



Weekly Information Sheet 05

# Shareholder Rights

**Corporation Defined:** Black's Law Dictionary defines a "Corporation" as *"An artificial person or legal entity created by or under the authority of the laws of the state or nation, which has an existence distinct from that of its associated individuals, and has a duration that is either perpetual or for a limited term of years, and which acts as a unit in matters relating to the common purpose of the association and within the scope of the powers conferred upon it by law."*

**Principal Characteristics:** In general, corporations have the following characteristics:

- Limited Liability
- Entity Powers (Corporate Personhood)
- Centralized Management
- Continuity of Existence
- Free Transferability of Interests
- Statutory Sources of Authority
- Constitutional Status

## Corporate Finance

**Share Defined:** Black's law dictionary defines a "Share" to be:

*"One of the definite number of equal parts into which the capital stock of a corporation is divided, and which represents and equity, ownership interest in the corporation".*

**Common Stock:** "A class of stock entitling the holder to vote on corporate matters, to receive dividends after other claims and dividends have been paid, and to share in assets upon liquidation."

**Preferred Stock:** "A class of stock giving its holder a preferential claim to receive dividends and to corporate assets upon liquidation, but which carries no voting rights."

**Treasury Stock:** "Stock either issued by a corporation, but then reacquired or held, or stock authorized but unissued by the corporation."

**Shares Are Represented by Signed Certificates; Only Evidence of Share Ownership**

**Every Share of Common Stock Entitles Owner to One Vote**

**Bond Defined:** Black's law dictionary defines a "Corporate Bond" to be:

*"An interest bearing instrument containing a corporation's promise to pay a fixed sum of money to the holder at a future time."*

**Debt Securities:** The Bonds of a corporation represent its power to borrow, and are debt securities. Bonds are often freely transferable and a more permanent part of the capital structure. The issuance of Bonds is a matter within the board's discretionary power.

**Bearer Bonds v. Registered Bonds:** Bonds are negotiable securities. Registered Bonds have their owners' names and addresses recorded with the secretary of the corporation, and are payable only to that registered owner. Bearer Bonds do not have such registration, and are payable to anyone who presents them for payment.

# Corporate Finance Continued

## **Capital Structure - Generally**

**Nature of Stock:** Ownership of a corporation is represented by stock. An interest in a corporation is based on ownership of one or more shares of stock of the corporation. Each share represents a fractional interest in the total property of the corporation. The shareholder does not own or have an interest in any specific property of the corporation, because as an artificial person under the law, the corporation is the owner of all of its property [BCL Article 5].

**Capital of the Corporation:** Capital refers to the net assets of the corporation. Such assets include the monies received from stock issued to shareholders, monies from bonds issued to bondholders, profit from income from the operation of the business of the corporation, and property owned and acquired by the corporation [BCL §506].

### **Valuation of Stock:**

**Par Value:** The stock of a corporation may have a specified par value. This value is the amount per share, specified on the stock certificate, that a person subscribing to purchase it, must pay the corporation to acquire it.

**No Par Value:** Shares may be issued with no par value. In such case, no amount is stated on the certificate, and the amount that the subscriber pays the corporation is determined by the board of directors.

**Book Value:** This is the value found by dividing the value of the net corporate assets, by the total number of shares issued by the corporation.

**Market Value:** This is the value for which the stock will sell per share on the open, free market.

**Corporate Bonds:** Corporate Bonds are interest bearing instruments containing a corporation's promise to pay a fixed sum of money to the holder at a future time. They are often freely transferable and a permanent part of the corporation's capital structure. The issuance of Bonds is a matter within the board's discretionary power [BCL §518 (a)].

**Dividends:** A dividend is a pro rata payment by the corporation to equity shareholders based on corporate earnings. Dividends can take many forms, including cash, property, common shares, preferred shares, debt, even property rights. The declaration of dividends is within the discretion of the board of directors, limited by the corporation's financial and legal ability to pay [BCL §510].

## **Stock is Issued Pursuant to the Certificate of Incorporation**

**Shares are Acquired:** By either direct subscription from the corporation or from other shareholders.

**Statute of Frauds:** Pursuant to the Statute of Frauds, all contracts for the sale and purchase of shares of stock must be in writing and signed by the party to be charged.

### **Common Stock and Preferred Stock:**

**Common Stock:** Ownership of Common Stock entitles the owner to voting rights, whereby such owner can cast a vote per share to elect members of the Board of Directors.

**Preferred Stock:** This is an investment vehicle, which entitles the owner to be paid dividends first, but which generally confers no voting rights to the owner.

**Each share of common stock owned represents a fraction interest in the total property of the corporation**

### **Publicly Traded Corporations:**

**Free Transferability:** Once legally acquired, the owner of shares of stock of a publicly traded corporation, can freely transfer (sell or gift) their shares to any other natural person (over the age of 21), or corporation (including the corporation from which the shares are issued).

**Transfers on Exchanges:** Stock trades for corporations traded on exchanges (such as the New York Stock Exchange) are regulated by the Federal Securities and Exchange Commission, while stocks not available on such exchanges are regulated solely pursuant to state law (in New York – The Business Corporation Law and the Martin Act - Article 23-A of the NYS General Business Law).

# Shareholders

## Shareholders - Defined

**Shareholder Defined:** Black's law dictionary defines a "Shareholder" to be:  
"One who owns or holds a share in a corporation".

**Share Defined:** Black's law dictionary defines a "Share" to be:  
"One of the definite number of equal parts into which the capital stock of a corporation is divided, and which represents and equity, ownership interest in the corporation".

**Owners of the Corporation:** A shareholder's rights stem from their status as owners of the corporation.

**Ownership Rights:** Shareholder control over the corporation is indirect. Periodically (ordinarily once a year), the shareholders elect the corporation's board of directors (the policy making body of the corporation), and by this means control the corporation. Corporate governance is a representative, republican form of governance. The shareholders have no direct right or power to control or manage corporate activity.

**Shareholder Rights:** Shareholders of common stock have the following rights in the corporation:

- **Ownership:** The right to have a properly executed stock certificate representing their ownership interest;
- **Transferability:** The right to freely transfer their shares;
- **Voting Rights:** The right to vote their shares in the election of the Board of Directors;
- **Dividend Rights:** The right to received dividends as declared by the corporation;
- **Limited Liability:** The right to have their exposure limited to the amount paid for their stock shares; and
- **Disclosure Rights:** The right to inspect the books, records and proceeding minutes of the corporation.

## Shareholder Ownership Rights:

### Indirect Control

### Vote for Representative Governance

**Shareholder Limitations on Corporate Control:** Because of this representative system of corporate governance by the board of directors, **Shareholders cannot:**

- **Act on the ordinary business and affairs of the corporation;**
- **Represent or bind the corporation contractually;**
- **Select and remove officers (even for cause);**
- **Fix employees' compensation;**
- **Compel or overturn individual Board decisions or**
- **Have the corporation pay dividends.**

**Shareholder's rights do include the right to have a properly executed stock certificate**

**Free Transferability:** Unless limited by a valid restriction, such as a limitation in the certificate of incorporation, a shareholder has the right to transfer their shares. This share transferability also allows shareholders to transfer their shares (and attached voting rights) to an acquirer, by means of sale, gift or by means of a post death, estate transaction.

**Voting Rights:** Shareholders of common stock have the right to vote at shareholders' meetings for the election of members of the board of directors and on certain other special matters that shareholders must vote on (according to the certificate of incorporation).

**Who May Vote:** Ordinarily, only shareholders of record those common stock shareholders in whose name the stock appears on the books of the corporation (who are registered with the secretary of the corporation as the owner of the common stock shares) are entitled to vote.

### Number of Votes:

**Straight Voting:** Unless there is a provision to the contrary, for each share owned, each shareholder is entitled to one vote on each matter to be voted.

**Cumulative Voting:** To elect directors only however, *cumulative voting* is allowed [BCL §618]]. Under a cumulative voting plan, each shareholder has as many votes as the number of shares owned multiplied by the number of directors to be elected.

**Proxy Voting:** Voting Shareholders need not be present to vote but can vote by means a of a written proxy sheet. With proxy voting they can also assign their right to vote to another person.

# Shareholders Continued

## **Shareholder Rights Continued:**

**Dividend Rights:** A shareholder has the right to receive a dividend as they are declared, subject to the relative rights of other shareholders to preferences, accumulation of dividends, and participation.

**Payment of Declared Dividend:** There is no absolute right that dividends be declared.

## **Funds Must Be Available for Declaration of Dividends**

**Discretion of Directors:** It is then a matter primarily within the discretion of the board of directors whether a dividend shall be declared.

**Form of Dividends:** Customarily, a dividend is paid in money. However, it may be paid in property, such as a product manufactured by the corporation, in shares of other corporations held by the corporation, or in shares of the corporation itself.

**Limited Liability:** Shareholders generally have the right to have their investment exposure limited to the amount paid for their stock shares. This is known as limited liability.

**Meaning of Limited Liability:** Limited Liability means that the shareholder is not personally liable for the debts and liabilities of the corporation. As a result no personal liability will be placed on the shareholders.

**The Effect of Limited Liability:** The concept of limited liability has become one of the essential elements of the modern business corporation. Being able to limit the exposure from one's investment has served as a magnet for the raising of capital, and has resulted in the extreme popularity of the corporation.

## **Beyond the Limits of Limited Liability:**

**Piercing the Corporate Veil:** Under certain limited circumstances a shareholder can be held liable for the actions of a corporation, under the legal doctrine known as "**piercing the corporate veil**" The factors under which liability applies pursuant to this doctrine include:

- **Failure to maintain adequate corporate records.**
- **Commingling of assets.**
- **Grossly inadequate capitalization.**
- **Diversion by shareholders of corporate funds or assets.**
- **Formation of the corporation to avoid existing obligations or commit fraud.**
- **Injustice would result if the corporate entity were recognized.**

**Special Circumstances:** Under very special circumstances, the top 10 shareholders of common stock of a corporation can also be held personally liable for wage claims, unpaid subscriptions, and unauthorized dividends. Additionally, a Professional Corporation cannot be created to avoid liability for malpractice.

**Disclosure Rights:** In accordance with the Business Corporation Law, Shareholders of Common Stock of a corporation have the right to inspect the books, records and proceeding minutes of the corporation.

**What May Be Inspected:** Each corporation must keep correct and complete books and records of account and shall keep minutes of the proceedings of its shareholders, board and executive committee, a record containing the names and addresses of all shareholders, the number and class of shares held by each, and the dates when they respectively became the owners of record thereof.

**Reason for Inspections/Disclosure:** A shareholder is entitled to inspect the records to determine the financial condition of the corporation, the quality of its management, and any matters relating to rights or interests in the corporate business, such as the value of stock.

**Financial Statements:** The Business Corporation requires a corporation to produce and furnish annual financial statements. These statements include a balance sheet at the end of the fiscal year, an annual income statement, and a statement of changes in shareholders' equity for that year.