-
tion's other creditor according to equitable standards.43

Stockholders' Suits. Ordinarily, of course, in actions involving
derelictions by corporate officials, the suit must be brought by the
corporation itself or by a stockholder in its behalf through what is
known as the stockholders' derivative suit. Failure to observe this
requirement proved fatal, along with a defect in parties defendant,
to the plaintiff stockholder's petition in Kirchdorfer v. Liberty
Nat. Bank & Trust Co.,44 which was brought by the plaintiff stock-
holder in his own name to recover from the estate of his deceased
co-stockholder an amount representing assets of the corporation
alleged to have been converted by such co-stockholder to his own
use while acting as the president and general manager of the
corporation. The Court approved the ruling of the trial court
that the action should have been brought in the name of the
corporation by the plaintiff, who was the vice-president of the
corporation, as its highest living officer.

With reference to the stockholders' derivative suit, the Court
had occasion in Graves v. Southeastern Fly Control Co.,45 to con-
firm that in such a suit it is proper to join as parties defendant
such other persons as are charged with conspiracy or participation
with the directors and officers of the corporation in the breach of
duty. And in Roush v. First Nat. Bank & Trust Co.,46 the Court,
while recognizing the general rule which requires as a condition
precedent to a derivative suit that the stockholder have made
demand on the directors to institute action, applied the exception
to this general rule where the situation is such as to excuse failure
to make demand. "Such a situation exists", said the Court, "when
it appears that a demand would be an idle, useless, and unavailing
effort because, if granted, the litigation would be in the control
of unfriendly hands."47

43 For other recent cases involving a consideration of fiduciary principles, see
Lewis & Co. v. Radford, 257 S.W. 2d 56 (Ky. 1953), and Scuddy Mining Co. v.
Mullins, 262 S.W. 2d 192 (Ky. 1953).
44 303 Ky. 446, 197 S.W. 2d 608 (1946).
45 255 S.W. 2d 635 (Ky. 1953).
46 310 Ky. 408, 220 S.W. 2d 984 (1949).
47 Id. at 413, 220 S.W. 2d at 987. The 1946 Revised Corporation Law of
Kentucky provides, as to stockholders' suits, that "The petition shall also set forth
Authority of Corporate Officers. The scope of authority of corporate officers is a familiar source of litigation in the corporate field, and such litigation more often than not involves the authority of the president. Much of this litigation turns on the application of agency law with its doctrines of express, implied, and apparent authority, although it is true there still exists difference of opinion as to whether the president is to be considered as having certain inherent powers merely by virtue of his office. But whatever difference of opinion may exist as to this question, it is agreed that the corporation through its directors and stockholders may so clothe the president with authority, or recognize and acquiesce in his actions to such an extent, as to preclude later attack on his authority to act. For example, in 20th Century Coal Company v. John P. Taylor, a suit was brought to obtain an accounting based upon an agreement entered into with the president of the defendant corporation whereby in return for plaintiff's services in locating coal fields to operate, defendant was to pay plaintiff's expenses and share with plaintiff the profits derived from the operation of the coal fields. The binding effect of this agreement on the corporation was brought into question. The Court said that while it is true that ordinarily a corporation only acts through its board of directors, it appeared from the evidence that the president was in effect the corporation and that he handled all its important business affairs. Furthermore, the corporation had accepted the benefits of the plaintiff's services. "Under the circumstances", reasoned the Court, "the corporation will not be heard to say it is not bound under the agreement made on its behalf and for its benefit." In Big Sandy Realty Co. v. Stansifer Motor Co., the authority of Ben Stansifer, the vice-president and general manager of defendant company, to enter into a binding contract with the plaintiff corporation for an advance of money for the purpose of buy-
ing and selling automobiles, was questioned. While the Court agreed with the contention of the defendant corporation that there was no proof of any actual or apparent authority for Stansifer to make the contract, it held that there was a jury question as to whether the corporation had become bound on the alleged contract by ratification through acceptance of funds with the knowledge on the part of its officers and stockholders that the money was being furnished under the contract.

IV

STOCK AND STOCKHOLDERS

Transfer of Stock. Problems of the small closely held corporation have been reaching the courts with increasing frequency and regularity in recent years. Of much concern to the stockholders in many of these corporations has been the matter of keeping ownership and control within the existing group, thereby preventing the possible intrusion of hostile outside interests. One of the most effective devices to assure a continued control by the existing group has been through the use of the stockholders' agreement in which each stockholder agrees that in case of his death or retirement from the corporation the remaining stockholders shall have a first right to purchase his shares of stock. These agreements are now usually upheld as valid as not involving unreasonable restraints on the alienation of personal property. They vary considerably, however, in their precise terms and litigation may be expected to arise concerning the meaning and enforceability of particular terms of the agreement. Such litigation occurred in connection with the stockholders' agreement entered into by the stockholders of the Southern Optical Company in *Krebs v. McDonald's Ex'r.*52 Under that agreement, in case of the death of a stockholder, the surviving stockholders were given the right to purchase the stock of the deceased stockholder at a reasonable price as fixed at the last annual meeting of the stockholders. Valuations had been made each year at the annual meeting pursuant to this agreement, but it appears the valuations never reflected closely the fluctuations in the real or actual value of the stock. McDonald, one of the stockholders, died, and his widow,

52 266 S.W. 2d 87 (Ky. 1953).
who was executrix and sole heir of his estate, refused an offer from the other stockholders to purchase the stock at $100 per share, the price as set pursuant to the agreement, but expressed a willingness to sell the stock at $175 a share, the value which had been placed upon the stock by the State Department of Revenue for inheritance tax purposes. Suit was brought to compel a sale pursuant to the agreement. The Court upheld the validity and enforceability of the agreement, emphasizing that, while the criteria for evaluating the stock were so broad as to amount in effect to a blanket grant of power to the shareholders to set the valuation at whatever they considered reasonable, there was no legal objection to this so long as they acted in good faith. Furthermore, the Court reasoned, since McDonald was one of the architects of the agreement and knew the valuations through the years did not accurately reflect actual values, his widow should not now be heard to complain.

The practical significance of participation by a stockholder in corporate action which he or his representatives later seek to question was illustrated in an entirely different setting in the case of Woodford Shannon's Co-Executors v. Shannon Spring Bed Mfg. Co. In that case suit was brought by the corporation against Shannon to require him to surrender for redemption certain preferred debenture stock which he held in the corporation. Shannon died during the pendency of the appeal, which was revived in the name of his co-executors. They contended that Shannon was not required to surrender the stock for redemption because the Articles of Incorporation did not specifically authorize the corporation to redeem, and, therefore, the resolution authorizing the redemption of the stock, as well as the conditions to that effect printed on the stock certificates, were ultra vires and of no effect. The Court rejected this contention on the ground that Shannon, and his co-executors, were estopped from asserting the ultra vires nature of the redemption provisions, since Shannon had given his consent to the resolution at the stockholders meeting and had participated actively in the action giving rise to the resolution.

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53 313 Ky. 463, 230 S.W. 2d 457 (1950).
54 See also Garvin v. Pythian Mut. Industrial Ass'n, 263 S.W. 2d 114 (Ky. 1953) (delay by stockholders of 14 years in asserting claim held to constitute laches and a bar to suit by them to set aside deed of corporate property).
The possibility for change in control which may lurk behind transfers of stock in the small corporation was exemplified in the case of *Klaproth v. Tanner.*$^{55}$ Tanner acquired 51 shares of the capital stock of the Cumberland Manufacturing Company. He later pledged this stock to secure payment of a note in the sum of $4,000. When demand was made for payment of the note, it was arranged that the stock would be released upon the payment of $3,000. Tanner claimed he borrowed the $3,000 from Klaproth and pledged the 51 shares as security for the debt. Klaproth, on the other hand, claimed he purchased the stock, and refused to return the stock to Tanner on tender of the $3,000. The Court resolved the case in favor of Tanner on the theory that the weight of the evidence sustained his contention that the transaction with Klaproth was a pledge and not a sale of the stock. The practical significance of the result is brought into sharp focus by the conclusion of the Chancellor that the motive behind Klaproth's efforts to obtain the stock was his desire to obtain control of the corporation and the statement by the Court on appeal that acquisition of the additional 51 shares by Klaproth would have given him control of the company.

**Lost Certificates.** In an action brought to compel a corporation to issue a new stock certificate to replace one alleged to have been lost, it was held in *Bringardner Lumber Co. v. Crockett's Adm'x,*$^{56}$ that the corporation could not be compelled to do this until plaintiff, administratrix of the estate of the deceased owner of the certificate, had furnished a bond as required by the Uniform Stock Transfer Act for the protection of the corporation.$^{57}$ The Court pointed out that, even before the adoption of the Uniform Act in Kentucky, a similar procedure had been required by the Court in order to obtain the reissue of certificates of stock in lieu of lost certificates, and that it seemed only fair to the corporation that such bond be executed, since otherwise the corporation might not be protected against loss should a bona fide holder later appear as holder of the old certificate. As the Court remarked:

> This statute may work a hardship on these heirs who are entitled to the stock, but certainly the responsibility

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$^{55}$ 303 Ky. 292, 197 S.W. 2d 418 (1946).
$^{56}$ 304 Ky. 324, 200 S.W. 2d 753 (1947).
of the loss of the certificate can in no way be placed upon the appellant [the corporation]. The appellant certainly has a right to ask for protection under the provisions of the statute as well as under the direction of the court.\textsuperscript{58}

**Preemptive Rights.** One of the well-recognized rights of the stockholder in his relations with his corporation is his right to purchase his proportionate share of any increase in the capital stock, commonly referred to as his preemptive right. While there are exceptions and qualifications to this right, and while the right may be restricted or even denied by provisions in the articles of incorporation,\textsuperscript{63} it still exists in many corporations as an important protection to the stockholder in maintaining his relative position in the corporation. Where a corporation offers a new issue of stock to its existing stockholders pursuant to this right, two important questions may arise as to the issuance price. One is whether the stockholder can insist that the new stock be issued at book or market value rather than at par; the other is whether the stockholder can insist that the new stock be issued at par even though the corporation desires to issue it at its book or market value. Some years ago the Kentucky Court of Appeals held, as to the first question, that a corporation could offer an additional issue of stock at par even though the book value might be greater than the par value.\textsuperscript{60} The Court said:

There is no precedent or authority whatever for requiring a corporation to sell new shares at book value to its stockholders. The almost unanimous voice of the courts and commentators is that stockholders are entitled, as a matter of right, to take these new shares at par.\textsuperscript{61}

The inference from this statement seemed to be that a stockholder could insist on the issuance of the additional stock at par even if the corporation might wish to offer it at a higher price commensurate with its book or market value. The doubt thus cast on the freedom of the corporation to set the issue price of additional stock was resolved in 1947 in the case of *McClanahan v. Heidelberg Brewing Co.*,\textsuperscript{62} in which the Court upheld the right of

\begin{itemize}
\item \textsuperscript{58} 304 Ky. at 328, 200 S.W. at 755.
\item \textsuperscript{59} See Ky. Rev. Stat. sec. 271.035(1)(f) (1953).
\item \textsuperscript{60} Scheirich v. Otis-Hidden Co., 204 Ky. 289, 264 S.W. 755 (1924).
\item \textsuperscript{61} Id. at 294, 264 S.W. at 757.
\item \textsuperscript{62} 303 Ky. 739, 199 S.W. 127 (1947).
\end{itemize}
a corporation to sell its additional stock at its market value over the objection of an existing stockholder who insisted on the right to purchase the stock at par. The Court pointed out very sensibly that good business practice would seem to justify the sale of additional stock at its market value, for in that way the old and new stockholders would be placed on the same footing.

V

Miscellaneous

Cooperative Corporations. Although the primary intent of this survey has been to review the decisions relating to the private business corporation, a brief reference to a decision pertaining to rural electric cooperative corporations organized under the Rural Electric Cooperative Act of Kentucky seems appropriate. The Warren County Electric Cooperative Corporation sought to borrow a sum of money from the United States government under the Rural Electrification Act, and authorization for its board of directors to borrow the sum was obtained at a meeting of the members of the cooperative at which a quorum was present. The vote, however, was less than a majority of the entire membership, and the question arose as to whether valid authorization had been obtained in view of the provision in the Kentucky Cooperative Act which states that the obligations of the cooperative "shall be authorized by resolution of the board of directors, after a resolution is first passed by a majority of the common stockholders giving the board that power."\(^3\) In *Warren Rural Electric Cooperative Corporation v. Harrison*,\(^4\) the Chancellor ruled that this provision of the statute was not applicable to a cooperative association such as the Warren County Association which was organized without capital stock and had no stockholders. Other applicable provisions of the statute, along with the provisions of the Articles and By-laws of the cooperative, were deemed to require only a resolution approved by a majority vote of those present and voting at that meeting. The Court of Appeals approved the ruling of the Chancellor and adopted in full his opinion as their own.


\(^4\) 312 Ky. 702, 229 S.W. 2d 473 (1950).
Foreign Corporations. Three cases involving foreign corporations may also be mentioned. In Kentucky Straight Creek Coal Co. v. Commonwealth,\textsuperscript{65} it was held that in the case of a foreign corporation which conducted business only in Bell County, it was the Bell County Circuit Court, rather than the Franklin County Circuit Court, which had jurisdiction of penal actions brought by the Commonwealth based on the doing of business by the corporation in the state without having first filed the necessary qualification papers in the office of the Secretary of State. The Court observed that the penalty provided for by the corporation statute was for doing business in the state without having first complied with the conditions precedent prescribed by the statute.\textsuperscript{66} Therefore, the offense "consists not in the failure of filing certain papers with the Secretary of State, but in doing business without having first filed them."\textsuperscript{67} Since under Section 63 of the Civil Code of Practice then in effect and made applicable to this type of proceeding by Section 11 of the Criminal Code, actions were required to be brought in the county where the cause of action, or some part thereof, arose,\textsuperscript{68} the Court concluded that there was no basis for suits by the Commonwealth in Franklin county.

In City of Winchester v. Lohrey Packing Co.,\textsuperscript{69} the Court held that a company soliciting meat orders through a local agent in Winchester was not required to aver it had qualified to do business in the state as a prerequisite to its suit to enjoin the city from enforcing a license tax on its distribution of merchandise in that city. The Court referred to previous decisions in which it had been held that the provisions of the corporation statute pertaining to qualification of foreign corporations did not apply to a company which only sent drummers or soliciting agents into Kentucky to obtain orders which were filled in a foreign state and then shipped into Kentucky.

Finally, in Big Four Mills, Limited v. Commercial Credit Co.,\textsuperscript{70} in which a foreign corporation, Commercial Credit Co., sued Big Four Mills, Ltd., a Kentucky corporation, on a written

\textsuperscript{65} 304 Ky. 247, 200 S.W. 2d 470 (1947).
\textsuperscript{67} 304 Ky. at 250, 200 S.W. 2d at 472.
\textsuperscript{68} This requirement now appears in Ky. Rev. Stat. sec. 452.405 (1953).
\textsuperscript{69} 237 S.W. 2d 868 (Ky. 1951).
\textsuperscript{70} See note 26 supra.
contract, the Court rejected a contention by defendant that since Commercial had not qualified to do business in Kentucky, it had no standing to sue. On the basis of the record, the Court did not believe Commercial could be considered as doing business in Kentucky to such an extent as to require its qualification, but went on to hold that, even if Commercial were required to qualify, its failure to do so would not forfeit its right to sue in Kentucky. The Court approved as sound previous decisions reaching a similar result, remarking that "It is not the province of the Court to penalize a foreign corporation for failure to comply with our laws where the Legislature has specifically provided criminal penalties for such violations."\(^\text{71}\)

\(^{71}\) 307 Ky. at 619, 211 S.W. 2d at 835.