**RIGHTS OF SHAREHOLDERS**

**A.VOTING RIGHTS**

1.RIGHT TO VOTE IN GENERAL--shs may generally vote for the election and removal of dirs, to amend the articles or bylaws, and on major corporate action or fundamental changes.

a)Who May Vote--the right to vote is held by shs of record as of the record date;

b)Restrictions on Right--shares may be either voting or nonvoting, or have multiple votes per share.

2.SHAREHOLDER MEETINGS--generally, shs can act only at meetings duly called and noticed at which a quorum is present.

a)Compare--informal action--statutes permit sh action without a meeting if there is unanimous written consent of all shs entitled to vote.

3.SHAREHOLDER VOTING

a)Straight Voting--this system of voting allows one vote for each share held and applies to all matters other than director elections, which may be subject to cumulative voting. Certain fundamental changes (e.g., merger) frequently require higher shareholder approval.

b)Cumulative Voting For Director--this system allows each share one vote for each director to be elected, and the votes may be cast all for one candidate or divided among candidates as the sh chooses, thereby helping minority shs to elect a dir. Cumulative voting may be mandatory or permissive.

4.VOTING BY PROXY--a proxy authorizes another person to vote a shareholder’s shares. The proxy usually must be in writing, and its effective period is statutorily limited unless it is validly irrevocable.

a)Revocability--a proxy is normally revocable by the sh at any time, although it may be made irrevocable if expressly stated and coupled with an interest in the shares themselves. Absent written notice to the corp, the death or incapacity of a sh does NOT revoke a proxy. a sh may revoke a proxy by notifying the proxy holder, giving a new proxy to someone else, or by personally attending the meeting and voting.

b)Proxy Solicitation--almost all shs of publicly held corps vote by proxy. Solicitations of proxies are regulated by the Securities Exchanges Act of 1934 Section 14a, federal proxy rules and, in some cases, state law. Federal proxy rules apply to the solicitation of all proxies of registered securities, but NOT to nonmanagement solicitation of 10 or fewer shs. The term “solicitation” is broadly interpreted by the SEC to include any part of a plan leading to a formal solicitation, e.g., inspection of shareholder list.

1)1992 amendments--the SEC revised the proxy rules to make it easier for shs to communicate with each other. Significant changes include: a safe harbor for communications that don’t involve solicitation of voting authority, relaxation of requirements involving broadcast of published communications, relaxed preliminary filing requirements for solicitations, and removing communications between shs concerning proxy voting from definition of “solicitation.”

2)Requirement of Full Disclosure--the proxy rules require full and accurate disclosure of all pertinent facts and the identities of all proxy participants, disclosure of compensation paid to certain officers and dirs, and disclosure of conflict-of-interest transactions involving more than $60, 000.

3)Inclusion of Shareholder Proposal--shareholder proposals must be included in corporate proxy materials if the proponent is a record owner or beneficial owner of at least 1% or $1000 worth of securities entitled to vote on the matter. The proposal must not exceed 500 words.

I)Exceptions--a proposal need NOT be included if it: is not a proper subject for shareholder action, would be illegal, is false or misleading, seeks redress of a personal claim, relates to operations accounting to less than 5% of the corp’s total assets and is not otherwise related to the corp’s business, concerns a matter beyond the corp’s power to effectuate, relates to ordinary business operations, relates to an election to office, is counter to a proposal submitted by the corp at the same meeting, is moot or duplicate, deals with the same subject matter as a very unsuccessful prior proposal, or relates to specific amounts of cash or stock dividends.

ii)Private right of action--a private right of action is available to a sh whose proposal was rejected by the corp on the ground that it fails within one of the exceptions.

iii)Providing shareholder lists--a sh has a right to obtain a list of shs or to have his communication included with the corporate proxy materials.

4)Remedies for violation of proxy rules--these include suit by the SEC to enjoin violations or to set aside an election and individual suits, class actions, or derivative suits by the shs (In a private suit, the P must show materiality and causation, but causation is normally presumed from materiality. Fairness to the corp is NOT a defense to a violation of proxy rules ). The court may rescind corporate action resulting from a misleading proxy solicitation or award damages.

c)Expenses Incurred In Proxy Contests--corporate funds may be used by management with respect to reasonable proxy solicitation expenses incurred in order to obtain a quorum for the annual meeting or regarding controversy over corporate policy (as opposed to a personnel controversy). The corp may, with sh approval, voluntarily pay the reasonable expenses to insurgents who win a proxy contest involving policy.

5.OTHER METHODS TO COMBINE VOTES FOR CONTROL (CLOSE CORPORATIONS)--other methods include shareholder voting agreements which may be enforced by specific performance, agreements regarding greater-than-majority approval, shareholder agreements binding the discretion of dirs, and voting trusts.

**B.RESTRICTIONS ON TRANSFER OF SHARES**--although most frequently used in close corps, stock transfer restrictions may also be imposed by larger corps (e.g., to restrict ownership to employees). The two most common types of restriction are a right of first refusal and a mandatory sell-buy provision. Restrictions must be reasonable and will be strictly construed.

a)Notice Requirements--a lawful stock transfer restriction is of no effect unless noted conspicuously on the stock certificate. If there is no such notice, an innocent transferee is entitled ti have the shares transferred to him.

**C.SHAREHOLDERS’ INFORMATIONAL RIGHTS:**

1.TYPES OF BOOKS AND RECORDS--these include shareholder lists, minutes, financial records, and business documents.

2.COMMON LAW--at CL, a sh has a right to inspect records for proper purpose.

3.STATUTES--statutes govern these rights in most states. Many statutes apply only to certain shs but are usually interpreted to supplement the common law. Most statutes preserve the proper purpose test, but place the burden on the corp to prove improper purpose.

4.PROPER VERSUS IMPROPER PURPOSES--the test is whether the sh is seeking to protect the sh interest. Multiple purposes that include a proper one usually will not preclude inspection. Generally, a sh can inspect the sh list because it is often necessary to the exercise of other rights like proxy fights, sh litigation, etc. Inspection of a sh list for proxy contest is a proper purpose. However, it has been held that corporate records cannot be examined solely for the purpose of advancing political and social views or to aid a sh as a litigant on a personal, non-shareholder claim.

5.COMPARE--MANDATORY DISCLOSURE OF INFORMATION--a sh’s inspection right is separate and distinct from the statutory requirements governing the affirmative disclosure of certain information by corps (e.g., Section 12 of Securities Exchange Act of 1934, proxy rules, state statutes).

**D.FIDUCIARY OBLIGATIONS OF CONTROLLING SHAREHOLDERS**--a controlling sh owes a fiduciary duty in his business dealings with the corp, in taking advantage of corp opportunities (rules more lenient than those applied to dirs and officers), and in causing fundamental changes.

1.ACTIONS ENTIRELY IN SHAREHOLDER CAPACITY--a controlling sh must NOT act to benefit himself at the expense of the minority shs; i.e., in a transaction where control of the corp is material, he must act with good faith and inherent fairness toward the minority.

2.OBLIGATIONS OF SHAREHOLDERS IN CLOSE CORPORATIONS--both majority and minority shs owe each other an even stricter duty (utmost good faith and loyalty) than is owed by controlling shs in publicly held corps. This duty has been interpreted to mean that there must be equal treatment of all shs, i.e., they must be afforded equal opportunities.

3.DISCLOSURE--a controlling sh must make full disclosure when dealing with minority shs.

4.SALE OF CONTROL--in most jurisdictions, a controlling sh is permitted to sell his stock at a premium, i.e, a price not available to other shs. Exceptions to these rule include a bare sale of office (invalid), the corporate action theory, sales involving fraud or nondisclosure, and knowing sales to transferees who plan to loot or deal unfairly with the corp.

**E.SHAREHOLDER SUITS**

1.DIRECT (INDIVIDUAL) SUITS--a direct suit may be brought by a sh on his own behalf for injuries to sh interests. If the injury affects a number of shs, the suit may be brought as a class action.

2.DERIVATIVE SUITS--if a duty owed to the corp has been abridged, suit may be brought by a sh on behalf of the corp.

a)Distinguish Direct From Derivative Suits--the test is whether the injury was suffered by the corp directly or by the sh, and to whom the D’s duty was owed

1)Close corporations--in some cases, minority shs have been allowed to bring a direct action against controlling shs for breach of fiduciary duty

b)Prerequisite to Suit--Exhaustion of Corporate Remedies--the P-sh must specifically plead and prove that he exhausted his remedies within the corporate structure

1)Demand on directors--the P-sh must make a demand on the dirs to remedy the wrong, unless such demand would have been futile. Note that in the absence of negligence, self-interest, or bias, the fact that a majority of dirs approved the transaction does NOT itself excuse the demand.

I)Model statutes--under both model statutes, demand should be excused only if it is shown that irreparable injury to the corp would result;

ii)Effect of rejection of demand--if the matter complained of does not involve wrongdoing by the dirs, the board’s good faith refusal to sue bars the action, unless the P-sh can raise a reasonable doubt that the board exercised reasonable business judgment in declining to sue. If the suit alleges wrongdoing by a majority of dirs, the board’s decision not to sue will NOT prevent the derivative suit.

2)Demand on shareholders--in most states, the p-sh must also make a demand on shs unless excused (e.g., the alleged wrongdoing is beyond the power of the shs to ratify). Where demand on shs is required, a good faith refusal to sue by the majority of disinterested shs will preclude the suit.

c)Qualifications of Plaintiff--a few states require the P to be a registered sh; most states also allow a beneficial owner of shares to bring suit. Also, a sh of a parent corp can bring a derivative suit on a subsidiary’s cause of action. Shs cannot complain of wrongs committed before they purchased their shares except:

1)where the P acquires shares by operation of law;

2)in section 16(b) violations;

3)where serious injustice will result;

4)where the wrong is continuing in nature.

The P must fairly and adequately represent the interests of all shs

d)Securities For Expenses--in a number of states, the P, under certain circumstances, must post a bond to indemnify the corp against certain of its litigation expenses, including attorney’s fees, in the event the P loses the suit. a p-sh who loses may also be liable for the court costs incurred by the parties.

e)Defenses--defenses to derivative suit include the SOL and equitable defenses (laches, unclean hands, etc);

f)Settlement And Recovery--any settlement or judgment belongs to the corp, absent special circumstances. Settlement or dismissal of the suit is generally subject to court approval after notice to all shs.

g)Reimbursement to Plaintiff--a victorious plaintiff may be entitled to reimbursement from the corp for litigation expenses;

h)Indemnification of Officers And Directors--indemnification issues arise when officers and dirs are sued for conduct undertaken in their official capacity. If the officer or dir wins on the merits, he may be indemnified. Most statutes also authorize the corp to advance (not pay) expenses in defending against the claim. Statutes vary where the officer or dir settles or loses; they are most liberal concerning indemnification in a third-party suit as opposed to a derivative suit.

I)Liability Insurance--in most states, a corp can obtain liability insurance for its indemnification costs and for any liability incurred by its officers in serving the corporation.