Approved April 8, 1988
Date

MINUTES OF THE SENATE COMMITTEE ON JUDICIARY.

The meeting was called to order by Senator Robert Frey at
Chairperson

9:30 a.m./~~p~~x~~x~~ on April 6, 1988 in room 514-S of the Capitol.

~~All~~ members ~~were~~ present ~~except:~~ Senators Frey, Hoferer, Burke, Langworthy, Parrish, Steineger, Talkington, Winter and Yost.

Committee staff present:

Gordon Self, Office of Revisor of Statutes
Mike Heim, Legislative Research Department
Jerry Donaldson, Legislative Research Department

Conferees appearing before the committee:

Representative Joan Adam
Rita Noll, Assistant Attorney General
Bill Graves, Secretary of State
Dan Rice, Secretary of State Legal Counsel
Merlin Wheeler, Kansas Bar Association
Gerhard Metz, Kansas Chamber of Commerce and Industry
Jack Glaves, K N Energy in Phillipsburg
John Reiff, Coleman Company, Wichita
T. C. Anderson, Kansas Society of Certified Public Accountants
Belva Ott, Dunn and Bradstreet

House Bill 3049 - Supreme court nominating commission shall not be subject to the Kansas open meetings act.

Representative Joan Adam testified this bill would ensure that the same procedure is kept that has been used. We have had a very good process in the last few years in interviewing people. We feel it is important to keep that process. During committee discussion Representative Adam responded if it is a judicial function, we would not be subject to the open meetings law. A copy of her handout is attached (See Attachment I).

Rita Noll, Assistant Attorney General, testified the attorney general supports the bill. She stated if this legislative action is not taken, the meetings of the Commission will be subject to the Kansas Open Meetings act. A copy of her handout is attached (See Attachment II).

Senator Talkington moved to report the bill favorably. Senator Steineger seconded the motion. The motion carried.

House Bill 3018 - Cumulative voting in corporations.

Bill Graves, Secretary of State, asked the committee to consider including House Bill 3019 and House Bill 3021 in House Bill 3018. He said House Bill 3018 is the only bill that has remained in the House, the other two bills didn't make it. A committee member inquired if there is some purpose to be served having this information? Secretary Graves replied there are a number of people who come into our office besides Dunn and Bradstreet, to research on corperations to see if they exist on paper. The information is used.

Dan Rice, Secretary of State Legal Counsel, testified although the Secretary of State has no position on House Bill 3018, our

MINUTES OF THE SENATE COMMITTEE ON JUDICIARY,

room 514-S, Statehouse, at 9:30 a.m./~~p.m.~~ on April 6, 1988

House Bill 3018 continued

office would like the committee to consider amending the bill to contain the provisions of House Bill 3019 and House Bill 3021, with a few minor amendments. Attached are a list of minor changes to House Bill 3021 that are necessary before adding the provision to House Bill 3018. The changes are primarily technical except for the deletion of sections 45 and 46. Copies of his testimony are attached (See Attachment III).

Merlin Wheeler, Kanss Bar Association, testified I believe that the current economic climate not only justifies but requires the passage of House Bill 3018 as a protective device to ensure the rights of corporate shareholders in Kansas and to ensure that Kansas remains competitive in the market place for the organization of new business enterprises. I strongly urge your passage of the bill. A copy of his testimony is attached (See Attachment IV).

Mr. Wheeler also testified on House Bill 3021. He stated the work performed by the Secretary of State's office is comprehensive in all respects and was not undertaken lightly. In my opinion, the further deferral of this legislation will not necessarily result in the opportunity for additional input and will certainly not serve the interests of the State of Kansas. Deferral of this legislation further will be amove away from that goal. He said he had no problems with the amendments proposed by the secretary of state. A copy of his testimony is attached (See Attachment V).

Gerhard Metz, Kansas Chamber of Commerce and Industry, appeared in support of the bill. He testified it is worth pointing out that this bill merely allows a corporation not to have cumulative voting. It does not mandate abolition of existing cumulative voting rights, nor does it forbid the according of those rights where they are deemed to be appropriate, or consonant with the desires of the shareholders of the corporation in question. A copy of his testimony is attached (See Attachment VI).

Jack Glaves, K N Energy in Phillipsburg, testified the majority of the states do not have cumulative voting. Corporate debt has tripled in the last 10 years. This represents 40% of the gross national product of this country. K N has been the subject of a takeover attempt by an out-of-state firm that is principally engaged in gas production. He referred the committee to the statement of Lloyd Culbertson and copies of newpaper clippings he submitted (See Attachments VII).

Dan McGee, Centel Electric-Kansas, testified giving corporations the option, instead of imposing upon them a voting system which has been increasingly rejected in modern American corporate law, would be consistent with the basic policy objectives and fundamental interests of Kansas in a fair and flexible corporate law. A copy of his testimony is attached (See Attachment VIII). He requested the committee to amend the bill the effective date be publication in the Kansas Register.

John Reiff, Coleman Company, testified my company supports House Bill 3021 and House Bill 3018 . There is no good argument against permitting a company to have its shareholders determine whether they want cumulative voting. The main use of cumulative voting today is as additional leverage for corporate greenmailers. A copy of his testimony is attached (See Attachment IX).

MINUTES OF THE SENATE COMMITTEE ON JUDICIARY,

room 514-S, Statehouse, at 9:30 a.m./pxx. on April 6, 1988

House Bill 3018 continued

T. C. Anderson, Kansas Society of Certified Public Accountants, testified Section 806 of the Federal Tax Reform Act of 1986 reuired most partnerships, personal service corporations and S corporations to conform their taxable years to those of their owners, forcing many of these entities to switch from a fiscal to calendar year beginning in 1987. Many Kansas business owners are being forced to file the short year reports with the Secretary of State's Office for a period ending after November 30, 1987. He urged favorable consideration of the amendment which would permit these affected Kansas businesses to prorate their annual franchise tax. A copy of his testimony is attached (See Attachment X).

Belva Ott, Dunn and Bradstreet, appeared in support of the changes requested by the secretary of state. She testified we will continue to do business. How many states are closed and how many are open, I don't honestly know. Missouri is open with the secretary of state's office. Arizona did close their records for one year and had so many corporations who came in that they opened. There are a large number of companies here in Kansas who want to keep this open.

The chairman recognized John Reiff and he stated the legislative committee of the Chamber of Commerce in Wichita also support House Bill 3018 and House Bill 3021.

The hearings on House Bill 3049 and House Bill 3018 were concluded.

Following consideration of House Bill 3018, Senator Burke moved to amend the bill by amending in House Bill 3019 and House Bill 3021, with the proposed amendments of the secretary of state; also include changing effective date to the Kansas Register. Senator Yost seconded the motion. The motion carried.

Copies of a proposed amendment and the attorney general's opinion regarding corporations had been handed out to the committee members. The chairman explained this proposed amendment would create another exemption of the corporate code. It has everything in it that the other bill had including Senator Montgomery's amendments. Senator Burke moved to adopt the proposed amendment. Senator Langworthy seconded the motion. The motion carried. Senator Burke moved to report the bill favorably as amended. Senator Hoferer seconded the motion. The motion carried. Copies of the proposed amendment and the attorney general's opinion are attached (See Attachments XI).

The meeting adjourned.

A copy of the guest list is attached (See Attachment XII).

GUEST LIST

COMMITTEE: SENATE JUDICIARY COMMITTEE DATE: 4-6-88

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
[illegible]	Topeka	[illegible]
Ivan L. Brauer	Wichita	The Coleman Co.
Vicky Reiff	Wichita	—
Tom Taylor	Topeka	KPL Gas Service
DAN McGEE	GREAT BEND	CENTEL ELECTAIC
Merlin G. Wheeler	Emporia	Kansas Bar Ass'n & Western Fin. Corp.
John Reiff	Wichita	Coleman/Wichita Chamber
Ch Chamberland	Topeka	KS Soc CPA
Tom Vack	Topeka	KSCPA
T.C. Coleman	Topeka	KSCPA
Jack Glaves	Wichita	KN Energy
Rita Noll	Topeka	Atty Gen.
GERHARD METZ	TOPEKA	KCCI
S. Steeff	Topeka	AP
Rick Kready	Topeka	KPL Gas Service
Jerry Typer, Jr.	Topeka	observer
Bill Sparr	Topeka	Sec. of State
Mark B. Rice	Topeka	SOS
M. Haaver	"	Cap-Journal
Bud Grant	"	KCCI
Ron Smith	"	KBA

Att. XII

FEB 10 1988

STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

February 9, 1988

MAIN PHONE (913) 296-2215
CONSUMER PROTECTION: 296-3751

The Honorable Marvin Barkis
House Minority Leader
State Capitol, Room 327-S
Topeka, Kansas 66612

Dear Representative Barkis:

The purpose of this letter is to inform you of a situation that has come to my attention on which you may wish to take legislative action. I am directing this letter to the majority and minority leaders of the Senate and House of Representatives. As you may know, upon a recent inquiry to this office I stated that it appears the Supreme Court Nominating Commission in selecting nominees for judges of the Court of Appeals is subject to the provisions of the Kansas Open Meetings Act.

The Kansas Open Meetings Act (KOMA), K.S.A. 75-4317 et seq., provides that, unless otherwise exempted by law or by rules of the house or senate, all meetings of public bodies must be open to the public. Public bodies include "all legislative and administrative bodies and agencies of the state and political and taxing subdivisions thereof, including boards, commissions, authorities, councils, committees, subcommittees and other subordinate groups thereof, receiving or expending and supported in while or in part by public funds . . . ." K.S.A. 1987 Supp. 75-4318(a).

We were asked in 1982 whether the KOMA is applicable to the Supreme Court Nominating Commission (Commission). In Attorney General Opinion No. 82-254 we noted that by its terms the KOMA does not cover judicial bodies. However, we stated that the functions of the Commission are not judicial in character as the process of nominating three candidates to submit to the Governor is an executive function. Even though the Commission meets both tests of a public body, we concluded that "the legislature is without authority to dictate to the Commission the manner of its operation since the Commission derives its powers directly from the people through the Constitution." (A.G. Opin. No. 82-254, p. 2).

Att. I

The procedure for the selection of justices to the Kansas Supreme Court is provided in Article 3, Section 5, of the Kansas Constitution. The Supreme Court Nominating Commission is created in this section as follows:

> "(d) A nonpartisan nominating commission whose duty it shall be to nominate and submit to the governor the names of persons for appointment to fill vacancies in the office of any justice of the supreme court is hereby established, and shall be known as the 'supreme court nominating commission.' Said commission shall be organized as hereinafter provided."

Paragraph (e) specifies the composition of the Commission's membership. The legislature's powers are enumerated in paragraph (f) as follows:

> "The terms of office, the procedure for selection and certification of the members of the commission and provision for their compensation or expenses shall be as provided by the legislature." (Emphasis added).

① term ② selection and certification ③ compensation

The legislature has authority over the Commission only in the three areas specified in paragraph (f). No mention is made in the Constitution of legislative authority over the operations or procedures of the Commission. Therefore, in Attorney General Opinion No. 82-254 we concluded that, in exercising its constitutional duties, the Commission is not subject to the KOMA as the legislature is without authority to impose such requirements on the Commission.

The Kansas Court of Appeals was created by legislative act in 1975 (L. 1975, ch. 178), and came into being on January 10, 1977. K.S.A. 20-3001 et seq. (The Constitution in Article 3, § 1 gives the legislature authority to establish courts.) K.S.A. 20-3004 provides that "the supreme court nominating commission established by section 5 of article 3 of the constitution of the state of Kansas shall nominate persons to serve as judges of the court of appeals. . . ." (Emphasis added). The legislature also gave the Commission the duty to nominate judges to fill vacancies and to fill new positions created by court expansion. K.S.A. 20-3004; K.S.A. 1987 Supp. 20-3005; K.S.A. 20-3007.

Since the Commission is a constitutional body, and the only duty of the Commission under the Constitution is to nominate Supreme Court justices, I question whether the legislature has authority

to impose a statutory duty on the Commission to nominate judges of the Court of Appeals. While it seems that the legislature cannot mandate the Commission to perform this function, the commission has accepted this duty the eleven years the Court of Appeals has been in existence.

In contrast to our 1982 opinion that the Commission is not subject to the KOMA while performing its constitutional function, it appears that Commission meetings must comply with the open meetings law when performing those duties imposed by statute. The constitutional reasons for KOMA exemption when nominating Supreme Court justices do not extend to the Commission when nominating Court of Appeals judges, as the latter selection process is provided by statute, not the Constitution. Since the Commission is performing a statutory function in nominating judges, the Commission must comply with all applicable statutory requirements.

The Commission is a public body as defined in the KOMA because its functions are administrative and it expends public funds. See K.S.A. 20-136; 20-137; 20-138. Our research has not revealed any law which exempts meetings of the Supreme Court Nominating Commission concerning the selection of nominees of judges of the Court of Appeals from the open meetings law. Therefore, I am taking the position that, absent any legislative action this session creating a specific exemption, such meetings of the Commission are subject to the Kansas Open Meetings Act.

Very truly yours,

Bob Stephan

ROBERT T. STEPHAN
ATTORNEY GENERAL OF KANSAS

RTS:RLN:bas
cc: Chief Justice David Prager
Supreme Court

Chief Judge Bob Abbott
Court of Appeals

Robert C. Foulston
700 4th Financial Center
100 N. Broadway
Wichita, Kansas 67202

Howard Schwartz
Judicial Administrator

Mary Galligan
Legislative Research Department

4-6-88
AG

STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

MAIN PHONE: (913) 296-2215
CONSUMER PROTECTION: 296-3751

February 9, 1988

The Honorable Robert Talkington
President of the Kansas Senate
State Capitol, Room 359-E
Topeka, Kansas 66612

Dear Senator Talkington:

The purpose of this letter is to inform you of a situation that has come to my attention on which you may wish to take legislative action. I am directing this letter to the majority and minority leaders of the Senate and House of Representatives. As you may know, upon a recent inquiry to this office I stated that it appears the Supreme Court Nominating Commission in selecting nominees for judges of the Court of Appeals is subject to the provisions of the Kansas Open Meetings Act.

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Att. II

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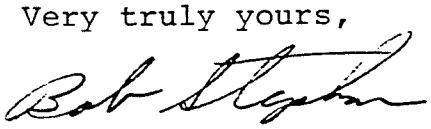
Very truly yours,



ROBERT T. STEPHAN
ATTORNEY GENERAL OF KANSAS

RTS:RLN:bas
cc: Chief Justice David Prager
Supreme Court

Chief Judge Bob Abbott
Court of Appeals

Robert C. Foulston
700 4th Financial Center
100 N. Broadway
Wichita, Kansas 67202

Howard Schwartz
Judicial Administrator

Mary Galligan
Legislative Research Department

4-6-88

Bill Graves
Secretary of State

2nd Floor, State Capitol
Topeka, KS 66612-1594
(913) 296-2236

STATE OF KANSAS

TESTIMONY BEFORE THE SENATE JUDICIARY COMMITTEE
ON HB 3018

April 6, 1988

By: Danton B. Rice - Legal Counsel
Deputy Assistant Secretary of State

House bill 3018 would remove the provision requiring mandatory cumulative voting for directors from the Kansas Corporation Code. Cumulative voting for directors is a method of voting that assists minority shareholders in obtaining representation on a board of directors.

An example of cumulative voting would be a corporation with 2 shareholders, A with 10 shares, and B with 20 shares. Further, assume that there are three directors positions and that the three candidates with the most votes in the election win the seats. If cumulative voting is required, the total number of votes that each shareholder may cast is equal to the number of shares owned multiplied by the number of positions available. In this example A will have 30 votes to cast and B will have 60 votes to cast. If A casts all 30 votes for one candidate they can assure representation on the board.

Currently 18 states require mandatory cumulative voting for directors. However, the voters of the state of Missouri considered a constitutional amendment to remove the provision from the Constitution of the state of Missouri on March 9 of this year. Additionally, this change would be consistent with the current Delaware Code.

Although the Secretary of State has no position on HB 3018, our office would like the committee to consider amending the bill to contain the provisions of HB 3019 and HB 3021, with a few minor amendments.

House bill 3019 amends K.S.A. 17-7507 which deals with the annual franchise tax liability paid by corporations that change tax year ends. Under the present statute, if a corporation changes its tax year end a short report is required. However, no proration or reduction of the tax owed is allowed.

The provisions of house bill 3019 would allow proration of the annual franchise tax in these situations.

This change is of particular importance at this time due to recent federal tax law changes that have required many

Att. III

subchapter S corporations, professional corporations and limited partnerships to change tax year ends.

The Secretary of State strongly supports this bill because it is equitable and will remove an adverse economic consequence that hinders many Kansas corporations when making a necessary business decision.

The provisions of house bill 3021 make a number of changes to the General Corporation Code to bring the majority of the code back into conformity with Delaware. The advantage of adopting the majority of the Delaware Corporate Code is the vast number of reported decisions interpreting it. This will improve corporate decision making and should encourage more businesses to incorporate in Kansas.

Work on this bill began in June of 1987 when our office was contacted by both the Kansas Bar Association and the Wichita Bar Association concerning a possible revision of the Kansas General Corporation Code. From July until November our office reviewed the current code, the Delaware code and all available information on the drafting of the 1972 version of the Kansas code. From this research, a draft was developed and circulated to the Kansas Bar Association, Tom Triplett and Dave Edwards of the Wichita Bar Association, John Reiff of Coleman Company, Inc., Bob Alderson and Professors Lovitch and Hecker of the University of Kansas School of Law.

Our office received comments from a number of these individuals and groups and incorporated these into the draft that is now HB 3021. Subsequent to these revisions no individual or group has expressed reservations with regard to specific provisions of the bill and the bill was reported favorably by the House Judiciary Committee.

Due to the great deal of work done by a number of individuals and groups and the necessity of these changes the Secretary of State urges you to support the amendment.

Finally, attached are a list of minor changes to HB 3021 that are necessary before adding the provisions to HB 3018. The changes are primarily technical except for the deletion of sections 45 and 46. These sections have been deleted on the suggestion of Professor Lovitch as possibly substantive changes to our code.

Necessary Amendments to HB 3021

On page 14, lines 493 and 494, delete the words "by term of office."

On page 25, line 394, replace "certificate" with "articles."

On page 34, at line 349 beginning with the word "the," insert "act of the."

On page 40, line 464, replace "certificate" with "articles."

On page 41, line 503, replace "certificate" with "articles."

On page 52, lines 345, 354 and 358, replace the words "certificate" with "articles."

On page 56, line 523, replace "certificate" with "articles."

On page 57, line 10, replace "certificate" with "articles."

On page 79, delete section 45.

On page 80, delete section 46.

On page 85, lines 592 and 594, delete "17-6803" and "17-6804".

4-6-88

Perkins, Hollembeak & Wheeler, Chartered
ATTORNEYS AT LAW
SUITE 401, BANK IV BUILDING
527 COMMERCIAL STREET
EMPORIA, KANSAS 66801

(316) 342-6335

ELVIN D. PERKINS
TED HOLLEMBEAK
MERLIN G. WHEELER

KRISTIN H. HUTCHISON

MEMORANDUM

TO: SENATE JUDICIARY COMMITTEE
FROM: MERLIN G. WHEELER
RE: HOUSE BILL 3018

House Bill 3018, as passed by the House of Representatives, amends K.S.A. 17-6504 to provide that the articles of incorporation of any corporation may provide for cumulative voting at all elections of directors of the corporation rather than making cumulative voting mandatory. The Bill, as passed by the House, continues the mandatory cumulative voting feature for all corporations organized prior to the effective date of House Bill 3018 unless the shareholders have an affirmative vote to amend the articles of incorporation to eliminate the requirement of cumulative voting.

As a substantive change to the Kansas General Corporation Code, the elimination of cumulative voting as a mandatory requirement in Kansas is important for a variety of reasons, not the least of which is that it removes one of the most distinct weapons utilized by a hostile corporate raider. Cumulative voting is utilized by the corporate takeover specialist as a means of placing persons upon the Board of Directors of the target company who may not necessarily have the best interests of the target company at heart. This tool quite often has the effect of destroying the capital structure of the target company solely for the benefit of the corporate raider and has proved to have an extremely devastating effect on numerous occasions.

I also believe that the passage of HB 3018 will have the effect of removing a potential impediment to the development of new corporations and enterprises in Kansas. I am aware of no new publicly held enterprises being organized under the laws of the State of Kansas and I do not believe that we can expect that any will organize under the laws of Kansas as long as Kansas maintains its mandatory cumulative voting provisions. Simply put, I believe that this one feature of the Kansas General Corporation Code, as much as any other feature, is a stumbling block to the organization of new publicly held corporations in Kansas.

The opponents of House Bill 3018 have advanced various arguments against passage thereof. Among these arguments is the contention that passage of House Bill 3018 will work to the disadvantage of the minority shareholder. I think that this argument is probably more imagined than real in that minority shareholders have ample opportunities under other provisions of the Corporation Code for the protection of their interest. I do not believe that mandatory cumulative voting is a feature that is necessary to protect the true minority shareholder as much as it is a feature desired by the minority shareholder who is in the process of attempting to take over

Att. IV

control of the company without expending the resources to acquire a majority interest in the corporation. The elimination of mandatory cumulative voting does not mean that the vote of the minority shareholder is lessened in any respect or that any rights of the minority shareholder have been taken away.

Opponents of House Bill 3018 might also point out that Kansas made a conscientious decision in 1972 not to adopt the provisions of the Delaware Code which did not have mandatory cumulative voting. There may well have been reasons to adopt the mandatory cumulative voting requirement in Kansas in 1972, but I believe that the current economic climate has so distinctly changed from that in existence in the early 1970's that this substantive change is now necessary.

Finally, it should be noted that the Bill does carry with it a feature that requires an affirmative majority vote of the shareholders of existing corporations to eliminate mandatory cumulative voting, thus insuring that existing shareholders will have an opportunity to voice their position regarding the retention of cumulative voting. Additionally, it should be noted that incorporators of new enterprises will retain the option under House Bill 3018 to include mandatory cumulative voting provisions in the articles of incorporation of newly formed businesses.

In summary, I believe that the current economic climate not only justifies but requires the passage of House Bill 3018 as a protective device to insure the rights of corporate shareholders in Kansas and to insure that Kansas remains competitive in the market place for the organization of new business enterprises. I strongly urge your passage of House Bill 3018.

4-6-88

Perkins, Hollembeak & Wheeler, Chartered
ATTORNEYS AT LAW
SUITE 401, BANK IV BUILDING
527 COMMERCIAL STREET
EMPORIA, KANSAS 66801

ELVIN D. PERKINS
TED HOLLEMBEAK
MERLIN G. WHEELER

KRISTIN H. HUTCHISON

(316) 342-6335

MEMORANDUM

TO: SENATE JUDICIARY COMMITTEE
FROM: MERLIN G. WHEELER, PRESIDENT OF KANSAS BAR ASSOCIATION, CORPORATION, BUSINESS AND BANKING LAW SECTION
RE: HOUSE BILL 3021--CORPORATION CODE CHANGES

Since 1972, Kansas has modeled its General Corporation Code upon the Corporation Code of the State of Delaware. Delaware has, over the years, adopted various amendments to its Code which have not been adopted in the State of Kansas and House Bill 3021 is designed to realign the Kansas Corporation Code with that of its model.

There has been a considerable amount of work undertaken by various groups in preparing House Bill 3021 for action by the Kansas Legislature. The office of the Secretary of State of Kansas has been instrumental in pulling together representatives of various segments of the legal community, including the Kansas Bar Association, University of Kansas School of Law, Wichita Bar Association, and counsel representing private industry.

In addition to the input into the development of House Bill 3021 by these various groups, comments on the proposed Bill were solicited from an even broader group. I am aware of no significant negative comments toward the legislation and am further of the belief that it is the general consensus of the legal community that an appropriate updating of the Kansas Corporation Code should take place.

There are a number of obvious advantages to the adoption of legislation that keeps the Kansas Corporation Code in step with that of the State of Delaware. Foremost among these advantages is the vast body of reported decisions and case law in existence in Delaware interpreting its code which serves as a corporate decision making base for Kansas. This advantage undoubtedly improves and facilitates corporate decision making in Kansas by allowing us to avoid mistakes or legal battles over matters already decided.

Secondly, the legislative model for Kansas is considered to be designed to promote and encourage businesses to incorporate in the State of Kansas. In the mobile economy in which we now do business it is imperative that Kansas legislation be responsive to the needs of the corporate community and continually revise and update its Corporation Code to accommodate business enterprises.

The work performed by the Secretary of State's office is comprehensive in all respects and was not undertaken lightly. In my opinion, the further deferral of this legislation will not necessarily result in the opportunity for additional input and will certainly not serve the interests of the

Att. V

State of Kansas. Kansas succeeds as a whole by the prompt enactment of legislation which is responsive to the needs of its business community. Deferral of this legislation further will be a move away from that goal.

I am aware that the Bill is quite large and that it takes a great deal of time to review and understand the provisions of it. However, the Bill makes very few substantive changes in the rights of corporations and their shareholders. The changes are largely technical or procedural in nature and do not affect the substantive rights of either corporations or their shareholders. I certainly would not recommend to this group the passage of any legislation affecting substantive rights of corporations or their shareholders without encouraging significant study and debate on the issue. However, I do not believe that that is the case with House Bill 3021 and I strongly encourage your approval of the same.

4-6-88

LEGISLATIVE TESTIMONY

Kansas Chamber of Commerce and Industry

500 First National Tower One Townsite Plaza Topeka, KS 66603-3460 (913) 357-6321

A consolidation of the Kansas State Chamber of Commerce, Associated Industries of Kansas, Kansas Retail Council

HB 3018

April 5, 1988

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

Senate Judiciary Committee

by

Gerhard Metz
Director of Taxation

Mr. Chairman and members of the committee, I am Gerhard Metz, representing the Kansas Chamber of Commerce and Industry. Thank you for the opportunity to appear here this morning in support of House Bill 3018.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 55% of KCCI's members having less than 25 employees, and 86% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

This bill, introduced at the request of the Secretary of State's office, would amend the Kansas Corporate Code to allow corporations chartered in this state the same freedom granted to those chartered under the Delaware Code with regard to the issue of

Att. VI

cumulative voting. Current law requires Kansas corporations to allow cumulative voting--a device whereby minority shareholders are purportedly protected by the right to cast a "super vote" in favor of a director, thereby increasing the chances of electing a director to the Board. The extra weight accorded to this minority vote comes from the statutory provision allowing minority shareholders to cast a number of votes equal to the number of shares held by the number of directorate positions. As was noted on the House floor, this provision goes far beyond the "one-share, one vote" provisions advocated by some supporters of cumulative voting, and results in one share, many votes. Proponents of shareholder democracy should see some inconsistency in a policy which would have the intent of guaranteeing a seat on a board of directors.

The bill was amended by the House Committee of the Whole to insert language at lines 39-43 requiring that corporations chartered before the bill's effective date would have to "opt in" by taking an affirmative action--a shareholder vote--in order to come under its provision. Corporations chartered after the bill's effective date would automatically come under its provisions, so that in order to have cumulative voting, such a provision would have to appear in the articles of incorporation. The effect of the floor amendment is to ensure that no shareholder of an existing corporation is subject to the rules' changing without notice.

KCCI took no position on HB 3018, or any of the other bills in the package introduced at the request of the Secretary of State's office, because at that time it appeared that none of the bills was controversial, and that there was no need to advocate bills which could be characterized as classic examples of the "good government" bill. Since the House committee's hearings, it has become apparent that there were some concerns about the business community's position on this bill. It is the considered opinion of most of the Board members who have spoken to this issue that HB 3018 is a good bill, and is consistent with the same policies about which we had the opportunity to speak to you in support of SB 586, the Control Shares Acquisition Act

The effect of this bill is to promote shareholder equality in its truest sense--certainly legislators understand that whether it is an election or a committee vote, the side which can muster the most votes must win; it would make about as much sense to allow some voters to raise both hands when the question arose, simply because they were in the minority. By allowing corporations to decide for themselves whether they wish to have cumulative voting provisions, the state of Kansas would be permitting a greater flexibility to businesses, and providing a climate more favorable for businesses who wish to incorporate in this state, or those Kansas corporations which must decide whether to remain in Kansas, or to relocate where they have more options. Allowing more options is clearly an incentive to economic development.

Finally, it is worth pointing out that this bill merely allows a corporation not to have cumulative voting; it does not mandate abolition of existing cumulative voting rights, nor does it forbid the according of those rights where they are deemed to be appropriate, or consonant with the desires of the shareholders of the corporation in question. KCCI supports HB 3018, and would strongly urge you to do the same when this bill comes to a vote.

Thank you once again for the opportunity to speak here this morning. I will be happy to stand for questions.

4-6-88
Glover

Borrowing Binge

Takeover Trend Helps Push Corporate Debt And Defaults Upward

Analysts Worry That Load Will Worsen Downturn In the Next U.S. Recession

Reaping the Reagan Harvest?

By Lindley H. Clark Jr.
And Alfred L. Malabre Jr.
Staff Reporters of The Wall Street Journal

Corporate restructuring left many American companies leaner in their operations but more heavily in debt. And now, a wave of stock buy-backs, corporate takeovers and sales of companies to their managements is pushing them even further—perhaps dangerously—into hock.

Already, the corporate debt in default is climbing rapidly. The 1981-82 recession raised it, just as you would expect: Annual corporate defaults climbed to more than $840 million from $60 million. But now, despite an economic rebound for more than five years, defaults have, perversely, soared. Last year alone, they reached a towering sum of nearly $9 billion.

To many analysts' surprise, even the Oct. 19 stock-market crash hasn't discouraged companies from increasing their borrowings. Right after the crash, many companies, despite fears of an impending recession, launched extensive programs to borrow funds and buy back their shares to try to shore up stock prices.

And in recent months, the merger-and-acquisition mania has broken out again; on Feb. 29 alone, more than $12 billion of takeover plans, mostly involving debt, were announced. Companies may be rushing to buy while the Reagan administration still keeps the antitrust watchdogs on a short leash.

Worried Economists

The borrowing binge has many economists worrying about what may happen in the next recession, which most analysts surveyed by Blue Chip Economic Indicators, a newsletter, expect next year.

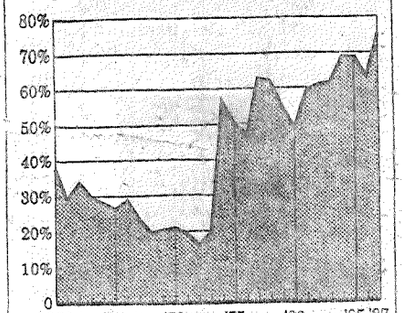
"Once the economy begins to weaken, as it sooner or later will, the high levels of corporate debt will exacerbate the downturn," warns Mickey D. Levy, the chief economist of First Fidelity Bancorp. in Philadelphia. "A company in trouble can simply cut or suspend dividend payments on stock but will go bankrupt if it can't service its debt."

And companies do have a lot of debt to service. Nonfinancial corporations' debt last year hit $1.8 trillion, triple the $586.2 billion in 1976. Since the mid-1970s, it has grown much faster than their revenues.

The debt buildup worries many corporate executives as well as economists. In a speech in New York City yesterday, Rand Araskog, the chairman of ITT Corp., warned that the recent high volume of low-quality debt is helping to finance the resumption of takeover activity, which, in turn, is fueling stock-market speculation. He said he had thought that last fall's stock-market crash would end such activity, but now, he said, "I think we're headed for another Oct. 19."

The Rise of Debt

Ratio of par value of bonds to market value of equity for NYSE-listed issues, in percent



Source: New York Stock Exchange

Some corporate chieftains, however, remain unworried about debt levels—at least at their own companies.

'Comfortable' Executive

"We're very comfortable," says Joseph Neubauer, the chairman of ARA Services Inc., which went private in 1984 in a management-led buy-out that entailed heavy borrowing at rates as high as 16.5%. He takes comfort in ARA's traditionally recession-resistant businesses; the company is a diversified supplier of services ranging from food distribution to health and family care. He also cites its cash flow—its profit after taxes but before depreciation.

"Whether a company has a highly leveraged balance sheet or not, the real issue is whether it can sustain cash flow in a downturn, and we think we can," Mr. Neubauer declares. "Banks are looking much more at cash flow and, as a result, will underwrite risks they wouldn't have touched 10 years ago."

Some general measures of the debt burden have improved a bit. As corporate profits increased last year, the share of earnings soaked up by interest payments fell to an estimated 49.2% from 56.8% in 1986. But most analysts aren't impressed. As recently as 1984, that ratio was about 40%, and it was far lower before the last recession. Analysts complain that after an economic expansion, the debt load should have eased.

They also cite other statistical forebodings. Corporate debt ran close to 40% of gross national product last year, up from 31.8% in 1976. And a so-called liquidity ratio—companies' cash-type assets plus receivables as a percentage of debt due

Please Turn to Page 22, Column 1

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Borrowing Binge: Takeover Trend Helps Push Up Corporate Debt and Defaults to Worrisome Levels

Continued From First Page

within one year—has recently dropped below 83%. That trails even its 1981-82 recession level, when it fell to about 85% from nearly 90%.

From a longer-range perspective, corporate liquidity looks even worse. Long deeply worried about debt levels, T.J. Holt, an investment analyst in Westport, Conn., estimates that "America's corporate giants," including such eminent names as Exxon, General Motors and General Electric, "have less than one-tenth the liquidity of their 1929 counterparts."

Given the liquidity problems, many companies' initial response to the market's crash last Oct. 19—the stock buy-backs—dismays Mr. Levy. He regards the buybacks as "very untimely since companies are using up cash or going into debt to make the purchases." He says "these corporations are increasing their exposure" if the economy sours.

Although the stock market's subsequent rebound has helped a bit, corporate debt has already become more burdensome.

"The crash was like an increase in the cost of capital and in the cost of equity capital in particular," remarks James Tobin, Yale's Nobel-laureate economist. "You now have to sell more of your firm if you want to raise funds for investment projects. There's also a smaller equity base for bond financing."

Newmont Mining Corp. has felt the pinch. Once a major copper producer whose focus now has turned to gold mining, it borrowed nearly $2 billion last September to pay a special $33-a-share dividend designed to fend off a takeover group led by T. Boone Pickens Jr. Newmont had hoped to pay off much of the debt by selling only nongold assets, but the crash reduced their market value.

By selling 4,150,000 Du Pont shares as well as an 82% interest in Foote Mineral Co., Newmont managed to pare its debt to about $1.6 billion from $2.1 billion, according to Goldman, Sachs & Co. But that reduction was less than anticipated. Now, despite its original plans, Newmont is trying to sell all or part of its interest in Newmont Australia, a gold-mining unit. In December, credit ratings on Newmont's senior debt were lowered. Meanwhile, the Pickens group, with a substantial loss on its Newmont stock, is suing for damages.

Macy's Maneuvers

And the crash may be deterring some restructured corporations from reducing debt by selling stock. R.H. Macy & Co. was purchased in a highly leveraged deal by its management in 1986. A recent congressional study of buy-outs notes that the big retailer was "generally expected" to "go public again" soon through stock sales. But it hasn't. In fact, Macy, which is still privately held, has entered a bidding contest for Federated Department Stores, and a victory apparently would force it to borrow billions of dollars more.

Apart from the market crash, so-called leveraged buy-outs account for much of the continuing surge in debt. Typically, a company's management, institutional investors and investment bankers take it private through huge borrowings, with the proceeds of the new debt issues being used to retire equity capital.

The leveraged buy-out of Burlington Industries Inc. by a group headed by the New York investment banking firm of Morgan Stanley & Co. shows how profoundly a company's balance sheet can suffer. In early October, just after the buy-out (initiated by management to ward off a takeover), the big textile maker's ratio of debt to common shareholders' equity was 29.8 to 1, up from only 0.4 to 1 about a year earlier.

Warning in Prospectus

As a result, a Burlington prospectus issued in early February warns that "given the company's substantial level of indebtedness, adverse developments affecting its business and operations will have a greater impact" than they would have had before the buy-out.

The report notes that Burlington's new indebtedness "bears interest at higher average rates" than before. And it cautions that based on "anticipated levels of operations," the company "does not expect that it would be able to generate sufficient cash flow from operations" to service its debt without selling "certain assets." In the 1987 fourth quarter, Burlington incurred a $25.3 million loss despite increased earnings from operations; it mainly blamed $66.1 million in interest expense.

Such buy-outs aren't the only boardroom maneuver that adds debt. Often, debt is ballooned by well-intentioned efforts to reshape a company's business.

Allegheny International Inc., once primarily a steel producer, set out a decade ago to strengthen its consumer-products lines, mainly through acquisitions. Thus, in 1981, it acquired Sunbeam Corp. However, the home-appliance maker's profits haven't been big enough to enable Allegheny to reduce sufficiently the debt stemming from the $543 million acquisition. Strapped for cash, Allegheny recently filed for protection from creditors under the federal Bankruptcy Code.

Management Handicap

Higher debt can hobble a company in many ways. "Equity gives management the maximum freedom of choice in decision-making, while debt entails all sorts of obligations and limits," remarks Henry Kaufman, a managing director of Salomon Brothers who is leaving the firm next month to start his own consulting company. A case in point is Burlington, whose capital spending will be strictly limited under the buy-out agreement. Until 1991, annual outlays can't exceed $75 million, compared with $1.8 billion in a recent 10-year period.

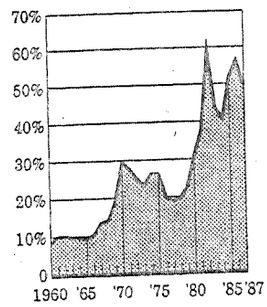
Not surprisingly, far more companies' credit ratings have dropped than risen in recent years (as an accompanying chart shows). More surprising, perhaps, is that many managers seem less bothered by a lowered rating than they once would have been. Mr. Kaufman largely attributes this "liberalization of standards" to the fact that "we haven't had a depression since the 1930s, and the intervening recessions have hurt relatively few firms; so, an attitude has developed where people say, 'Why should we be worried if our credit rating goes from single-A to triple-B?' Nobody's been hurt."

Mr. Kaufman also notes that the tax code still encourages the use of debt; corporations can deduct interest paid on debt but not dividends. And he suggests that the higher capital-gains tax rate, enacted in 1986, tilts the balance further toward debt because a major reason to buy stocks is the hope of capital gains.

The Fallout From Heavier Borrowing

Interest Payments Rise...

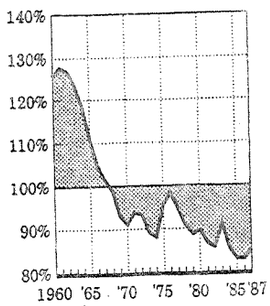
Interest charges as a percentage of pretax profits of nonfinancial corporations



Source: Salomon Brothers

...Companies' Liquidity Falls...

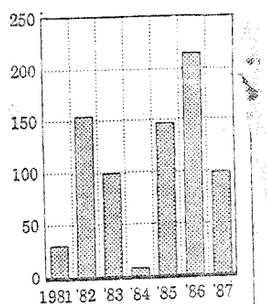
Corporations' liquid financial assets as a percentage of current liabilities



Source: Bank Credit Analyst

... And Credit Quality Suffers

Number of long-term corporate debt issues downgraded less number upgraded



Source: Standard & Poor's

4-6-88
Glenn

TO: THE HOUSE COMMITTEE ON JUDICIARY

STATEMENT OF LLOYD CULBERTSON
IN SUPPORT OF HOUSE BILL NO. 3018

Mr. Chairman, and Members of the Committee:

I am Lloyd Culbertson, a Senior Vice-President with the First National Bank of Phillipsburg, Kansas, which has been my home all my life. I am here in support of House Bill 3018 and earnestly hope that this legislation can be enacted in this Legislative Session.

My interest in this Bill arises from my concern over the economic importance of the offices of K N Energy in Phillipsburg, as well as the overall Kansas operations of K N, as a supplier of natural gas to Phillipsburg, and in fact, a substantial portion of Western Kansas. K N employs 115 people in Phillipsburg, which represents about 34% of its total employment in Kansas, with an annual payroll of over 2.7 million dollars, just in Phillipsburg. They pay over $90,000 in property taxes annually in our community and are a reliable supplier of natural gas.

Not only Phillips County, but all of North Central and Northwestern Kansas is fighting to survive. In a comprehensive plan developed by Bucher & Willis for the City of Phillipsburg, in 1978, very startling figures are revealed. From 1910 to 1960 the population of Phillips County had decreased from approximately 14,000 people to 8,000 people. They projected that if this trend continues, the year 2000 population for Phillips County will be 5,500 people. The way to counter this projection is with maintaining existing employers and attracting new ones. We have to have a good reason to keep our existing people and attract new ones.

The State of Kansas is developing new methods to attract business and spending large sums of money to do so. I think it is equally important to keep our current companies.

As you are probably aware, K N has been the subject of a takeover attempt by an out-of-state firm that is principally engaged in gas production.

I fully understand that this Bill simply makes cumulative voting optional with the stockholders by their power to amend the Articles of Incorporation to not require cumulative voting, which the present law makes mandatory. Some contend that the present law protects minority stockholders, enabling the minority interest to maximize its voting power for directors by multiplying its shares by the number of board vacancies open at a particular election. We have confidence in the integrity and reliability of the existing management of this firm. It is stable and predictable. The raiding firm has indicated that the current attempt to obtain representation on the Board of Directors, which the Kansas cumulative voting law makes much more achievable, is simply the first step in achieving takeover of the management of the firm. If the takeover attempt succeeds, I am sure the company will be split into various components in the raider's realization of maximizing its profits from the production of its gas reserves. We believe Kansas and Phillips County will be on the losing end, both from the standpoint of the loss of one of our major employers and from a threat to reasonably priced gas for K N's industrial, commercial and domestic customers.

We view this legislation of great importance to the economic prosperity of our area. I appreciate the fact that this legislation will not be enacted in time to alter the outcome of the current proxy fight, since K N's stockholder meeting is scheduled for March 24, 1988. It is, however, of

importance that it be enacted in this session in order to be available for future decision making by the stockholders in determining the future course of management and control of K N and like corporations.

In short, we believe that this legislation is important to the economic prosperity of Kansas in that it serves to protect existing Kansas companies and offers some attraction to companies that are headquartered in states with the same restrictive law as ours to relocate in Kansas.

I urge the adoption of the proposed legislation and if it is decided that it is more realistic to restrict the law to utility corporations, I would urge such an amendment, as I firmly believe that it is important that the legislation be enacted in this session, particularly with respect to utility companies such as K N.

I thank you very much for your time and consideration.

4-6-88

Testimony Before
SENATE JUDICIARY COMMITTEE

HB 3018
Cumulative Voting in Corporations

By DAN R. McGEE
CENTEL ELECTRIC-KANSAS
April 6, 1988

Mr. Chairman and Members of the Committee:

As a customer of, an employee of, and a stockholder in Centel Corporation, I thank you for the opportunity to voice my company's support for HB 3018, which would eliminate mandatory cumulative voting.

The overwhelming majority of states do not require cumulative voting, and the trend among states in recent years has been away from cumulative voting. Presently, cumulative voting is required only in 18 states; down from 22 in 1969. Moreover, cumulative voting is not required in any of the states where a large percentage of American corporations are incorporated (Delaware, Nevada, New Jersey, New York). As a result, cumulative voting exists today in only a very small minority of American corporations. The continued requirement of cumulative voting in Kansas (which has otherwise followed the general precedent of Delaware in its corporate law) is an anachronism which should be eliminated.

Among the reasons for eliminating mandatory cumulative voting are the following:

- The purpose historically underlying mandatory cumulative voting requirements, namely the protection of minority stockholders, is now served effectively through the disclosure requirements

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of federal securities laws and through heightened fiduciary responsibilites imposed on corporate officers and directors.

- Large stockholders can use cumulative voting as a coercive device, using the threat of board representation as a means of obtaining greenmail or otherwise unduly influencing management. This threat has been increased by the emergence in recent years of aggressive "raiders" who seek to utilize corporate machinery to serve their own interests.
- The elimination of cumulative voting promotes broader stockholder representation through the avoidance of directors who represent the interests of only a small group of stockholders.
- Stockholders of a corporation do not have interests that are so distinct in character as to require minority representation on the board of directors; rather, the stockholders have a shared interest in the economic well-being of the corporation.
- Through cumulative voting, a minority stockholder can frustrate the corporate governance objectives held by a majority of the stockholders. This result is fundamentally undemocratic and contrary to overall corporate interests.
- The existence of mandatory cumulative voting discourages corporations from organizing under the laws of Kansas, with a resultant decline in franchise tax revenues for the state and a decline in business activities in Kansas.

If mandatory cumulative voting is eliminated, corporations that wish to do so can still adopt cumulative voting through their articles of incorporation; however, the cumulative voting system would no longer be imposed on corporations which believe, for the reasons described above, that a standard one-share one-vote system is more desirable.

Giving corporations the option, instead of imposing upon them a voting system which has been increasingly rejected in modern American corporate law, would be consistent with the basic policy objectives and fundamental interests of Kansas in a fair and flexible corporate law.

4-6-88

TESTIMONY OF JOHN M. REIFF OF THE COLEMAN COMPANY, INC. BEFORE THE SENATE JUDICIARY COMMITTEE ON APRIL 6, 1988

Chairman Frey, members of the committee. My name is John Reiff and I am Sr. Vice President, Law and Personnel of The Coleman Company, Inc. You know our products and location. What is important for this testimony is that we are a public company with our stock listed on the New York Stock Exchange, and our company is chartered in Kansas. The Kansas corporation code, not Delaware's, controls our corporate law activities.

As virtually all public companies chartered in Kansas, the corporate law that controls us is an accident of history. We were in no way a public company in 1928 when our charter was originally filed. We were a small lamp and stove company with a Baptist founder who knew how to sell light, but wouldn't have known a corporate charter from a real estate deed.

We grew and drifted public, mostly through employee ownership, and began to raise money through stock sales to the public. In the late 60's, early 70's, some smart people kept us and others from re-chartering the company in another state. Professor Treadway, the late Don Bell, and others, helped encourage this legislature to adopt, almost verbatim, the Delaware Corporation Code. An important exception was the cumulative voting provision which I will discuss in a minute.

There are more advantages to a corporation code like Delaware's than I can list or even know. In summary, however, the Delaware type laws permit management greater flexibility in most all areas, including types of permissible financing, the latitude boards have to take action (yes, including action that will discourage unfair raids and greenmail), and less corporate "red tape."

My company supports H.B. 3021, the technical amendment bill, and H.B. 3018, the bill permitting the shareholders to decide whether a company must have cumulative voting. Present Kansas law requires cumulative voting and this is the most substantive difference between our corporation code and Delaware's.

There is no good argument against permitting a company to have its shareholders determine whether they want cumulative voting. That is the way it is done by Delaware and a number of other states. We support the shareholders' right to determine this issue just as we would oppose a code that mandates non-cumulative voting.

What does cumulative voting do? It allows a shareholder to aggregate votes in favor of one particular director - sort of a super vote feature. Does this help a small shareholder have a stronger voice? In the context of public companies, no, because you need a multi-million dollar position to own enough shares to elect a director, even with cumulative voting.

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Then why the hue and cry? That is easy to understand if you look at the hue and criers. You have all heard of corporate raiders, you have all heard of greenmail, and you have all heard of T. Boone Pickens, and others like him, the principal supporters of cumulative voting for all corporations except their own. You have all heard of Coleman and you have all heard of K N Energy, and other public companies that are not fond of the activities of Mr. Pickens and these people.

The main use of cumulative voting today is as additional leverage for corporate greenmailers. Greenmail is simple. Jump in with a bunch of Texas money, buy some shares, and harass in every way you can. One way in a mandatory cumulative voting state is to slip a greenmailer on the board.

Can he or she outvote the board? No. Can he or she divert management attention from selling products to non-productive procedural hassles? Yes. Does this encourage management in frustration to pay greenmail? Unfortunately, sometimes it does.

4-6-88

Kansas Society of
Certified Public Accountants

FOUNDED OCTOBER 17, 1932

400 CROIX / P.O. BOX 5654 / TOPEKA, KANSAS 66605-0654 / 913-267-6460

Kansas Senate Judiciary Committee

RE: Amendment to HB 3018

April 6, 1988

Mr. Chairman, members of the Committee, I am T. C. Anderson, Executive Director of the Kansas Society of Certified Public Accountants.

Section 806 of the federal Tax Reform Act of 1986 required most partnerships, personal service corporations and S corporations to conform their taxable years to those of their owners, forcing many of these entities to switch from a fiscal to calendar year beginning in 1987.

While the Omnibus Budget Reconciliation Act of 1987 contains provisions to give some relief to this situation it came to late (December 22, 1987) and with a $34 million tax increase over the next three years so as to cool most owners on the idea of keeping their fiscal year ends.

Thus many Kansas business owners are being forced to file the short year reports with the Secretary of State's Office for a period ending after November 30, 1987.

The Kansas Society's Federal and State Taxation Committee urges your favorable consideration of the amendment which would permit these affected Kansas businesses to prorate their annual franchise tax.

Att. IX

STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

MAIN PHONE: (913) 296-2215
CONSUMER PROTECTION: 296-3751

April 1, 1988

ATTORNEY GENERAL OPINION NO. 88- 47

The Honorable Don Montgomery
State Senator, Twenty-First District
State Capitol, Room 503-N
Topeka, Kansas 66612

Re: Corporations--Agricultural Corporations--Prohibition Against Certain Corporations Owning Agricultural Land; Exemption; 1988 Senate Bill No. 727

Synopsis: Section 7(a)(15) of a 1988 Senate Bill No. 727, amending K.S.A. 1987 Supp. 17-5904 by providing an additional exemption to the corporate farming act, is unconstitutional. It violates Sections 1 and 2 of the Kansas Bill of Rights and the Equal Protection Clause of the 14th Amendment to the United States Constitution in that it establishes an arbitrary classification that does not bear a rational relationship to the purpose of the act. Cited herein: K.S.A. 17-5902; K.S.A. 1987 Supp. 17-5904; 1988 Senate Bill No. 727; Kan. Bill of Rights, §§ 1, 2; U.S. Const., Amend. XIV.

* * *

Dear Senator Montgomery:

As vice-chairman of the Senate Committee on Agriculture, you inquire whether Section 7(a)(15) of Senate Bill No. 727 (S.B. 727) is constitutional. Specifically you inquire whether the amendment to K.S.A. 1987 Supp. 17-5904 of the corporate farming act is subject to constitutional challenge under sections 1 and 2 of the Kansas Bill of Rights and the Equal

Att. XI

Protection Clause of the Fourteenth Amendment to the United States Constitution.

The corporate farming act, K.S.A. 17-5902 et seq., prohibits certain corporate entities from either directly or indirectly owning, acquiring or otherwise obtaining or leasing any agricultural land in this state. K.S.A. 1987 Supp. 17-5904 lists several exceptions to this general prohibition. Sections 7(a)(15) of 1988 Senate Bill No. 727 provides an additional exemption for:

> "Agricultural land owned or leased by a corporation for use as a swine confinement if (A) such corporation is operating a swine confinement facility within the state which was exempted from the restrictions of this section by subsection (a)(7) and (B) land acquired for such use is located within 20 miles of the land upon which the swine confinement facility originally exempt from the restrictions of this section is operated."

The Kansas Supreme Court has interpreted §1 of the Kansas Bill of Rights as having much the same effect as the Equal Protection Clause of the 14th Amendment. State ex rel. Tomasic v. City of Kansas City, 237 Kan. 572, 583 (1985). While we note that the phrase "equal protection of the laws" is not subject to exact definition, it generally provides that all persons shall be treated alike under like circumstances, both in privileges conferred and liabilities imposed. 16 Am.Jur.2d Constitutional Law §§736 and 738; Lowe v. Kansas, 163 U.S. 81, 16 S.Ct. 1031, 41 L.Ed. 78 (1896). [We note at this point that for some purposes a corporation is treated differently from an individual without violating constitutional guaranties of equality. 16 Am.Jur.2d Constitutional Law §778. For our purposes this distinction is not relevant.]

The Kansas Supreme Court reiterates the rules that govern the courts of this state in determining issues pertaining to the constitutionality of legislative enactments in Henry v. Bauder, 213 Kan. 751 (1974) (a denial of equal protection challenge against the Kansas guest statute, K.S.A. 8-122b). Citing Tri-State Hotel Co. v. Londerholm, 195 Kan. 748 (1965) the court states:

> "This court is by the Constitution not made the critic of the legislature, but rather, the guardian of the Constitution; and every legislative act comes before this court surrounded with the presumption of constitutionality. That presumption continues until the Act under review clearly appears to contravene some provision of the Constitution. All doubts of invalidity must be resolved in favor of the law. It is not in our province to weigh the desirability of social or economic policy underlying the statute or to question its wisdom, those are purely legislative matters. . . . While the legislature is vested with a wide discretion to determine for itself what is inimical to the public welfare which is fairly designed to protect the public against the evils which might otherwise occur, it cannot, under the guise of the police power, enact unequal, unreasonable or oppressive legislation or that which violates the Constitution. If the classification provided is arbitrary, . . . and has no reasonable relation to objects sought to be attained, the legislature transcended the limits of its power in interfering with the rights of persons affected by the Act. . . . (p. 760.)" 213 Kan. at 753.

Accordingly, the desirability of social or economic policy underlying a statute is purely a legislative matter and as such, reasonable classifications do not offend the concept of equality. However, classifications cannot be made arbitrarily. In other words, equal protection of the laws does not mean that a statute cannot make any distinctions or classifications, but rather, that a statute cannot make any arbitrary distinctions or classifications that do not bear a rational relationship to the purpose of the act.

As such, the question is whether the classification of land owned or leased by a corporation operating a swine confinement facility [that (A) meets the exemption restrictions of (a)(7), K.S.A. 1987 Supp. 17-5904(a)(7), and (B) is located within 20 miles of the originally exempt swine confinement facility] is a reasonable classification in view of the purpose of the

corporate farming act. In other words, we must determine whether the classification established by 1988 Senate Bill No. 727, Section 7(a)(15) reasonably relates to the purpose of the act.

The classification established is that of corporations operating swine confinement facilities that must first have been exempted under K.S.A. 1987 Supp. 17-5904(a)(7). Generally this provision provides that a corporation owning or leasing agricultural land prior to July 1, 1965 (relying on existing law) is allowed to continue its operation in spite of the repeal of the law it relied on. In other words, the section is a "grandfather clause" that permits certain corporations engaged in business before the passage of the act prohibiting the activity, to continue in business without meeting the criteria of the new law. A grandfather clause attempts to balance the burden imposed by the repeal of existing law with the need to change the law. By definition, a grandfather clause provision contravenes the purpose of the new law. K.S.A. 1987 Supp. 17-5904 states in part:

> "No corporation, trust, limited partnership or corporate partnership, other than a family farm corporation, authorized farm corporation, limited agricultural partnership, family trust, authorized trust or testamentary trust shall, either directly or indirectly, own, acquire or otherwise obtain or lease any agricultural land in this state."

Therefore, if the purpose of the corporate farming act is to restrict the use of agricultural land by corporations, then it contravenes the purpose of the act to allow corporations grandfathered in under K.S.A. 1987 Supp. 17-5904(a)(7) to expand. In other words, the grandfather clause allowed certain corporations (those relying on the law as it existed prior to repeal) to continue operations in contravention to the new law. The amendment found in S.B. 727 would allow those grandfathered in to further contravene the law by allowing expansion if that expansion is within 20 miles of an originally exempt facility. It is therefore our opinion, without questioning the underlying policy reasons for the legislation that the classification made by S.B. 727 is arbitrary and thus unconstitutional because it does not bear a reasonable relationship to the purpose of the corporate farming act. We note that while S.B. 727 may promote the public purpose of economic growth by the retention and

expansion of existing business, we cannot reach the question of underlying policy. Our conclusion is not based on the wisdom of the amendment but solely on the determination that the classification provided in the amendment is arbitrary and discriminatory in that it bears no rational relationship to the fundamental purpose of the act in which it appears.

In conclusion, section 7(a)(15) of 1988 Senate Bill No. 727, amending K.S.A. 1987 Supp. 17-5904 by providing an additional exemption to the corporate farming act is unconstitutional. It violates sections 1 and 2 of the Kansas Bill of Rights and the Equal Protection Clause of the 14th Amendment of the United States Constitution in that it establishes an arbitrary classification that does not bear a rational relationship to the purpose of the act.

Very truly yours,

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