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MINORITY SHAREHOLDERS DO HAVE SEVERAL RIGHTS

Q: I own a minority share of an "S" corporation with two other stockholders. We all started as friends but now one shareholder who owns 75% of the stock runs the company with autonomy and passes no information on to the others. (1) What are my basic rights and where are they defined? (2) What is an "S" corporation required to send me? (3) Can Kentucky revoke the license to operate for failure to meet certain requirements? (4) If the 75% stockholder negotiated an agreement to buy my stock in 1995 but failed to do so, are he or the corporation liable? (5) Can the 75% shareholder rewrite the by-laws so he can act without discussion among the other shareholders?

A: Each of your questions could take a whole column to answer just on a surface level but the basic and very general answers are as follows: (1) Your rights as a minority shareholder are set out in the Kentucky Revised Statutes, Chapter 271B, your articles of incorporation, by-laws, if any, corporate resolutions, and in judicial decisions. Your rights under the statutes are minimal, but include "derivative" actions, dissenter's rights for certain specific types of corporate action entitling you to receive the "fair value" of your stock, fraud and other actions for "self dealing." Your rights under judicial decisions include many cases indicating that majority stockholders of closely held corporations owe a duty of full disclosure, good faith and diligence to protect the minority stockholders from oppression, to the point of making them fiduciaries. These cases run up against another line of cases which state that decisions, such as dividend policy, rest in the sound discretion of the board of directors and will not be interfered with unless the directors act in bad faith or willful abuse of discretion. This is obviously a very complicated area which revolves around individual fact situations.

(2) A corporation is required to keep certain documents as part of its permanent records at its principal office. Shareholders have a right to inspect and copy these required records, upon reasonable notice. When requested by a shareholder, a corporation must mail its recent financial statements. It must also send you reasonable advance notice of the statutorily required annual and other shareholder meetings, notice of certain specific corporate transactions, such as some with its own directors. Additionally, it must send you Schedule K, reflecting your share of income, credits, and deductions, since "S" corporation shareholders receive a pro

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rata (based upon their percent of stock ownership) "pass-through," for the most part, of these corporate items.

(3) All corporations are required in Kentucky to file a short and simple annual verification report with the Secretary of State and pay a minimal fee. Easy as this is, many companies are "administratively dissolved" for failure to do this, meaning they cease to exist as a legal entity. This happens when they move or the Secretary of State's Office loses contact with the corporate agent. Simply paying taxes is not enough, since the computers of the taxing authorities and the Secretary of State do not necessarily talk to each other.

(4) The answer to the stock purchase question depends upon whether the agreement was contractual (meaning both side reached a complete contract on all essential points, such as price, time frame and other conditions) and who made the offer, the corporation or the other owner. An agreement by the other stockholder only binds him. If he signed as president of the corporation, and had authority to do so, then it may very well be enforceable against the corporation.

(5) The board of directors may amend or repeal its by-laws without shareholder consent unless the articles of incorporation or then existing by-laws specify that shareholder action is necessary.

Remember that many of these issues depend upon a combination of specific facts and whether the corporation has acted to change the statutory "default" rights of shareholders. The majority stockholders have substantial but not necessarily absolute ability to dilute your stock, remove you from the board of directors, fire you as an officer or employee, reduce or eliminate your dividend from company stock, while increasing their own salary, etc. You do have the right to information and, under certain limited circumstances, the right to demand the fair value of your stock or to take legal action against the officers, directors or corporation, which is acting fraudulently or illegally. Most, if not all of these problems, could have been prevented when the company was formed, by careful drafting of the articles of incorporation, by-laws, and stock buy-sell agreement.

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