



Shareholder Rights

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Background

Investors who purchase [CORPORATE](#) stock enjoy a number of rights pertaining to their ownership. Unlike partnership law, where the owners of businesses are also the primary managers of the businesses, owners of a corporation generally do not run the company. Shareholders in a corporation are shielded from personal liability for the debts and obligations of the corporation. However, shareholders can lose their investments should the corporation fail.

Laws governing [CORPORATIONS](#) in the United States are fairly standard from one state to the next. The commissioners on uniform state laws drafted the Uniform Business Corporations Act in 1928, though only three states adopted this act. The American **BAR ASSOCIATION** in 1950 drafted the Model Business Corporation Act, which subsequently has been modified numerous times. The last major redrafting occurred in 1984. Thirty-one states have adopted all or a significant portion of the Model Act. Other states have modified their own state corporation statutes to contain sections similar to the Model Act. Delaware's corporation [STATUTE](#) is also significant, since most large, public corporations are incorporated in that state.

The rights of shareholders depend largely on provisions in a corporation's charter and by-laws. These are the first documents which a shareholder should consult when determining his or her rights in a corporation. Shareholders also generally enjoy the following types of rights:

- Voting rights on issues that affect the corporation as a whole
- Rights related to the assets of the corporation
- Rights related to the transfer of stock
- Rights to receive dividends as declared by the board of directors of the corporation
- Rights to inspect the records and books of the corporation
- Rights to bring suit against the corporation for wrongful acts by the directors and officers of the corporation
- Rights to share in the proceeds recovered when the corporation liquidates its assets

Ownership of Stock

The two broad types of financing available to a corporation include equity financing and debt financing. Equity financing involves the issuance of stock, which investors purchase and which represent a share in the ownership of the corporation. The two basic types of stock are [COMMON STOCK](#) and [PREFERRED STOCK](#). Debt financing involves a loan of money from an investor to the corporation in exchange for debt [SECURITIES](#), such as a bond. Holders of debt securities generally do not enjoy the same rights as shareholders in terms of voting rights, participating rights, or other rights related to the ownership of stock.

Common Stock

The lowest level of stock in a corporation is common stock. The rights related to common stock depend largely on the [ARTICLES OF INCORPORATION](#) and by-laws of the corporation. In general, owners of common stock have voting rights in a corporation as well as rights to receive distributions of money from the corporation (dividends). In a successful corporation, common stock ownership can be very lucrative. However, if a corporation is unsuccessful, common stock owners are usually the last in line to receive a distribution of the corporation's assets when the corporation's assets are liquidated.

State statutes often vary with respect to the [DEFAULT](#) rights of common stock owners. The corporation may also issue multiple classes of common stock, such as nonvoting common stock or common stock with special [DIVIDEND](#) rights.

Preferred Stock

Unlike common stock, holders of preferred stock are entitled to fixed dividends and fixed rights to receive a percentage of a corporation's assets are liquidated. With respect to the dividend rights, an example of such stock would include a name such as "\$20 preferred," which means the shareholder has a right to receive \$20 in dividends per share before dividends are paid to common stock owners.

It is noteworthy that the board of directors in a corporation usually has the discretion to decide whether dividends are issued in a given year. If dividends are not distributed during one year, whether preferred stock owners receive dividends in a subsequent year depends on whether the preferred stock is cumulative or noncumulative. If the rights are cumulative, the corporation must be dividends during some subsequent year. If the rights are noncumulative, the rights to receive dividends are lost if the corporation does not issue dividends in a given year.

Preferred stock owners generally do not have the same rights to vote as common stock owners. However, a corporation may grant voting rights and additional rights in its articles of incorporation or other provisions. State statutes also provide some rights to preferred stock owners by default.

Bonds and Debentures

Corporations may seek to borrow money in addition to (or in lieu of) issuing stock. One method for borrowing money is to exchange the loan for a debt security that can be traded on a public market. **BONDS** are long-term debt securities that are secured by corporate assets. Debentures are unsecured debt securities. Owners of debt securities generally do not enjoy the same types of rights are owners of stock. However, a corporation may grant voting rights to the owners of debt securities. These owners may also have the right to redeem debt securities in exchange for stock.

Shareholder Meetings and Voting Rights

Shareholders hold general meetings on an annual basis or at fixed times according to the by-laws of the corporation. The primary purpose of these meetings is for shareholders to elect the directors of the corporation, though shareholders may also vote on a number of additional issues. Persons with authority to do so may also call special meetings on matters that require immediate attention, though only those issues set forth in the notice of the special meeting may be the subject of the vote.

A quorum must be present at the shareholder meeting for a decision to be binding. The typical quorum consists of more than half of the outstanding shares of the corporation. This percentage may be increased or decreased in the by-laws of the corporation. Prior to each shareholder meeting, a list of shareholders eligible to vote must be prepared. Shareholders have the right to inspect the voting list at any time.

Shareholders may appoint proxies to vote their shares, which is common in publicly-held corporations. Most states prescribe few specific rules with respect to the proxy appointment, other than the issue of whether this appointment may be revoked. Proxy appointments must be in writing, and the proxy does not need to be a fellow shareholder. Since the relationship between the shareholder and the proxy is one of principal and agent, the proxy must abide by the instructions of the shareholder.

Shareholders by unanimous consent may conduct business without holding a shareholder meeting. Such actions are more common in closely held corporations, where shareholder actions are typically unanimous. In a larger, publicly held corporation, such actions are much less practical, especially because decisions of the shareholders affect a larger number of people.

Matters upon which shareholders vote, in addition to the election of the directors, depend on the issues affecting the corporation. The following are the most significant of these matters.

- Approval or disapproval of changes in the articles of incorporation
- Approval or disapproval of a merger with another corporation
- Approval or disapproval of the sale of substantially all of the corporation's assets that is not in the ordinary course of the corporation's business
- Approval or disapproval of the voluntary [DISSOLUTION](#) of the corporation
- Approval or disapproval of corporate transactions where some directors have a conflict of interest
- Approval or disapproval of amendments to [BYLAWS](#) or articles of incorporation
- Make nonbinding recommendations about the governance and management of the corporation to the board of directors

Shareholder Rights, Actions, and Liabilities

As noted above, many of the rights afforded to shareholders are contained in each corporation's articles of incorporation or bylaws. It is also noteworthy that shareholders generally do not have the right to vote on management issues that occur in the ordinary course of the corporation's business. Many decisions of the corporation must be made by the board of directors or officers of the corporation, and in most cases, shareholders may not compel the board or officers to take or refrain from taking any action.

Shareholder Direct Litigation

Shareholders can protect their ownership rights in their shares by bringing a direct action against a corporation. Such cases may involve contract rights related to the shares; rights granted to the shareholder in a

statute; rights related to the recovery of dividends; and rights to examine the books and records of a corporation. Some cases are not appropriate for direct actions by a shareholder against a corporation, however. For example, a shareholder may not bring a direct action against a corporation by alleging that an officer has breached a [FIDUCIARY](#) duty owed to the corporation. Such a case involves all shareholders and is more appropriate as a derivative action. By comparison, a shareholder may bring a direct action if he or she has been prevented from voting his or her shares in a vote.

Shareholder Derivative Litigation

Shareholders may bring suit as representatives of the corporation in a derivative action. Such an action is designed to prevent wrongdoing by the officers or directors of the corporation or to seek a remedy for such wrongdoing. These suits are generally brought when the corporation itself (through its officers and directors) refuses to bring suit itself. A party bringing a derivative suit acts as a representative of an appropriate class of shareholders, and in the action the shareholders enforce claims that would be appropriate between the corporation and the officers and directors of the corporation. For example, if the officers of the corporation have breached a fiduciary duty owed to the corporation, shareholders may bring a derivative action to protect the interests of the corporation on behalf of the corporation. While these actions in many cases protect the rights of the corporation and shareholders of the corporation, these actions are often controversial. Shareholders should study the procedural and substantive provisions of state statutes to determine whether the action is appropriate and determine which formalities should be followed with respect to these actions.

Shareholder Preemptive Rights

Corporations retain the right to issue new shares of stock, which could dilute the ownership of existing stockholders. Existing shareholders often hold preemptive rights, which allow the shareholders to purchase these new shares of stock before they are made available to the public. Thus, if a shareholder owns 10 percent of a corporation, and the corporation issues new stock, the shareholder would own less than 10 percent if he or she did not purchase new stock. If the shareholder exercises preemptive rights, he or she may purchase as many new shares as necessary to retain that 10 percent interest.

Shareholder Liabilities

As the owners of a limited liability entity, shareholders are generally shielded from personal liability for claims against the corporation. Thus, if a corporation incurs a debt or obligation against it, creditors cannot recover the personal assets of the shareholders. However, the average life of a corporation in the United States is only seven years, and more than half fail before seven years have elapsed. A shareholder can lose his or her entire investment if the corporation fails.

Transfer of Stock Ownership

Securities Laws

Federal and state securities laws govern the distribution and exchange of stock in a corporation. Many of these laws are designed to avoid [FRAUD](#) by the corporation to the detriment of prospective or existing shareholders, so shareholders should consult relevant securities laws if they believe they have been defrauded in the sale or exchange of stock. The sale and exchange of stock through electronic media have provided new methods for defrauding investors, and new securities laws have been enacted in the past ten years to address these issues.

Conversion Rights

Owners of one type of stock may want, at some point, to convert their stock to a different type of stock in the same corporation, rather than sell the stock outright. For example, an owner of preferred nonvoting stock may want to own common stock that has voting rights. If the shareholder has conversion rights, he or she may convert the preferred stock for the common stock. These rights can, and often are, limited by the corporation.

Redemption Rights

Shareholders may also possess redemption rights, which permit the shareholders to redeem their stock to the corporation for a value specified in the articles of incorporation or set by the board. In other words, the shareholder can demand that the corporation repurchase the shareholder's stock. This right may be limited by the corporation.

Sharing Proceeds Upon Liquidation of Corporate Assets

When a corporation dissolves, one of its first actions is the [LIQUIDATION](#) of corporate assets. Creditors of the corporation are the first to be paid with the funds received from the liquidation. Owners of debt securities are also paid before shareholders. Once these debts are paid, the remainder is paid to the stockowners. Preferred stock is paid before common stock. Some preferred stock includes a liquidation preference that fixes a price per share of preferred stock. If preferred stock includes this preference, it must be paid before the corporation pays any amount to the common stock. Common stock owners do not have any special liquidation rights and will receive assets on dissolution only after senior claims have been paid.

State Laws Governing Shareholder Rights

Since the majority of states have adopted the Model Business Corporation Act, shareholder rights are generally consistent from one state to the next. State statutes should be consulted to determine whether an individual state has granted any specific rights to shareholders of businesses incorporated in that state.

ALABAMA: Alabama statute is based on the Model Business Corporation Act. Shareholders are granted preemptive rights in the statute. Shareholders may bring derivative actions for fraud, dishonesty, or gross abuse on the part of the directors. Holders of 10 percent of the votes may call a special meeting.

ALASKA: A shareholder may bring a derivative action on behalf of the corporation. Each record shareholder is entitled to written notice of meetings.

ARIZONA: Arizona statute is based on the Model Business Corporation Act. Corporations must provide shareholders with a stock certificate upon request. Shareholders may petition for a special meeting.

ARKANSAS: Arkansas statute is based on the Model Business Corporation Act. Shareholders are entitled to notice of annual and special shareholder meetings. The statute grants preemptive rights to shareholders.

CALIFORNIA: The statute provides special rights to shareholders who dissent to corporate reorganization or merger.

COLORADO: Colorado statute is based on the Model Business Corporation Act. Statute provides special rules regarding entitlement to voting with respect to fractional shares. The statute provides specific rules

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regarding derivative actions.

CONNECTICUT: The articles of incorporation of a corporation must provide preemptive rights. The statute governs derivative suits brought by shareholders.

DELAWARE: The statute provides specific rules regarding derivative actions. The statute prescribes specific rules shareholder meetings and voting, including voting agreements and voting by proxy.

DISTRICT OF COLUMBIA: The statute is based on the Model Business Corporation Act. The statute permits derivative actions brought by shareholders, and prescribes specific rules for such actions.

FLORIDA: Florida statute is based on the Model Business Corporation Act. The statute permits derivative actions and prescribes specific rules for such actions. The statute prescribes specific rules for voting by shareholders, including voting trusts and voting agreements.

GEORGIA: Georgia statute is based on the Model Business Corporation Act. The statute does not provide preemptive rights to shareholders, except those in close corporations or in those corporations in existence prior to July 1, 1989. The statute permits derivative actions by shareholders.

HAWAII: Hawaii statute is based on the Model Business Corporation Act. The statute provides preemptive rights to shareholders. The statute permits derivative actions by shareholders and prescribes specific rules for such.

IDAHO: Idaho statute is based on the Model Business Corporation Act.

ILLINOIS: The statute permits derivative actions by shareholders. The statute requires vote of shareholders to approve mergers, acquisitions, and other significant and fundamental changes in the corporate structure.

INDIANA: Indiana statute is based on the Model Business Corporation Act. The statute restricts preemptive rights, except those provided under prior law. Shareholder derivative action is permitted, subject to some restrictions. The statute permits the creation of a disinterested committee of the corporation to consider a derivative action.

IOWA: The statute does not provide preemptive rights, which may only be granted by the articles of incorporation. The statute provides specific rules regarding shareholder meetings and shareholder voting.

KANSAS: The statute provides specific rules regarding derivative actions. The statute prescribes specific rules shareholder meetings and voting, including voting agreements and voting by proxy.

KENTUCKY: Kentucky statute is based on the Model Business Corporation Act. The statute permits derivative actions by shareholders and provides specific rules regarding representation of the corporation's rights.

LOUISIANA: The statute does not provide preemptive rights, which may only be granted in the articles of incorporation. The statute provides specific rules regarding shareholder meetings and voting, including the creation of voting trusts.

MAINE: Maine statute is based on the 1960 version of the Model Business Corporation Act. The statute grants limited preemptive rights in some circumstances. The statute permits derivative actions and prescribes specific rules regarding such actions.

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MARYLAND: Maryland statute is based on the Model Business Corporation Act. The statute prescribes specific rules regarding shareholder meeting and voting, including voting by proxy.

MASSACHUSETTS: The statute does not provide preemptive rights to shareholders. The statute permits derivative suits by shareholders under appropriate circumstances.

MICHIGAN: Shareholders are permitted to bring an action to establish that the acts of directors or other managers are illegal, [FRAUDULENT](#), or willfully unfair or oppressive to the shareholders or corporation. The statute sets forth detailed rules regarding shareholder meetings and voting, including voting without a meeting and voting trusts.

MINNESOTA: The statute sets forth detailed rules regarding shareholder meetings and voting and the rights of shareholders to inspect the books and records of the corporation.

MISSISSIPPI: Mississippi statute is based on the Model Business Corporation Act.

MISSOURI: The statute permits shareholders to bring suit to enjoin ultra vires acts. The statute provides detailed rules regarding shareholder meetings and voting, including voting trusts.

MONTANA: Montana statute is based on the Model Business Corporation Act. The statute provides specific rules regarding shareholder meetings and vot-ing, including a provision that permits shareholders to participate by telephone if the corporation consists of 50 or fewer shareholders.

NEBRASKA: Nebraska's statute is based on the Model Business Corporation Act.

NEVADA: The statute provides specific rules regarding shareholder meetings and voting, including voting trusts.

NEW HAMPSHIRE: New Hampshire statute is based on the Model Business Corporation Act.

NEW JERSEY: Statute does not provide preemptive rights for shareholders. The statute permits derivative suits subject to some restrictions, and provides specific rules regarding shareholder meetings and voting, including voting trusts and voting by proxy.

NEW MEXICO: New Mexico statute is based on the Model Business Corporation Act. The statute permits shareholder derivative suits, subject to some restrictions.

NEW YORK: In some limited circumstances, majority shareholders may incur personal liability for corporation's debts. The statute provides detailed rules regarding shareholder meetings and voting, including voting trusts.

NORTH CAROLINA: North Carolina statute is based on the Model Business Corporation Act. Shareholders under current statute do not have preemptive rights. The statute provides detailed rules regarding shareholder meetings and voting, including voting trusts and voting by proxy.

NORTH DAKOTA: Shareholder meetings are held on an annual or other periodic basis, but do not need to be held unless required by the articles of incorporation or the by-laws. A shareholder with more than 5 percent of voting power may demand a meeting.

OHIO: The statute permits derivative actions brought by shareholders. Shareholders provide detailed rules regarding shareholder meetings and voting, including voting trusts.

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OKLAHOMA: The statute permits derivative actions brought by shareholders. Statute and provides detailed rules regarding shareholder meetings and voting, including voting trusts.

OREGON: Oregon statute is based on the Model Business Corporation Act. The statute provides detailed rules regarding shareholder meetings and voting, including voting trusts.

PENNSYLVANIA: The statute permits derivative actions brought by shareholder and provides detailed rules regarding these actions. The statute provides detailed rules regarding shareholder meetings and voting, including voting trusts.

RHODE ISLAND: Rhode Island statute is based on Model Business Corporation Act. The statute permits derivative actions brought by shareholders and provides some limitation for voting trusts and shareholder agreements.

SOUTH CAROLINA: South Carolina statute is based on the Model Business Corporation Act. The statute provides detailed rules on shareholder meetings and voting, including voting trusts and voting by proxy.

SOUTH DAKOTA: South Dakota statute is based on the Model Business Corporation Act.

TENNESSEE: The statute contains special rules regarding derivative actions brought by shareholders.

TEXAS: The statute permits shareholder agreements, subject to a number of restrictions and provides detailed rules regarding shareholder meetings and voting, including voting trusts.

UTAH: Utah statute is based on the Model Business Corporation Act. The statute provides detailed rules regarding shareholder meetings and voting, including voting entitlement, voting trusts, voting agreements, and other shareholder agreements.

VERMONT: The statute does not provide preemptive rights to shareholders. The statute provides specific rules regarding voting trusts and voting by proxy and permits derivative actions brought by shareholders.

VIRGINIA: Virginia statute is based partially on the Model Business Corporations Act. The statute provides preemptive rights to shareholder by default. Statute and permits derivative actions brought by shareholders.

WASHINGTON: Washington statute is based on the Model Business Corporations Act. The statute provides preemptive rights to shareholders by default.

WEST VIRGINIA: The West Virginia statute is based primarily on the Model Business Corporation Act. The statute provides detailed rules regarding shareholder meetings and voting, including voting trusts.

WISCONSIN: The statute does not provide preemptive rights to shareholders. Statute and provides detailed rules regarding shareholder meetings and voting, including voting by proxy and voting trusts.

WYOMING: Wyoming's statute is based on the Model Business Corporations Act.

Additional Resources

The Active Shareholder: Exercising Your Rights, Increasing Your Profits, and Minimizing Your Risks.
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Organizations

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