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CLERK OF THE SEDGWICK COUNTY DISTRICT COURT
CASE NUMBER: 2021-CV-000234-CO

Court: Sedgwick County District Court

Case Number: 2021-CV-000234-CO

Case Title: Chris Leiszler DDS, et al. vs. Gary Yager, et al.

Type: Order on motion and cross motion for summary judgment

SO ORDERED.

/s/ William Woolley, Honorable District Court Judge

IN THE EIGHTEENTH JUDICIAL DISTRICT
DISTRICT COURT, SEDGWICK COUNTY, KANSAS
CIVIL DEPARTMENT

DR. MARK P. TROILO, D.D.S. AND DR. CHRISTOPHER LEISZLER, D.D.S., Individually and on Behalf of Nominal Defendant, DELTA DENTAL OF KANSAS, INC.	)	
Plaintiffs	)	
vs.	)	CASE NO. 2021 CV 234 chapter 60
GARY YAGER, DR. BRICK R. SCHEER, D.D.S. KIM BORCHERS, ANGELA MCCLURE, DR. NICHOLAS A. TROILO, D.D.S., DR. PATRICK MORIARTY, D.D.S., SHAWN NACCARATO, DR. LUCYNDA RABEN, D.D.S., RUTH TEICHMAN, AND NANCY ZOGLEMAN	)	
Defendants,	)	
vs.	)	
DELTA DENTAL OF KANSAS, INC.	)	
Nominal Defendant	)	
_____	)	

ORDER GRANTING PLAINTIFFS' 3/5/21 MOTION FOR SUMMARY JUDGMENT AND DENYING APPOINTED DIRECTOR DEFENDANTS' CROSS MOTION FOR SUMMARY JUDGMENT

Plaintiffs are asking for summary judgment on the declaratory judgment claim, Count I of the verified petition. Count I asks the court to declare as ultra vires certain actions taken by the Board of Directors of Delta Dental of Kansas, Inc. (DDKS) on December 11, 2020. Plaintiffs allege the DDKS board improperly stripped DDKS dentist members of their voting powers and improperly upset the allocated powers between the directors and the members.

Appointed Director filed a cross-motion for summary judgment on Count II, Plaintiffs' breach of fiduciary duty claim and ask the court to hold and find that the appointed directors of DDKS do not owe any fiduciary duty to the dentist members of DDKS, that Appointed Directors did not breach any fiduciary duty to the members of DDKS, and that Plaintiffs lack standing to file this breach of fiduciary duty claim on behalf of the corporation.

The Appointed Director defendants are Yager, Borchers, McClure, Naccarato, Teichman and Zogleman, none of whom is a dentist. Appointed Directors filed a motion to dismiss shortly after Plaintiffs' summary judgment motion and the motion to dismiss has been argued and is pending. Doctors Scheer, Nicholas Troilo, Moriarty and Raven (Elected Director defendants) are dentists who have been elected to the board as dentist members of DDKS and who have joined in Appointed Directors' motion to dismiss, response to this summary judgment, and cross-motion for summary judgment.

FACTS

I. GENERAL SUMMARY.

DDKS is a nonprofit dental service corporation organized in 1972 pursuant to the Kansas Nonprofit Dental Service Corporation Act, K.S.A.40–19a01, et seq., (The Act). The Act is part of the insurance code, Chapter 40, of the Kansas Statutes Annotated.

A. The Act.

Under the Act, a dental service corporation has members who are dentists who must be licensed and engaged in practice in Kansas. A dental service corporation under the Act does not have stockholders.

Prior to receiving a corporate certificate of authority to do business as dental service insurance company, a dental service corporation must demonstrate to the Kansas Insurance Commissioner that the corporation has obtained participating agreements from at least 50 percent of dentists who are licensed and engaged in dental practice in Kansas.

Because DDKS is a non-profit corporation, it does not have the authority to issue capital stock. Approximately 1,300 dentists, more than 95% of all Kansas dentists, are members of DDKS by having voluntarily signed participating agreements with DDKS.

DDKS is non-profit dental service corporation governed by the Act which provides services to subscribers pursuant to K.S.A. 17-10a02. DDKS primarily provides dental insurance services to group subscribers (Kansas companies that contract with DDKS to provide dental insurance to employees) and individual subscribers (individual Kansas residents who sign up directly with DDKS to participate in dental insurance plans) through its network of providers (participating dentists who voluntarily agreed to provide dental services to plan participants on such terms and conditions as DDKS deems appropriate). In addition, DDKS can provide services. DDKS sets the re-imbursement rates for dentists who are members and whose patients are subscribers, meaning how much DDKS will pay members from the money paid to DDKS by the subscribers for insurance.

Although DDKS is a non-profit corporation, ultimately what DDKS decides after selling insurance, administering claims, and paying administrative expenses, is how much subscriber money will go to member dentists, how much will be retained for the altruistic missions that the board has chosen to pursue, and how much surplus is reimbursed to the subscribers. *See*, K.S.A. 40-19a11 and 19a12. That fee splitting decision is the fundamental dispute between the DDKS members and the board.

The Act requires that a ten person board of directors manage DDKS's affairs. The Kansas government's executive branch has the power under the Act to appoint a majority (six) of the directors, two by the Governor and four by the Commissioner of Insurance. DDKS's members have the power to elect the four remaining directors.

By statute, the DDKS bylaws set the DDKS directors' terms of office. As of August, 2019, the DDKS bylaws gave each director a term of four years. Under the 2019 bylaws, when the directors' terms expired, the Governor, the Secretary of Insurance or

the dentist members had the power to select to retain or replace those directors that each person or group had the power to select.

The board amended the articles of incorporation and bylaws on December 11, 2020 ("2020 amendments"). This case primarily concerns the legal effect of those December 11, 2020 amendments to the DDKS Articles of Incorporation, and subsequent changes to the DDKS Bylaws. On December 11, 2020, the six lay appointed directors voted for the 2020 amendments while the four dentist member elected directors voted against the 2020 amendments. The board did not seek approval of the participating dentist members before passing the 2020 amendments to the articles or the bylaws.

Plaintiffs argue the 2020 amendments failed to comply with the voting procedures previously established by the 2000 amendments to the Articles. In addition, Plaintiffs argue the Act gives the participating dentists voting powers to veto the 2020 amendments.

The parties have noted some of the history of the Articles because the prior history is important to arguments.

B. 1972 Articles of Incorporation.

On October 2, 1972, DDKS amended the DDKS articles. Among other things, these articles state:

> FOURTH: This corporation shall not have authority to issue capital stock.
>
> FIFTH: The conditions of membership are: the membership shall be comprised of dentists who have executed participating agreements with the corporation as provided in "the Nonprofit Dental Service Corporation Act." Each member shall be entitled, at every meeting of members, to one vote per person, but no member shall be entitled to vote by proxy.

C. 2000 Articles.

On August 16, 2000, after a vote by the board and a vote by the members, the articles were amended. Among other changes in the 2000 articles, the former paragraphs

Fourth and Fifth were consolidated into a new article V and were amended to give the members the powers of the stockholders of a stock corporation and the exclusive power to amend the bylaws.

DDKS cannot have stockholders, only members. One of the 2020 amendments, V, states the members will have voting powers of a corporation stockholder. Those 2020 amendments to the article, V, read as follows:

V. Membership Organization

> This Corporation shall not have authority to issue capital stock, **and all voting powers normally vested in stockholders shall be vested in the members of this Corporation.** The membership of this Corporation shall be comprised of the dentists who have currently executed participating agreements with the corporation as provided in the Act. Each member shall be entitled, at every meeting of the members, to one vote per person, but no member shall be entitled to vote by proxy.

(emphasis added by Plaintiffs.) The highlighted portions are the important changes, which Plaintiffs argue aive the DDKS members the voting powers of a stockholder of a corporation.

Those same 2000 amendments to the articles added Article VII, stating who has the corporate power to amend the bylaws. Article VII states: "**The power to adopt, alter, or amend or repeal this Corporation's Bylaws, in whole or in part, at any time, shall be vested in the Membership.**" (emphasis added by Plaintiffs.)

The company's certification on the August 16, 2000 amendments both the DDKS board and DDKS members adopted the 2020 amendments, and it reads:

> IT IS HEREBY CERTIFIED that the following Amended and Restated Articles of Incorporation which restate, integrate, and further amend the corporations articles of incorporation as originally filed and is here to for amended and supplemented, **were duly set, proposed, approved, and declared advisable by a resolution duly adopted by the Corporation's Board of Directors, and were thereafter duly approved and adopted by the members of the Corporation in accordance with the provisions of**

> **K.S.A. § 17-6605** and amendments thereto, in the General Corporation Code of the State of Kansas, and that these Amended and Restated Articles of Incorporation constitute all of the Articles of Incorporation of the Corporation and do hereby supersede the Corporation's Articles of Incorporation originally filed as heretofore supplemented or amended.

(emphasis added by Plaintiffs.)

In response, Appointed Directors point to subsequent amendments to the DDKS articles that were passed without member approval or subsequent procedural objections by members. The board amended the Articles in 2002 (changing DDKS's registered agent), in 2005 (changing the corporation's name), and 2007 (changing DDKS's registered agent).

D. 2019 Bylaws.

In June of 2019, Plaintiffs proposed amendments to the DDKS bylaws. The Appointed Directors' response details what Appointed Directors argue was their response to the proposed bylaw amendments. There is no dispute that, at a minimum, there was a discussion among Plaintiffs, the board, and the attorneys about those proposed amendments. Some of the proposed bylaw amendments were presented to the membership at the annual August meeting and some approved by the majority of the members. Whether the bylaw amendments were the product of negotiation or over the objection of the board is a factual dispute.

E. **2020 amendments proposed by the members.**

In March of 2020, Plaintiffs proposed more amendments to the Bylaws. (C-1, Appointed Directors response). These member proposed amendments to the bylaws are important as a backdrop to the actions taken by Appointed Directors in December 2020, in response to the member proposed amendments to the bylaws.

Some of the members proposed changes to the bylaws included allowing up to six non-director or employee dentists to observe regular and special meetings of the board.

(Article V, sections 9-10). In addition, the proposed amendment to **Article XIII-Amendments** were as follows: "An amendment to the bylaws ~~shall~~ may be proposed by the ~~Corporation~~ Board, if approved by the two-thirds (2/3) of the members of the Board of Directors, or ~~at least fifty (50)~~ by ten (10) member dentists entitled to vote for such amendments." The remainder of Article XIII was to be unchanged.

Plaintiffs proposed an additional amendments to the bylaws to Article V-Board of Directors which had the following proposed amendment language, "The Board of Directors …shall have full supervision and control of the business, property, affairs and management of the Corporation and may exercise all such posers of the Corporation consistent with the Corporation's purpose and the laws of the State of Kansas and the Articles of the Incorporation under which the Corporation is formed."

A third proposed bylaw amendment was to Article VIII-Contracts with Dentists. This proposed bylaw amendment contained the most proposed new or added language. This amendment addressed contracts with dentists, including but not limited language addressing what claim is denied and a definition of "Medically Necessary in Dentistry" to be determined by licensed dentists.

Various forms of these proposed bylaw amendments were discussed among Plaintiffs, the board and the board's attorneys. The board was not receptive to Plaintiffs' proposed amendments. In fact, the board's attorneys cautioned Plaintiffs that, rather than submitting Plaintiffs' proposed amendments that the board viewed as illegal, the board would file a legal action to have Plaintiffs' 2020 proposed amendments declared illegal. As a result, the parties entered into a tolling agreement to allow further discussion and negotiation.

In October, 2020, Plaintiff Dr. M. Troilo sent a letter to the directors. Plaintiffs allege the letter requested a meeting with the board to have a long-promised dialogue about Plaintiffs' proposed amendments to the bylaws. Appointed Directors allege it contained another set of proposed amendments to the bylaws that Appointed Directors

allege sought to strip the DDKS board of its fiduciary powers and duties. No one has attached the letter to these summary judgment motions.

F. December 2020 amendments to the articles and bylaws.

Dr. M Troilo thought the board would consider his request for a meeting during the board's December 11, 2020 regular board meeting. The board did not discuss the member proposed changes to the bylaw at the December 2020 board meeting. Instead, the appointed directors approved amendments to the articles and to the bylaws in response to the member proposed bylaws. The appointed directors gave no notice to the elected directors that the appointed directors were going to change the articles and bylaws at to the December 1, 2020 board meeting. Plaintiffs are asking the court to declare the 2020 amendments *ultra vires* and void.

The six appointed directors voted for the amendments while the four elected directors voted against the amendments.

1. 2020 Amendments to the Articles.

On December 11, 2020, the board adopted by a 6-4 vote, amendments to the Amended and Restated Articles of Incorporation of Delta Dental Kansas Inc. (2020 Amendments) A redline copy is attached as Exhibit B to Appointed Directors' April 19, 2021 memorandum in support of the their motion to dismiss.

Some of the amendments to the articles passed by the appointed directors in response to the members proposed bylaws amendments are as follows.

a. Eliminating Members' Stockholder Powers.

Article V **Membership Organization** of the articles was amended to read as follows:

A.This corporation shall not have the authority to issue capital stock ~~**and all voting powers normally vested in the stockholders shall be vested in the**~~

~~**members of this Corporation**~~**…**No member shall have any rights, title, or interest in the Corporation's property, assets, or business.

B.Meetings of the members shall be held at the time and place, and in the manner, determined by the Board,…The Chairperson of the Board (the "Chairperson") shall presided and set the agenda for the meeting. The Annual Meeting shall be for the purpose of electing any members to the Board who are elected by the membership (the "Elected Directors") and transacting such other business as is properly presented to the members as such meeting, including considering any Properly Proposed Amendments pursuant to Article VII.

This amendment to Article V removed the previous language that had given the members the voting powers similarly held by corporation stockholders.

b. Article VI clarifying the board's terms.

The amendments to Article VI **Board of Directors** of the articles added to or clarified the powers of the Board. The amendment to Article VI also added new Article VI, section D., which extended the terms of office of each director to six years, automatically renewed the terms of each director of the board without any additional action, and stated the elected directors have exclusive authority to modify the bylaws regarding the terms and tenure of the elected directors, while the appointed directors have exclusive authority to modify the bylaws regarding the terms and tenure of the appointed directors.

In accordance with the act and as set forth in the bylaws, the terms of any directors appointed by the Gov. or the Kansas Insurance Commissioner ("Appointed Directors") shall be six (6) years and shall automatically renew for successive six (6) year terms until a vacancy occurs. The terms of any elected director shall be six (6) years and shall automatically renew for successive six (6) year terms until a vacancy occurs. The Board hereby delegates its authority to the Appointed Directors to modify the Bylaws as they may deem necessary and appropriate regarding the terms of office and tenure of Appointed Directors. The Board hereby delegates its authority to the elected directors to modify the Bylaws as they may deem necessary and appropriate regarding terms of office and tenure of elected directors. Elected Directors shall have no power or authority to modify or otherwise change the terms of officer tenure of Appointed Directors. Appointed Directors shall

have no power or authority to modify or otherwise change the terms of office or tenure of Elected Directors.

c. Article VII Procedure to Amend Articles and Bylaws.

The 2020 amendments to the articles made significant changes to Article VII Amendments of Articles and Bylaws, as to the procedures that would be required to amend the articles of incorporation and the bylaws after December 11, 2020.

The new section A amended the articles to state that the power to adopt, alter, amend or repeal the articles is now vested exclusively in the board "and shall occur upon an affirmative vote of a majority of the Board **and** a vote of the majority of the Appointed Directors." (emphasis added.) If the changes to Article V of the articles did not make it clear, this new section A makes it clear that only the board, and not the members, have the power to amend the articles of incorporation. In addition, the power amend the articles is not really given to the board as a whole. Instead, the new Article VII (A) gives the appointed directors a super power, by giving the appointed directors the exclusive power to amend the articles by requiring that there must be a majority vote of the appointed directors to pass any proposed articles amendment.

The new section B now states that the power to amend the bylaws is vested concurrently in the Board and the membership, and no longer in just the membership. Although the members still have the power to amend the bylaws, any member proposed bylaw amendment must first be reviewed and considered by the Board, to make sure it is a "Properly Proposed Amendment". If it is not a properly proposed amendment, then the member proposed bylaw amendment cannot be submitted to the membership for a vote. Article VII(B) is not clear, but it appears, at a minimum, the member proposed amendment to the bylaws must be consistent with the articles. There is no other definition or description of what is a properly proposed member amendment.

2. Vote and Plaintiffs' reaction.

At the December 11, 2020 annual board meeting, the board passed these amendments to the Articles by a 6-4 vote, with all the appointed members voting in favor and all the elected members voting against the amendments. After that vote, the Board voted to amend the Bylaws to conform to the amendments to the Articles. None of these Amendments to the Articles or Bylaws were presented to the membership for a vote.

After the Board passed these amendments, Plaintiffs' counsel sent an 11 page letter with 68 exhibits, objecting to the amendments and asking the State Insurance Commissioner to not approve the amendments. It is disputed whether the commissioner elected to take no action, or merely has chosen to leave the matter for the courts.

Appointed Defendants argue Plaintiffs have animosity that initially arises from what is alleged in controverted defense fact 113, as DDKS's decision in 2019, to drastically lower re-imbursements for the DDKS dentist providers with no warning and no explanation.

II. SPECIFIC MOTION FACT RULINGS.

All of these fact findings, whether for the motion for summary judgment or cross-motion for summary judgment are for purposes of these motions only and, to the extent permitted by the rules, for purposes of Appointed Directors motion to dismiss.

A. Plaintiff's facts.

The following are uncontroverted: Facts 1-10, 12-18, 21, 22, 25, 26, 29-32, 34, 35, 39, 41, 44, 45, 47.

Fact 11 is uncontroverted except the last examination was 2017, not 2013.

Facts 19, 23, 36-38, the language says what it says.

Fact 20, it is controverted that 2005 certificate was supplemental. The remainder is uncontroverted.

Fact 24 is uncontroverted except the issue of when M. Troilo became a member, to the extent it makes any difference.

Fact 27 is uncontroverted except whether the amendment was "proposed" or "possible".

Fact 28, it is uncontroverted that M. Troilo's 10/27/20 letter included a petition signed by some DDKS members. It is controverted that signatures were attached.

Fact 33 is uncontroverted but the court accepts the response's additional statement on this fact.

Facts 40, the only issue is whether it is "IV" or "V", to the extent it makes any difference. The language says what is says.

Fact 42, the language says what it says. The court agrees the second sentence is not part of IV(D), to the extent it makes any difference.

Fact 43, is uncontroverted except whether the word is "interest" or "interested", to the extent it makes any difference.

Fact 44, the language says what it says, but the court accepts the response's request to consider the full amendment.

Fact 48, the court agrees the statement, "The 2020 amendments…, took the following actions," is a legal conclusion. The language referenced in 48 A and B says what it says. 48 C is a legal conclusion.

B. Appointed Directors Response and Cross-Motion Facts.

The following facts are uncontroverted: 1,2, 7-12, 19, 20, 22, 25, 27, 32-34, 36, 42-46, 48-53, 55-61, 64, 67, 78-80, 82, 84, 85, 91-93, 103, 104, 106, 107, 109, 114, 116, 118-120, 122.

The following are legal arguments or legal conclusion. The court rules that, just because it was stated in Plaintiffs' petition, the statement does not change a legal statement into a fact. Facts 3, 5, 6, 14, 15, 18, 21, 28-30, 68-72, 75, 90, 111.

Fact 4 is uncontroverted but the court accepts Plaintiffs' reply's additional statement.

Fact 13, the 2000 amendments say what they say.

Fact 16 is uncontroverted except the first phrase.

Facts 23 and 24, the agreements say what they say.

Fact 26, the first sentence is a legal argument, the second sentence is controverted and the third sentence is uncontroverted.

Fact 31 is uncontroverted except that the facts use of the term "nevertheless" is argumentative.

Facts 35 and 37 are uncontroverted as clarified.

Facts 38-41, it is uncontroverted that the DDKS board amended the articles and/or the bylaws without member approval. What the board was "seeking" to do is controverted.

Fact 47, both the fact and Plaintiffs' reply are legal arguments.

Facts 54, 73, 83, 108 are controverted.

Facts 62, 63 the objection is sustained.

Facts 65, 66, 76, the proposed amendments say what they say.

Fact 77, the letters says what they say.

Fact 81, the phrase "serial and illegal requests" is controverted and argumentative. It is premature to determine what counsel did or did not do.

Facts 86 and 87, the objection is sustained.

Fact 88, the phrase " quest to take control" is controverted and argumentative.

Fact 89, the letter says what it says.

Facts 94-101 are premature without discovery.

Fact 102, the amendments says what they say.

Fact 105 is uncontroverted, but the court accepts Plaintiffs' reply's additional facts.

Fact 110, the petition says what it says.

Fact 112 is uncontroverted but the court accepts Plaintiffs' reply's additional facts.

Fact 113, the first phrase is controverted and argumentative. The rest is uncontroverted.

Fact 115, it is uncontroverted that M. Troilo sent the letter. The rest is controverted and argumentative.

Fact 117, the term "misrepresents' is controverted. The rest is uncontroverted and the court accepts Plaintiffs' Reply's additional facts.

Fact 121 is a legal argument and draws factual conclusions in the statement of facts portion that are inappropriate for a motion for summary judgment. The facts are premature.

ANALYSIS

In the petition, Plaintiffs are asking for the court to declare that this lawsuit is properly maintainable as a derivative action, to declare that the 2020 Articles Amendment and amended Bylaws are invalid and unenforceable, and to declare that Appointed Directors breached their fiduciary duty. In addition, Plaintiffs are asking the court to enjoin the defendants from enforcing the 2020 amendments. Plaintiff's motion is on the declaratory relief claim.

In their motion, Appointed Directors are asking the court to hold that the DDKS directors owe no fiduciary duty to the members, either directly or derivatively. In addition, Appointed Directors are asking the court to hold and find that Plaintiffs do not have standing to represent the members or have not met the pre-petition demand requirements to bring a derivative action under K.S.A. 60-223a.

The court's primary focus is the validity and enforceability of the amendments in the analysis of this motion.

I. STANDARD FOR SUMMARY JUDGMENTS.

The parties have properly stated the standards for summary judgment. Summary judgment is appropriate when the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law. *Mitzner v. State Dept. of SRS,* 257 Kan. 258, 260-261 (1995). Although the court does not weigh the evidence when considering a motion for summary judgment, the trial court is required to resolve all facts and inferences which may be reasonably drawn from the evidence in favor of the party against whom the ruling is sought. *Bergstrom v. Noah*, 266 Kan. 847, 871 (1999). When opposing a motion for summary judgment, an opposing party must come forward with evidence to establish a dispute as to a material fact. *Id*. In order to preclude summary judgment, the facts subject to dispute must be material to the conclusive issues. *Id.*

II. GENERAL CONCLUSIONS.

The court states some general conclusions about DDKS, the application of the Kansas Corporations Code K.S.A. chapter17 ("the Code"), the Kansas Insurance Code K.S.A. chapter 40 ("the Insurance Code") , and the Kansas Nonprofit Dental Service Corporation Act, K.S.A. 40-19a01, *et seq*.

First, DDKS is a Kansas corporation. Second, DDKS is a non-stock non-profit corporation as defined in the Code, meaning it has members and not stockholders.

Third, DDKS is an insurance company governed by the Kansas Insurance Code and is required by K.S.A. 40-19a05 to have a certificate of authority to write insurance that has been issued by the insurance commissioner as required by K.S.A. 40-214 of the Insurance Code.

Fourth, DDKS writes dental insurance. As a non-profit dental service corporation, DDKS is a special type of insurance company governed by the four specific additional requirements of the Act in addition to any requirements of the Code and the general organization requirements in articles 1 and 2 of the Insurance Code. The five specific Act requirements are: (1) DDKS must be a non-profit corporation; (2) the members must be licensed Kansas dentists; (3) DDKS must have at least fifty percent of all Kansas dentists as members; (4) the board of directors must consist of ten members, six appointed by the governor or insurance commissioner and four elected by the members; and (5) DDKS must be managed by the board. Other than these five requirements, the Act does not have any other exceptional organization or corporate governance requirements.[1]

Finally, if DDKS could not the meet Act requirements to obtain the fifty percent Kansan dentist membership, or if DDKS chose to have a different make-up of the board,

[1] The Act does have requirements about payment of fees, administrative expenses and subscription contracts. Those provisions are not relevant to the analysis of the general DDKS corporate governance.

DDKS could still technically attempt to operate as a dental insurance company under the Insurance Code, either as for profit or non-profit corporation, as long as DDKS had the certificate of authority to write dental insurance issued by the commissioner. Without meeting these Act requirements, DDKS merely would not be an Act corporation. Nothing cited or argued to the court would lead the court to conclude only Act companies can write dental insurance in Kansas.

III. LEGALITY OF THE 2000 AMENDMENTS UNDER THE CORPORATIONS CODE

The court first considers Plaintiffs motion for summary judgment on count I, declaratory relief that the 2020 Amendments are illegal.

Plaintiffs, in their argument at the hearing, asked the court to focus first on the language and legality of the 2000 amendments to the articles of incorporation. Plaintiffs argue that the 2000 amendments to the articles legally gave the sole power to the members to amend the DDKS articles and the bylaws. If true, then Plaintiffs argue the 2020 amendments are illegal and void.

Although the parties have presented quite a number of facts in their respective motions, responses and replies, the facts for this motion are pretty basic. The 2000 articles and the 2020 amendments say what they say. For this portion, the court interprets the 2000 articles and the 2020 amendments, then applies the Code and the Act to determine their legality.

As requested by Plaintiffs, the court will first focus on the legality of the 2000 Amendments, which the court warns is a long analysis.

As stated above, Article V of the articles was amended in 2000 to read as follows: "This Corporation shall not have authority to issue capital stock, and all voting powers normally vested in stockholders shall be vested in the members of this Corporation." This 2000 amendment was voted on and approved by both the members and the board. Those same 2000 amendments added Article VII, which stated: "The power to adopt, alter, or

amend or repeal this Corporation's Bylaws, in whole or in part, at any time, shall be vested in the Membership."

Appointed Directors argue the 2000 articles amendments violate the Code by giving impermissible control to the members in violation of the Code and the Act. In addition, Appointed Directors argue the default rules of the Code gives the board the ability to amend the articles of a non-stock corporation as passed by the board in 2020. Stated differently, Appointed Directors argue default provisions of the Code don't allow the article 2000 amendments that gave corporation stockholder powers to the members, in particular, the sole powers to amend the articles and bylaws. Therefore, the default provisions of the Code control, and allow or mandate the 2020 amendments.

Plaintiffs argue that the language of the 2000 article amendment to Article V legally gave the members the same voting powers as a held by stockholders, including the sole power to amend the articles of incorporation. If the 2000 articles gave this power to the members, then Appointed Directors improperly amended the articles in 2020 to eliminate this power without first obtaining a majority vote of the DDKS members.

Additionally, Plaintiffs argue the new Article VII of the 2000 article amendments legally gave the sole power to the members to amend to the bylaws. If the 2020 article amendments were not properly enacted including the power to amend the bylaws, then the 2020 bylaws amendments were not properly enacted.

A. Corporate Powers under the Kansas Corporations Code.

DDKS is a non-stock corporation organized pursuant to or organized to be regulated by Kansas Nonprofit Dental Service Corporation Act. However, because the 2000 amendments gave the members "stockholder powers", the court must first consider what are those powers, independent of any application of the Act. The court first considers the 2000 articles amendment language in the context of the Code, without considering the effect of the Act on board or members' corporate powers.

The parties argue for or against the applicability of the Code's corporate governance provisions for a stock corporation, for a non-stock corporations and for a non-stock corporation meeting the requirements of the Act.

As the parties have briefed extensively, a party may organize a corporation under the corporations code as a stock corporation, either to be authorized issue capital stock or to be a non-stock corporation, where the issuance of capital stock is not authorized. *See*, K.S.A. 17-6002(a). Non-stock corporations have members, not stockholders. *See, Id*.

1. What are the powers of Kansas corporation stockholders to amend the articles?

When a stock corporation is formed, the articles of incorporation must set forth the powers, rights, qualifications and restrictions with respect to any class of stock. K.S.A. 17-6002(a)(4)(A). Those powers, rights and qualifications of stockholders are set forth generally in K.S.A. 17-6401. With regard to amending the articles of incorporation, unless the amendment is merely to change the corporation's name or to delete certain provisions regarding incorporators, the Code gives stockholders the power to amend the articles of incorporation, not the board. K.S.A. 17-6602(b)(1).[2] In addition, the articles of incorporation may set for the manner of adoption, alteration and repeal of bylaws. K.S.A. 17-6002(b)(7).

The suggestion was made that, if DDKS was formed before July 1, 1972, the rule means that, only the board may thereinafter amend the bylaws, even if the corporation is a stock corporation. This would meant that the legislature intended that the pre-July1, 1972 stockholders will never hold, fifty, sixty, ninety years later, the same powers that are granted to post-July1, 1972 stockholders. This does not make sense, and doesn't even agree with a literal interpretation of the statute. The post July 1, 1972 rules apply to the pre-July 1, 1972 stock corporations. The reference is just to aid the transition to the new

[2] It is important for the reader to distinguish between the court's use of K.S.A. 17-6002 and K.S.A. 17-6602.

Code.

Therefore, the default rule for a stock corporation gives the stockholders the voting power to amend the articles. This would be the default rule for DDKS, if DDKS were a stock corporation. Under this default rule, DDKS stockholders would have the voting power to amend the articles, not the board.

2. What are the powers of Kansas corporation stockholders to amend the bylaws?

The right to adopt, amend or repeal bylaws for a corporation in existence on July 1, 1972 shall be vested in the corporation's board, unless otherwise provided in the articles of incorporation and subject to the right of the stockholders to adopt, amend or repeal the bylaws. K.S.A. 17-6009(a). For corporations created after July 1, 1972, the original bylaws may be adopted by the board, until the corporation has issued stock. Thereafter, the power to amend the bylaws rests with the shareholders entitled to vote, or in the case of a nonstock corporation, in its members entitled to vote. *Id.* The articles may, but are not required to, confer a concurrent power to amend the bylaws on the board. *Id*. The statute uses the term "power" for the ability to make post-incorporation, amendments to the bylaws.

The default rule for a stock corporation gives the stockholders the powers to amend the bylaws. This would be the default rule for DDKS if DDKS were a stock corporation

If DDKS had stockholders, those DDKS stockholders would have the power to amend the articles and the bylaws.

B. Stockholder Governance Powers versus Rights.

The parties argue whether there is a distinction between stockholder powers versus stockholder rights under the Code. Appointed Directors argue the reference to stockholder powers in the 2000 articles really means stockholder voting rights. Plaintiffs

argue that stockholder powers are those that the stockholders hold as a whole, that is, the power to enact changes. Whereas, stockholder rights are what each stockholder is given holds individually. Both terms are used and granted by the Code. The court agrees there is a distinction between the use of the term "power" and "rights" under the Code.

For example, K.S.A. 17-6101 use the term "power" when discussing what a corporation, officers, directors and stockholders are given by the Code. Also, K.S.A. 17-6102 gives the corporation specific powers to act. Another example of the use of "power", K.S.A. 17-6301(a) says the board is given the power to act as set forth in the articles of incorporation. Additionally, K.S.A. 17-6301(c) allows those board powers to be given to a committee.

Alternatively, K.S.A. 17-6301(c)(2) says the articles may confer upon holders of any class or series of stock the right to elect one or more directors, and have such voting powers as shall be stated the articles of incorporation. The section sets out a distinction between giving a stockholder the right to vote, versus giving a class of shareholders the powers to act.

The court notes that the title of K.S.A. 17-6401 highlights that there is a statutory distinction between rights and voting powers. "Classes or series or stock; rights, voting powers, designations, preferences, qualifications, limitations or restrictions; …; issuance of stock where rights, voting powers, …, limitations or restrictions not stated in the articles; …" For example, K.S.A. 17-6401(a) provides that the corporation may issue one or more classes of stock with voting powers, and then repeatedly uses both the term powers and rights.

In the alternative, the voting rights of stockholders are provided for in K.S.A. 17-6502. "Each stockholder shall be entitled to one vote." Similarly, K.S.A. 17-5605(b) references members' rights by giving each member the right to vote.

In analyzing the distinction in the Code between power and rights, the court concludes that *power* is given to a group or class to act, that is, the corporation has the

power to act, the board may have the power to act, and stockholders, or a class of stockholders, may have the power to act. For example, one class of shareholders may have the power to elect one member of the board, or amend to the articles of incorporation. Whereas, *rights* are given to individual stockholders or members, such as the individual stockholders of a class have the *righ*t to vote on that amendment when the class has been given power to act.

The court applies this analysis when it interprets Article V of the 2000 articles. The court holds that when Article V says "all voting powers normally vested in stockholders", this means "powers" under the Code and does not mean "rights". Under Article V, if stockholders as a group would have the power to act, then Article V of the 2000 articles gives those same powers to the members. This would include the power to amend articles and bylaws amendments.

C. Nonstock Corporations Governance Powers.

As decided above, if DDKS were a stock corporation and the dentists were stockholders, then the dentists would have the power as stockholders to amend the articles of incorporation and the bylaws. The issue is whether the Code prohibits members of a nonstock corporation from having or from being given these powers.

1. K.S.A. 17-6002.

When creating the articles of incorporation, the requirements of K.S.A. 17-6002(a)(1)-(4)(A) do not apply to a non-stock corporation. K.S.A. 17-6002((a)(4)(B)(i) ("foregoing"). But, preliminarily, the Code's general default provision, for the member voting rights and powers of a non-stock corporation, is that members of a non-stock corporation may be given voting rights and powers in the articles. K.S.A. 17-6002(a)(4)(B)(ii) specifically says,

> Except as otherwise provided in this code, nonstock corporations may also provide that any member or class or group of members shall have full, limited or no voting rights or powers, including that any member or class or group of members shall have

> the right to vote on a specified transaction even if that member or class or group of members does not have the right to vote for the election of the members of the governing body of the corporation.

The exception is, "Except as otherwise provided in this code," The arguments in this case focus on that language, that is, whether other portions of the Code prohibit giving the members the same voting powers of stockholders.

Because corporations are subject to other regulations in the statutes, one exception would be the limitation in the Act, where six of the ten DDKS board directors must be appointed by non-members. In spite of this limitation on voting for the election of some members of the governing, K.S.A. 17-6002(a)(4)(B)(ii) states members can have voting rights and powers. This section does not contain any specific limitation or exception on having the power to vote for amendments to the articles of incorporation or bylaw. Therefore, members may have these powers.

These voting rights or powers of a member of a non-stock corporation may be set forth in the articles of incorporation or the bylaws. K.S.A. 17-6002(a)(4)(B)iii). If the articles or bylaws are silent, the default rule is that the members of the corporation shall be deemed to be those entitled to vote for the election of members to the governing body. *Id*.

2. K.S.A. 17-6505.

K.S.A. 17-6505(a) has an additional discussion if the voting rights of members of non-stock corporations regarding voting and attending meetings:

> The provisions of K.S.A. 17-6501 through 17-6504 and 17-6506, and amendments thereto, shall not apply to nonstock corporations, except that K.S.A. 17-6501(a) and 17-6502(c), (d) and (e), and amendments thereto, shall apply to such corporations, and, when so applied, all references therein to: (1) Stockholders and to the board of directors shall be deemed to refer to the members and the governing body of a nonstock corporation, respectively; and (2) stock, capital stock, or shares thereof shall be deemed to refer to memberships of a nonprofit nonstock corporation and to membership interests of any other nonstock corporation.

K.S.A. 17-6501 through 17-6504 and 17-6506 govern shareholder meetings. This is an example of when the Code uses the term "stockholder" it also means "member". Importantly, K.S.A. 17-6501(a) references stockholder meeting requirements while K.S.A. 17-6502(c)(d) and (e) discuss proxy and other voting rules when the stockholder is not present. These are references to the requirements for voting power and voting rights references, meaning the voting requirements stockholders and members are the same.

3. K.S.A. 17-6602.

As both sides agree, K.S.A. 17-6602(b)(1) of the Code states the procedure for amending the articles of incorporation of a stock corporation. Those rules require a resolution adopted by the board and then calling a meeting for a vote by the stockholders unless the articles amendments are of the type listed in K.S.A. 17-6602(a)(1)(7). The Code provides the articles may include total voting powers that are greater than a simple majority. *See*, K.S.A. 17-6602(b)(4).

For a non-stock corporation, only a vote of the members of the governing body are required to amend the articles. K.S.A. 17-6602(b)(3). This means the board of directors.

The issue becomes, is the K.S.A. 17-6602(b)(3) language just a default provision or is it an absolute that cannot be abrogated by an amendment to the articles to allow member voting on articles amendments. The court considers the comparison of K.S.A. 6002(a)(4)(b)(iii) (the ability to confer voting rights or powers) with K.S.A. 17-6602(b)(3) (articles amendments of a nonstock corporation require only a vote of the board). Stated differently, can a board of a nonstock corporation, pursuant to 17-6002((a) give members powers that are not given to members in K.S.A. 17-6602(b)(3)?

Neither side has given the court any controlling or persuasive authority on this issue. The Delaware case cited by Plaintiffs, *Farapour v. DCX, Inc*. 635 A. 2d 894 (1994), actually interprets section 242(b)(3) of the Delaware code to mean that nonvoting

members do not vote on changes its certificate (articles). At 899. *Farapour* does not address if the certificate (articles) can be amended to allow for such a vote.

4. Non-Profit distinction.

When the court considers this argument, the court also believes that the distinction between the DDKS purpose and a typical non-profit purpose is important. DDKS is not a museum, a foundation, or a public television station, where members may donate money and time, but might object to how the money is spent. The court would agree that limitations on members being in the governance of the corporation might be appropriate.

DDKS is not that same type of non-profit. DDKS is a business. DDKS is an insurance company organized to provide dental insurance to subscribers, to attract providers, to set re-imbursement rates for providers and to provide non-profit services to lower income patients if funds allow.

5. Amendments to Articles.

The court holds that the provision of K.S.A. 17-6602(b)(3) are default provisions and that K.S.A. 17-6605 allows the articles to include a provision that provides for the right of members to approve any amendments to the articles.

Therefore, the court agrees with Appointed Directors that if the Act does not apply, the default provision to amend the DDKS non-stock articles merely requires the vote of by the board and does not require a vote by the members for the amendment to be approved. The board followed this procedure in 2000.

However, the court agrees with Plaintiffs that the Code allows the articles of a non-stock corporation to be amended to give stockholder powers to members of a non-stock corporation. This power includes the power to amend the articles. When the 2000 amendments were adopted by the DDKS board, the amendments legally gave sole power to the DDKS members to amend the articles.

6. Bylaws Amendments.

The issue then becomes the effect of the 2000 articles amendments relating to the bylaws, and the 2000 bylaws amendments

The articles of a non-stock corporation may also include the manner of adoption, alteration and repeal of bylaws. K.S.A. 17-6602(b)((7), K.S.A. 17-6009. If the articles of incorporation confer the power to amend bylaws on the governing body, the fact that such power has been conferred on the governing body does not divest or limit the members of the non-stock corporation to adopt, amend or repeal bylaws. K.S.A. 17-6009. K.S.A. 17-6009 says *if* the articles confer the power to amend the bylaws on the governing body. The use of "if" in K.S.A. 17-6009 is conditional. The use of "if" means that there is the other statutory possibility, that is, the articles do not confer the power to amend the articles on the governing body. This subsection makes no distinction between stock and non-stock corporations. Therefore, the default is, whether or not the articles confer the powers to amend the bylaws on the governing body, the stockholders of a stock corporation and members of a non-stock corporation can have that power to amend the bylaws.

There is no dispute that the board followed this procedure in 2000, when the board adopted Article V that gave the members "all voting powers normally vested in stockholders".

The court also notes that K.S.A. 17-6602 is not one of the sections excluded by K.S.A. 17-6505, voting rights for non-stock corporations. In the court's analysis, the court notes the general corporate rule that K.S.A. 17-6505 includes the default provision that the general voting rights given to stockholders in 6501-6504 and 6506 are not given to members, but unless specifically excluded by the code, members are stockholders. While the DDKS members cannot statutorily vote for six of the directors, they can be given voting rights.

The court holds that the Code provides that the members of a non-stock corporation have the default power to amend the bylaws. In addition, even if the members do not have the default power to amend the bylaws, the Code allows the articles to be amended to grant that power to the members. The DDKS members had the power to amend the bylaws in 2000, or alternatively, were legally given that power in 2000.

D. Effect of the 2000 Amendments.

In spite of Appointed Defendants arguments to the contrary, the language of the 2000 amendments gave the members the powers of the stockholder class, not just rights as individual stockholders. K.S.A. 17-6602(b)(1) provides that a change to the articles of incorporation requires the vote of the stockholders. The 2000 amendments legally and properly gave the power of stockholders to the members. Thus, the 2000 amendment to the articles legally and properly gave the sole power to the members to amend the articles of incorporation. Similarly, the 2000 articles legally and properly gave the sole power to the members to amend the bylaws, if they did not have that power before the 2000 amendments.

The court wants to emphasize this conclusion does not mean the 2000 amendment gave the members the power to manage DDKS, or to amend the bylaws in such a way that interferes with the management of DDKS. The Code is clear that DDKS is to be managed by the board whose directors have been selected in compliance with the Act.

Whether Plaintiffs' proposed 2020 amendments were an attempt to improperly interfere with DDKS management is not the subject of this motion, although it probably was the underlying theme for the board's 2020 amendments.

IV. EFFECT OF THE ACT ON CORPORATE GOVERNANCE.

The parties argue the effect of the Act on the corporate governance of a non-profit dental corporation. The argument is that, because DDKS is organized under the Act, and

not the Code, the Code's corporate governance rules do not apply to DDKS. The issue is whether the Act prevents, as a matter of law, the actions taken by the DDKS board and members in 2000 and negates applying this court's interpretation of the legal effect of those 2000 articles. Alternatively, the issue is whether any of the Code governance rules that might prevent enforcement of the 2000 articles, are not enforceable against an Act non-profit dental corporation.

A. Default Rules Code vs. the Act.

Preliminarily, the parties argue the legal effect of K.S.A. 17-6001(c). Specifically, does K.S.A. 17-6001(c) prohibit the use of the Code in the corporate governance decisions of a K.S.A. 40-19a01, *et seq*, nonprofit dental service corporation?

K.S.A. 17-6001(c) of the Code provides

> "Corporations subject to special statutory regulation may be organized under this code if required by or otherwise consistent with such other statutory regulation, but such corporations shall be subject to the special provisions and requirements applicable to such corporations. Where the provisions and requirements of this code are not inconsistent, they shall be construed as supplemental to such other statutes and not in derogation or limitation thereof, and such corporations shall be governed thereby. Subject to the foregoing provisions of this subsection, any corporation organized under the laws of this state or authorized to do business in this state shall be governed by the applicable provisions of this code."

The parties do not dispute that DDKS is a corporation subject to a special statutory regulation, that is, K.S.A. 40-101, *et seq*, the Insurance Code, and in particular, the Insurance Code's title 19a for non-profit dental corporations.

While the parties have extensively argued about the meaning of the Code's K.S.A. 17-6001(c) to this court, this court concludes the interpretation of this section is pretty clear for purposes of this analysis. First, if a corporation is special statutory regulations corporation, those corporations are subject to the provisions of those regulations. In this case, because DDKS is an insurance company, DDKS is subject to the insurance code. In addition, DDKS is subject to the Act. This is a straightforward interpretation of K.S.A.

17-6001(c).

Second, K.S.A. 17-6001(c) says that if the provisions of the Code are not inconsistent with the other statutes, then the Code supplements and does not limit the effect of the other statutes. Again, this simply means that the regulatory statutes' rules are to be applied and not the Code's if the two are inconsistent. But the Code still supplements if the two are not inconsistent. So, if the Insurance Code and Act conflict with the Code, the Insurance Code and the Act are to be applied. If there is no conflict, the Code applies.

Finally, if any corporation is organized under the laws of this state or organized to do business in this state, K.S.A. 17-6001(c) says the Code applies. The section does not read organized under the corporations code, it says organized under the laws of this state. This is an important distinction. Whether DDKS is organized under the Ac, under the Insurance Code or under the corporations code, DDKS is governed by the Code, unless the Insurance Code or the Act conflict with the Code. If there is a conflict, the Insurance Code of the Act govern DDKS's corporate affairs.

Re-stated, the default rule is that Act applies to DDKS, if the Code is inconsistent with the Insurance Code or the Act. If the Code is consistent with Act, the Code's rules apply by default.

B. Code Inconsistencies with the Insurance Code.

Although DDKS is an insurance corporation, neither side has argued that any specific provisions of the general Insurance Code are in conflict with the Code and those inconsistent provisions should be applied to the 2000 amendments. The exception is the application of the Act, that is, are there any provisions or requirements of the Act that are inconsistent the Code and also would affect the court's analysis of the outcome in this case?

C. The Act, K.S.A. 40-19a03 requirements.

What are the specific statutory governance requirements that are applied to non-profit dental insurance corporation operating under the Act? The Act is small and has few rules regarding governance of DDKS. To the extent they apply to the facts of this case, the rules are found primarily at K.SA. 40-19a03.

1. Non-profit Corporation.

First, DDKS must be a nonstock non-profit corporation with members. This language in section K.S.A. 40-19a03 requires that the membership be limited to dentists licensed to practice in Kansas who have executed participating agreements with the DDKS. This requirement is more restrictive than the Code's general rules for stockholders or members of a corporation. Because the non-profit restriction is inconsistent with the Code's default rules, this Act restriction applies.

2. K.S.A. 40-214 certificate of authority by insurance commissioner.

Second, to do business as an insurance company, a corporation must have been issued a certificate of authority from the Insurance Commissioner to do business as an insurance company. K.S.A. 40-214. As part of the requirements to be able to transact insurance business in Kansas pursuant to K.S.A. 40-214, a corporation must be duly authorized to under the laws of the state of Kansas and shall have received proper written authority from the insurance commissioner. "Is shall be unlawful for any…corporation…to transact the business of insurance …unless such…corporation shall have been duly authorized under the laws of this state to transact such business and shall have received proper written authority from the commissioner of insurance in conformity with the laws of this state relative to insurance…." K.S.A. 40-214. The language has two requirements: (1) Shall be authorized under the laws of this state and (2) shall have received written authority from the insurance commissioner. These two requirements are not the same.

The parties have attempted to argue the issue of whether the certificate of authority issued by the insurance commissioner is the equivalent of organizing a

corporation, meaning "authorized to do business" means having been issued a written authority from the insurance commissioner and not something else. If this analysis were true, then the argument is that the corporations code does not apply, and therefore, the corporations code's governance rules do not apply. The statutory interpretation is relatively simple. The legislature used two distinct phrases in K.S.A. 40-214. This indicates the legislative intent that "authorized to transact such business" means something different than a certificate of authority. The court concludes "authorized to transact such business" means, for a corporation, organized under Kansas law, or, if a foreign corporation, registered to do business. Both would be with the Kansas secretary of state.

The certificate of authority merely gives an insurance corporation, organized under the corporations code or registered, the authority to transact insurance business in Kansas.

Because the certificate of authority requirement is inconsistent with the Code's default rules, this Act restriction applies.

3. Participating Dentist Requirements.

In addition to the general requirements that the insurance commissioner must be satisfied that a non-profit dental insurance corporation should be issued a certificate of authority to conduct insurance business, K.S.A. 40-19a03 has an additional requirement applying to the members. Before issuing the K.S.A. 40-214 certificate of authority, the commissioner must be satisfied that that DDKS has obtained participating agreements from at least fifty (50%) percent of the dentists licensed to practice in Kansas.

Because this member participation requirement is inconsistent with the Code's default rules, this Act restriction applies.

4. Only the Board Manages DDKS.

Next, section, K.S.A. 40-19a03, requires the "affairs" of the corporation to be

managed by the board of directors. By comparison, K.S.A. 17-6301(a) of the corporations code states that the "business and affairs" of a corporation "shall be managed" under the direction of the board of directors, except as may be otherwise provided in the corporation code or in the articles of incorporation. Under the Code, management by the board is the default rule. Under the Act, management by the board is the rule, without exception. This rule is more restrictive than the general corporations code rule for boards of directors of Kansas corporations, therefore this restriction applies. This means the articles of incorporation of a K.S.A. 40-19a03 cannot be amended to provide for the management by anyone other than the board. This means neither the board nor the members of DDKS can pass articles or bylaws amendments that give management of the corporate affairs to the members.

Because this limitation on the management of the corporation is inconsistent with the Code's default rules, this Act restriction applies.

5. Size and Membership of the DDKS Board.

Finally, pursuant to K.S.A. 40-19a03, the DDKS board must have ten (10) members, six of whom are appointed and four of whom are elected. Two board members are appointed by the governor and four are appointed by the commissioner. The remaining four are elected by the dentist members. This rule is more exclusive than the general rule for boards of a Kansas corporation, therefore this restriction applies.

K.S.A. 40-19a03 allows the bylaws to determine the length of each board members term. In addition, a board quorum is determined by the bylaws. These rules are not more restrictive than the general rule for boards of Kansas corporations.

The size and membership of the board is inconsistent with the Code's default rules, this Act restriction applies. However, the requirements for the quorum and term lengths are consistent with the Code.

6. Other sections of Article 19a.

The remaining rules of article 19a primarily address the who, what, why and how of the insurance contracts with the dentists, DDKS and the persons or entities who buy DDKS dental insurance. While these are limited to dentist members, these sections really are specific insurance statutes appropriate for specific insurance code regulation, and are not applicable for general corporations code application.

D. Conclusion on Act versus Code.

The court holds the Code applies to DDKS governance except as noted above. Meaning, the articles and bylaws of DDKS may be established and amended as allowed by the Kansas Code, unless one of the specific restrictions of K.S.A. 40-19a03 apply. When the court applies the Act in the context of the K.SA. 17-6001(c) rule on inconsistent statutes, only the sections that the court has address above are applicable to this analysis on corporate governance. Other than what is specifically set out in K.S.A. 40-19a03 and discussed above, there are no other inconsistent provisions of the Code that require the Act to be applied to DDKS's corporate governance.

E. Do the 2000 amendments violate the Act?

The court has already ruled that the 2000 amendments do not violate the Code. However, K.S.A. 40-19a03 was in effect in 2000, and is applicable to the 2000 amendments.

The issue is do the 2000 amendments conflict with K.S.A. 40-19a03? Appointed Directors argue that the 2000 amendments violate 40-19a03 by improperly taking management of the affairs of DDKS and giving it to the members.

1. Article V (2000).

The language at issue in article V is as follows: "This corporation shall not have authority to issue capital stock, and all voting powers normally vested in stockholders

shall be vested in the members of the corporation." The court has already interpreted this language and held that this language gives the members, as a group, the voting powers of stockholders of a corporation. The 2000 articles gave the members the power to amend the articles by giving the members the powers of corporate stockholders. The 2000 articles vested in the members the power to amend the bylaws. (2000 Articles **Article VII Bylaws**.)

The court has already held as a matter of law, under the corporations code, this power can be given to members of a corporation.

The issue is, does this transfer of power conflict with K.S.A. 40-19a03? The main issues are: voting for bylaws changes and voting for articles changes.

Appointed Directors argue the 2000 articles that gave the members the power of corporate stockholders violates the Act's requirements that DDKS can only be managed by the board. In addition, Appointed Directors argue that vesting the power to amend the bylaws with the members interferes with the board's statutory exclusive power to manage the affairs of DDKS.

2. Board Management.

The language of **Article VIA. Board of Directors** in the 2000 articles specifically states that the board manages DDKS and it specifically references the nonprofit dental corporation act. VI A reads, "The business of the Corporation shall be managed and all affairs shall be conducted at all times in accordance with the provisions of the Act. The affairs of the Corporation shall be managed and conducted by a Board of Directors, the size, composition and selection of which shall be governed by the Act." This language cannot be any clearer as a specific acknowledgement of the Act's requirement that the board, and only the board, manages DDKS. This does not conflict the Act, it only reinforces the understanding of the Act's requirements for the DDKS corporate management.

The Act prevents any attempt by the members to take the management powers from the board.

3. Amendments to the Articles.

As far as who may amend the articles, there is no specific or general mention in the Act of the process to amend the articles, such as whether any amendments to the DDKS articles must be passed by the board or the members. The court notes this lack of reference in the Act to the articles and their amendment and leads the court to conclude that the only requirements for an amendment to the articles is that the post-amendment articles comply with the Code, continue to meet the Act's requirements to be granted a certificate of authority to conduct insurance business, and continue the requirement of board management and board membership. The 2000 articles meet these requirements. DDKS operated for almost twenty years with no objection or other issue stated by commissioner to the 2000 amendments to the articles.

4. Bylaws amendments.

Similarly, the Act is silent as to the process for adopting and amending corporate bylaws, other than, "The bylaws shall specify the number of directors necessary to constitute a quorum, which shall be not less than one more than one-half of the number of directors". K.S.A. 40-19a03. This last language means, that any vote by the board the Act requires that at least two appointed directors must be part of the six directors to have a quorum at the board meeting.[3]

Again, noting this lack of reference in the Act to bylaws and their amendments, the court concludes that the only requirement for an amendment to the bylaws is that the post-amendment bylaws comply with the Code, continue to meet the Act's requirements to be granted a certificate of authority to conduct insurance business, and continue the

[3] The court is not sure why it wouldn't have just been easier to say, "A quorum must include at least six directors" which, by definition, must have at least two appointed directors.

requirement of board management and board membership. In addition, the bylaws must have the Act's quorum requirement.

Appointed Directors ask the court to consider **VII Bylaws** of the 2000 articles. It reads, "The power to adopt, alter, amend or repeal this Corporation's Bylaws, in whole or in part, at any time and from time to time, shall be vested in the Membership.". Appointed Directors argue this gives the members the ability to adopt and amend bylaws that interfere with the board's statutory powers the Act to manage the affairs of the corporation. Appointed Directors argue that the members' proposed 2020 amendments interfered with the board's statutory powers and the members were using **VII Bylaws** as the means to accomplish that goal.

As the court stated before, the Code expressly provides that the articles may confer upon stockholders or members the power to adopt, amend or repeal bylaws. K.S.A. 17-6009. This does not change even if the power has been conferred upon a governing body of a non-stock corporation such as DDKS. "The fact that such power has been so conferred upon the directors or governing body, as the case may be, shall not divest the stockholders or members or the power, nor limit their power to adopt, amend or repeal bylaws. *Id*. The Code confers management powers in the board of directors, yet still allows stockholders and members to adopt bylaws. The shareholder power to adopt bylaws does not interfere with the board's statutory power to manage the corporation, or else the corporations code would not expressly allow the shareholders to have this power. This does not contradict the Act, so the **VII Bylaws** of the 2000 articles does not contradict the Act.

5. Board's Powers.

Appointed Directors have not cited to the court any express provisions in the articles that would allow the members to interfere with the power of the board to manage the affairs of the corporation. **Article VI B Board of Directors** of the 2000 articles specifically defines more of the DDKS board's powers.

> The Board shall have full power and authority to manage the Corporation and any and all of its assets, properties, and affairs, including the right to elect such officers and assistant officers and to designate and appoint such agents and employees as the Board deems advisable and to allow them suitable compensation, and shall have any and all additional powers and authority, not inconsistent with the express terms of these Articles of Incorporation, that are expressly or impliedly granted to or invested in the Board by the Act and by the other statutes or laws of the State of Kansas, as now in effect and as hereafter amended or modified. Unless otherwise provided in the Bylaws of the Corporation, the election of those directors who are elected by the members, in accordance with the Act shall, be by written ballot (sic) shall be required only if requested by a member entitled to vote at said election.

In addition, nothing argued by Appointed Directors would convince the court that this section of the 2000 articles expressly or impliedly is prohibited by the Act. In fact, this Article specifically gives the board the power to manage the affairs of the DDKS, as required by the Act.

6. The 2000 Amendments do not violate the Act.

The court concludes the 2000 DDKS Articles and Bylaws were properly enacted, do not violate the Code and do not violate the Act.

V. LEGALITY OF THE 2020 AMENDMENTS TO THE ARTICLES AND BYLAWS

Plaintiffs' motion asks the court to grant summary judgment on Count 1, declaring that the 2020 amendments passed by the appointed directors are illegal and void. As requested by Plaintiffs, the court first analyzed the legality of the 2000 amendments, because that analysis is necessary to consider the legality of the 2020 amendments.

A. 2020 Articles Amendments.

The board met in December, 2020 and made changes to the articles. Only the appointed directors voted for the changes. The elected members voted against the changes. The board did not submit these 2020 changes to the articles to the members for a vote although that procedure was required by the 2000 articles.

Some of the changes that are material to this analysis include the change to Article V. The new subparagraph A of the 2020 amendments eliminated the stockholder powers granted to the members in Article V of the 2000 articles.

In addition, the 2020 amendments to the articles added paragraph D to Article VI. These changes increased the directors' terms to six years and made the terms automatically renewable unless a vacancy occurs. The legal effect of this change is that if a director's term expires but the director wants to stay on the board, nothing can be done to replace the director, because the term automatically renews. Under this new article, the governor and the commissioner cannot replace their appointed directors and members cannot vote out their elected directors if the directors vote to extend their terms.

The new paragraph D also gives the power to each director class, appointed or elected, to separately modify the bylaws concerning that class's term and tenure of office.

The new paragraph A of Article VII eliminated the power of the members to amend the articles, which this court has ruled legally vested in the members in 2000. Instead, the new paragraph A of Article VII gives the board the exclusive power to amend the articles of incorporation.

More specifically, the new Article A does not really give the power to amend the articles to the board as a whole. Instead, amendments to the articles now require a majority of appointed directors. The court has already referenced this as a super-majority. Effectively, if four elected directors and three appointed directors, for a total of seven of the ten directors, wanted to pass an amendment, it will not pass if the other three appointed directors vote against the amendment.

The new Article VII also modifies the power of the members to vote on changes to the bylaws. New paragraph B now states the power to amend the bylaws is vested concurrently in the board and the membership, which is consistent with the Code. However, any bylaw amendment proposed by the members must first be reviewed and considered by the Board, to make sure it is a "Properly Proposed Amendment". If it is

not a properly proposed amendment, it will not be submitted to the membership. Nothing defines what is a "properly proposed amendment". The Code does not require the board review the members proposed bylaws for propriety before the members pass bylaws.

The court has already held that a corporation that is regulated by the Act, may legally have articles of incorporation that give the power to amend the articles to the members. The court has already held that the 2000 articles legally gave the exclusive power to amend the articles to the members of DDKS. The DDKS appointed directors passed these 2020 amendments to the articles without a proper prior approval of the DDKS members. As a result, the court concludes 2020 amendments to the articles have no legal effect on the governance of DDKS.

B. 2020 Bylaws Amendments.

The DDKS board amended the bylaws in 2020 after adopting the 2020 articles that gave the board concurrent authority to adopt, amend or alter the bylaws. Similarly, because the court has held the 2000 articles were legal under the Code and the Act, that ruling also implicates the board's 2020 amendments to the bylaws. The 2000 articles gave the members the exclusive power to adopt, alter or amend the DDKS bylaws. Because the 2000 articles are legal, and the court has held the 2020 amendments to the articles have no legal effect, the board did not have the power to adopt the 2020 amendments to the bylaws.

The court reminds the parties that K.S.A. 17-6009 gives the power to the stockholders or members to adopt, to alter or to amend the bylaws, unless in the corporation's articles, the power has also given to the board. While paragraph B of the 2020 VII articles mirrors the concurrent power in K.S.A. 17-6009 to amend the bylaws, the 2000 articles do give the board the concurrent power, and the Code does not require it.

Finally, even if the default provisions of the Code do not give the members the powers given to them in the 2000 articles, the power to amend the bylaws was legally

given to the members. Once the power to amend the bylaws was legally given to the members, the board had to act within those powers when it attempted to amend the bylaws in 2020.

The court holds the board did not have the authority to pass the 2020 amendments to the bylaws. Therefore, the 2020 amendments to the bylaws have no legal effect unless approved by the members.

Plaintiffs' motion for summary judgment on Count I, asking the court to declare that the 2020 amendments to the articles and bylaws are illegal and void, is granted.

VI. PLAINTIFFS' BREACH OF FIDUCIARY DUTY CLAIMS.

Appointed Directors' cross-motion asks the court to grant summary judgment in favor of the defendants on Plaintiffs' claims in Count II that the DDKS directors breached their fiduciary duty to the members and to the corporation when the appointed directors adopted the 2020 amendments to the articles and the bylaws. Appointed Directors argue, because of the statutory legal structure of DDKS under the Code and the Act, that, as a matter of law, the appointed directors owe no fiduciary duty to the members, and that the members lack standing to bring a breach fiduciary duty derivative action.

Appointed Directors argue the petition alleges three fiduciary duty violations: (1) The directors allegedly violated the fiduciary duty of loyalty to members when the board adopted the 2020 amendments which plaintiffs allege improperly stripped the members of their power to amend the articles and to amend the bylaws; (2) the directors allegedly violated the duty of loyalty to DDKS when the board adopted amendments to entrench themselves as directors; and (3) the directors allegedly violated the duty of care to DDKS when the board adopted the 2020 amendments without sufficient prior notices and without being fully and properly informed by legal counsel of the validity and legality of the amendments.

The court notes three fundamental facts or rulings. The Act gives the members the power to elect four members to the DDKS board. Because of this grant of power, the members, through their elected directors, have a voice in the management of the affairs of the corporation, even if that voice is in the minority.

Second, although DDKS is a non-profit corporation under the Act, one of the board's major management decisions is how to divide the net revenue between the members or the other DDKS service missions.

Finally, the court has ruled that the board's 2020 amendments to the articles and the bylaws are *ultra vires*.

A. Does the board of an Act corporation owe fiduciary duties to the members?

Appointed Directors do not dispute that all the DDKS directors owe a duty of loyalty and care to DDKS. However, Appointed Directors argue that the board does not, as a matter of law, owe fiduciary duties to members of a non-profit Act corporation such as DDKS.

Neither side has been able to cite any Kansas authority on whether the board of a non-profit, non-stock dental insurance corporation owes fiduciary duties to its dentist members, some of whom are required to be elected to the board.

Appointed Directors argue that Kansas should follow Delaware law as it applies to non-profit charitable corporations, citing *Gassis v. Corkery*, No. 8868, 2014 WL 2200319 at *14-15 & n. 108 (Del.Ch. May 29,2014), *aff'd* 113 A.3d 1080 (Del.2015) (citing *Oberly v. Kirby*, 592 A.2d 445 (Del. 1991). The *Gassis* court commented, "[M]embers of a charitable nonstock corporation do not as members have an economic interest in the corporation; rather, it is the beneficiaries who have an economic interest, and accordingly, it is the beneficiaries to whom fiduciary duties are owed." *Id*, 2014 WL 2200319, at n. 108. The Appointed Directors ask this court to hold that members of a non-profit charitable corporation are neither beneficiaries nor the corporation.

By asking the court to apply *Gassis*, Appointed Directors appear to be asking the court to conclude that DDKS provides no benefit to the members, either factually or legally. If DDKS provides no benefit to the members, then the board owes no duty to the members.

In response, Plaintiffs argue that DDKS is unique in that DDKS is not a *charitable* non-profit corporation as was in the *Gassis* case. The court agrees that DDKS is not organized like the charitable non-profit corporation in *Gassis*. Instead, Plaintiffs argue DDKS has a business purpose. DDKS is a non-stock, non-profit insurance company established for benefit of both the subscribers and Kansas dentists. If true, then the board owes a duty of loyalty to the members. If the board owes that duty to the members, Plaintiffs argue that the board breached that duty when the appointed directors voted in 2020 to eliminate the members' power to amend the articles and substantially limited the members' power to amend the bylaws to the bare, or to less than the bare, minimum required by the Code and the Act.

In support, Plaintiffs ask the court to apply *Simon v. Nat'l Farmers Org., Inc*., 250 Kan. 676 (1992). Simon was a member of a dairy co-operative and had entered into a purchase/marketing contract with the co-op to buy his milk and/or to market his milk to achieve a certain price above a base blend price. Simon alleged the co-op failed to attempt to market his milk above the certain base blend designation, thereby breaching the contract to buy milk for a certain price and breaching a fiduciary duty market Simon's milk. *Simon,* 250 Kan. at 677. In analyzing the issue of a fiduciary duty, the Court held it had no quarrel with applying a fiduciary duty to Simon's relationship with the co-op, but it came in the context of a principal agent relationship. *Simon*, at 683-684.

Plaintiffs also ask the court to apply *Unrau v. Kidron Bethel Retirement Services, Inc*., 271 Kan. 743 (2001). In *Unrau*, the plaintiffs owned condominiums that were the subject of a non-stock non-profit association, but was managed by the for profit defendant who had developed the condominiums. The *Unrau* plaintiffs alleged the board

was illegally constituted, and breached fiduciary duties to condominium owners by mishandling the members money, conversion and similar acts. The Court discussed the overlap between the duty of good faith and the duty of loyalty. *Unrau*, 217 Kan. at 759-760. The Court agreed that the development board members owed fiduciary duties to the condo owners, holding, "Fiduciary duties are those imposed in order to prevent one in whom a special trust or confidence is placed from representing his or her own interests over those of his or her charges." *Id*., at 760. Although the condominium association in *Unrau* was a non-profit, there really was no dispute that the association board owed a duty to the condo owners by the board directors from development company.

Plaintiffs argue that *Simon* and *Unrau* stand for the proposition that, under Kansas law, the boards of non-profit corporations that are not charities can owe fiduciary duties to their members. The court agrees. The court concludes that whether the DDKS directors owe a fiduciary duty of loyalty to the members is really driven by the facts of this case. Although DDKS is a non-profit, non-stock corporation, it is not a charitable organization. DDKS is a commercial business. It is an insurance company that was organized to help subscribers obtain dental services, either individually or for the subscriber's employees, and to help dentists be paid for providing those services. DDKS is just a dental insurance company that happens to be a non-profit.

Most importantly, the Act requires that no less than forty percent of the board consist of DDKS dentist members. At least four directors must be elected by DDKS members. The court concludes those four elected member directors represent the DDKS members' financial interests and are there to protect those interests. The requirement that members be on the board is a recognition that DDKS provides benefits to the dentist members, in addition to the subscribers. The law is clear that, if the corporation provides benefits to such as those that DDKS provides to its members, the board owes a duty of loyalty to those members.

Finally, Appointed Directors argue that, because the members do not have a say in

how the appointed directors are placed on the board, those appointed directors owe no duty to the members. Stated differently, under this theory, Appointed Directors argue only the elected members would owe duties to the members and the appointed directors would not. Appointed Directors have not provided the court with any binding or persuasive authority that Appointed Directors owe fiduciary duties only to the subscribers, to the governor and commissioner who appointed a particular director, and not to the members.

The court would respectfully suggests that in a normal corporation, the board owes duties to all the stockholders, not just to the stockholders who voted for those particular directors to be placed on the board.

Because DDKS provides benefits to dentist members, the court holds that the DDKS board may owe a fiduciary duty of loyalty to the members that can be breached. For purposes of this motion, whether the 2020 board actions violated any duty to a member is a question of fact that is pre-mature for summary judgment.

B. Breach of Fiduciary Duty to the Corporation.

The court wants to be perfectly clear that the court is definitely not ruling on the relative merits of the breach of fiduciary duty claims, only whether the claims can withstand summary judgment on the issue of whether the board had duties to the corporation and to the members that could legally be breached.

Plaintiffs allege that, by passing the 2020 amendments, Appointed Directors, in their managerial status, participated in a scheme to seize control of and shift the allocation of powers within DDKS, by disenfranchising the members, by marginalizing the elected directors, and by entrenching themselves with extended terms of office in a way that prevents the members from reversing any of the 2020 amendments. Specifically, Plaintiffs allege the 2020 amendments entrenched directors by increasing all directors' terms from four years to six years, and by automatically reinstalling appointed directors whose terms had expired in 2018. Plaintiffs allege the appointed directors

breached their duty of care to DDKS in adopting these amendments in 2020.

Petition ¶ 73 alleges,

> Defendants who voted in favor of the 2020 Amendment have a material self-interest in the 2020 Amendment and amended Bylaws. The amendments entrench directors. They reduce the risk of member scrutiny into Board actions. They alter the allocation of power with Company, by effectively disenfranchising the members. Individual Defendants unlawfully placed their own interests above the interests of the Company and its members.

In their motion for summary judgment, Appointed Directors argue that the board's actions were taken to protect DDKS and its mission from a few self-interested members' efforts to dictate that DDKS's affairs be changed to those members' own personal financial benefit and that those changes would harm DDKS, its mission, Kansas residents and DDKS employees. Appointed Directors argue their actions were actions of loyalty to protect the company, not self-interested disloyalty. In essence, Appointed Directors argue they took pre-emptory action against the members but their motive was for the benefit of the corporation.

1. Entrenchment and the business judgment rule.

Plaintiffs claim the appointed directors motives were for the purposes of entrenchment, entrenching powers in the appointed directors with the motive of deliberately taking powers from the members and the elected directors. .

For purposes of Appointed Directors' motion, they argue that the law of entrenchment does not apply to directors of a non-profit, non-stock dental service corporation because members do not vote for or select the appointed directors.

In addition, Appointed Directors argue their actions are covered by the business judgment rule that would shield the board's decision to amend in 2020. Nothing in the Code or the Act expressly or impliedly would lead the court to this conclusion. The court has already held the entire board owes duties to the members. Whether members can bring a derivative action is really a question of standing which the court addresses below.

For a stock corporation, corporate management, including officers and directors, owes a fiduciary duty to both the corporation and its stockholders. *Burcham v. Unison Bancorp, Inc*., 276 Kan. 393. 416-417 (2003). When corporate management makes decisions, the business judgment rule shields management from liability for unprofitable or harmful corporate transactions if the transactions were made in good faith, with due care, and within the directors' or officers' authority. *Burcham*, 276 Kan. at 427, citing *Unrau,* 271 Kan. at 759. "The presumption that in making business decisions *not involving direct self-interest or self-dealing*, corporate directors act on an informed basis, in good faith, and in the honest belief that their actions are in the corporation's best interest." *Unrau*, 271 Kan. at 759, as quoted in *Burcham*, 276 Kan. at 427. (emphasis as made in the quotation.) Appointed Directors argue this presumption applies to the board's decision to amend the articles and the bylaws in 2020.

For the presumption to apply, at a minimum, the board's decision had to have been made within the directors' authority. If it was not, the business judgment rule does not apply. The court has held the appointed directors acted outside their authority. However, if the court's determination that the appointed board acted outside of its authority is reversed, whether the transactions were made in good faith and with due care is still a controverted factual dispute that precludes summary judgment on the application of the business judgment rule.

The issue is whether the court can apply the test from *Burcham* that adopted the rule from *Unocal Corp. v. Mesa Petroleum Co*., 493 A.2d 946, 954 (Del. 1985). Because of the omnipresent specter that a board may be acting primarily in its own interests, rather those for the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred. *Burcham,* 271 Kan. at 417, quoting *Unocal,* 493 A. 2d at 954.

This application of this enhanced judicial scrutiny is proper "[w]henever the record reflects that a board of directors took defensive measures in response to a

perceived threat to corporate policy and effectiveness which touches upon issues of control." *Burcham*, 276 Kan. at 420, quoting *Unitrin, Inc. v. American General Corp*., 651 A.2d 1361, 1372 (Del. 1995). The *Unocal* test is two prong. The first prong, the reasonableness test, requires the directors to demonstrate that, after a reasonable investigation, it determined in good faith, that the offer presented a threat that warranted a defensive response. *Burcham*, 276 Kan. at 420, quoting *Unitrin*, 651 A.2d at 1375. This analysis includes the presence of outside directors. *Id*.

The second prong, the proportionality test, requires only that a court examine whether the defensive measure was draconian by being either preclusive or coercive, and if it was not draconian, whether it was "within a range of reasonable responses to the threat. *Burcham*, 276 Kan. at 421, citing *Unitrin,* 651 A.2d at 1367.

In applying the *Unocal* test, the court considers that the factual claims that, the board extended their terms to six years and created the technical possibility that a board member could automatically renew their term and thereby choose to remain on the board until death or voluntary retirement, even if the governor or commissioner wants them replaced. The appointed directors' amendments included retroactive re-appointment for two directors, whose terms expired in 2018 but somehow had their terms retroactively renewed in 2020.

In addition, the amendments significantly shifted corporate powers to the directors that had been given to the members in 2000. Finally, the board adopted the 2020 amendments without giving prior notice to the elected directors, and after allegedly reneging on the alleged promise to Plaintiffs that Plaintiffs would be allowed to discuss Plaintiffs' proposed changes at the December 2020 board meeting.

Whether or not the board's actions were draconian and were within a range of reasonable responses to the alleged perceived threat posed by the members proposed 2020 amendments is a question of fact.

Appointed Directors do not dispute that a board, when acting for the sole or

primary purpose of perpetuating its own control, is not entitled to the presumptions of the business judgment rule. As an alternative argument, Appointed Directors argue that, if the court grants Plaintiffs' partial summary judgment motion on Count I, the Count II breach of fiduciary duty claim disappears.

Whether or not this is true, the court must address this issue at the trial level, even if the appellate courts' practice is to cease that court's analysis when that court reaches a decision on one issue that decides the merits. If this court's decision on the 2000 and 2020 amendments is not affirmed or if the appellate court holds that the breach of duty claim survives this court's decision on the corporate powers, then the court should still analyze this portion of the cross-motion.

As an additional response, Appointed Directors also argues this means the board cannot be held liable for a breach of fiduciary duty if the board acted outside their authority. The argument is that if the board acted within its authority the business judgment rule presumption applies, but if the board acted outside of its authority, there can be no breach of fiduciary duty, because there is no duty. The court is uncertain about this argument, because it is without cited binding authority. It would seem an action outside of corporate authority would mean even more proof of a breach of fiduciary duty. However, for purposes of this analysis, it merely mean the business judgment rule would not apply. The court has already held, the board acted outside its authority when it approved the 2020 amendments.

Finally, regarding the argument that the business judgment rule does not apply because, under the Act, the members cannot remove the appointed members, the court emphasizes that these claims are alleged violations of the duty of care owed to the corporation, not to the members. The appointed directors' argument really goes to the issue of whether the members have standing to bring the breach of the duty of care claims.

2. **Corporate loss as a result of the breach of the duty of care**.

Appointed Directors argue that Plaintiffs have not alleged or presented any facts that the corporation suffered a loss in support of Plaintiffs' that the appointed directors breached their duty of care under the theory of entrenchment and the theory of the failure to properly obtain and consider the advice of outside counsel before adopting the amendments.

The argument is: So what? Why should the court care if the appointed directors entrenched themselves at the expense of the members and the elected directors if the corporation has not suffered any loss because of the appointed members actions. The parties have not fully briefed the issue of whether a loss is required under Kansas law and what are the types and manner of losses if Kansas requires there be a loss to bring a derivative lawsuit.

At a minimum, the court agrees that this is a potential fact issue. However, none of the defendants have filed an answer and no discovery has taken place. The court can speculate or theoretically conceive of possible harm, but will not address it at this time.

C. Standing: Breach of Duty of Care to the Corporation.

The Appointed Directors argue Plaintiffs lack standing to bring the derivative breach of the duty of care claims. Appointed Directors argue two theories: First, Plaintiffs do not fairly and adequately represent the interests of the membership as required by K.S.A 60-223a(a), and therefore are inadequate representatives to bring the claims.

Second, Plaintiffs failed to make a pre-suit demand on the board, did not plead demand futiltiy and cannot demonstrate demand futility as required by K.S.A. 60-223a(b)(3).

1. Inadequate representatives.

Plaintiffs' claims for breach of the duty of care to the corporation are derivative claims pursuant to K.S.A. 60-223a. One prerequisite to a derivative action is adequate representation. "A derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association." K.S.A. 60-223a(a).

In support of their theory, Appointed Directors make several arguments. One argument is the claim that the membership at large does not support Plaintiffs' lawsuit, because only two of the roughly 1,300 members are named plaintiffs to the suit. Appointed Directors emphasize that Plaintiffs have not been able to obtain significant support for some of the bylaws changes that Plaintiffs were proposing before the 2020 amendments.

However, these arguments do not address the point of the rule. The rule does not have a minimum number of members or shareholders required to bring a derivative action. Appointed Directors do not dispute that Plaintiffs are DDKS members and are claiming to represent DDKS member. In addition, the argument that the members do not support Plaintiffs' proposed amendments is irrelevant to representation. If for some reason the law allowed the court to consider member support, then theoretically member support could only possibly be important to whether the members disagree with the 2020 actions taken by the board, not whether the members agree with Plaintiffs' proposed 2020 amendments.

In addition, the Appointed Directors argue that Plaintiffs actions as alleged in the Appointed Directors Statement of Facts demonstrate Plaintiffs great animosity not just to the board, but to DDKS. As proof, Appointed Directors cite to correspondence in the fall of 2020. Appointed Directors argument is that the court can consider Plaintiffs' motives in filing the lawsuit when the court makes its determination of whether Plaintiffs are adequate representatives for purposes of this cross-motion.

When a shareholder believes that an officer or director of the corporation has breached their fiduciary duty, the shareholder may file a derivative action under K.S.A. 60-223a. *Richards v. Bryan*, 19 K.A.2d 950, 961 (1994). When considering adequate representation, the ultimate question is whether Plaintiffs are members and whether Plaintiffs believe that the appointed members breached their directors' duty to the corporation when the appointed directors adopted 2020 giving the appointed directors powers at the expense of the members and elected directors.

The court considers this in the context of burden of proof on a summary judgment. Normally a plaintiff, when faced with defendant's summary judgment on a plaintiff's claims, the plaintiff has to do more than just say, "I object", but must come forward with facts sufficient to withstand summary judgment. However, Plaintiffs argue that the Appointed Directors have the burden of proof to obtain a judicial finding of inadequate representation. Appointed Directors have not disputed that they have this burden, but instead rely on the facts as stated to meet their burden.

Plaintiffs have not disputed that Plaintiffs sent the letters referenced in the statement of facts. But Plaintiffs effectively argue that any animosity against the board for the board's actions is ultimately irrelevant because the animosity, and this lawsuit, is primarily focused on having the board change the 2020 amendments or having the court find that the board adopted the 2020 amendments without to corporate power to do so. Plaintiffs' argument in response to the animosity motive allegation is that the breach of care claim is the result of the board's actions against the members, with resulting harm to the corporation, not and for the purpose of Plaintiffs' animosity against the board.

Plaintiffs are properly members of the corporation and, as members, may bring this claim. Without weighing the facts, Plaintiffs have sufficiently stated facts that the purpose of the lawsuit is to challenge the legality of the lawsuit and the effect on the corporation, sufficient to withstand summary judgment on this theory. The Appointed Directors have not met their burden on the inadequate representation theory.

2. Failure to make pre-suit demand. (Demand Futility).

Appointed Directors argue Plaintiffs did not make a pre-suit demand on the board to withdraw the 2020 amendments and did not state in the petition with particularity any facts as to why making demand on the board would have been futile. As stated above, the pleading rules for a derivative lawsuit require that the petition state with particularity any efforts by Plaintiffs to obtain the desired change in action from the board. K.S.A. 60-223a(b)(3)(A). ("Demand requirement") In addition, the petition must plead with a particularity the reasons for not obtaining the desired action or not making the effort. K.S.A. 60-223a(b)(3)(B). ("Demand Futility")

The issue is whether Plaintiffs have sufficiently pleaded facts or stated any uncontroverted facts as to why Plaintiffs did not make the effort required by K.S.A. 60-223a(b)(3)(B). In addition, Plaintiffs did not plead demand futility with any degree of particularity. Plaintiffs filed this lawsuit instead of making a formal demand on the board to take action.

In this case, none of the defendants has filed an answer, but instead they filed a motion to dismiss which is pending. Plaintiffs do not deny they have not alleged facts to support a claim that Plaintiffs made demand upon the board to reverse the 2020 amendments. However, prior to filing the lawsuit, Plaintiff' counsel did send the board an 11 page letter, with 68 exhibits, which objected the 2020 amendments.

Also, Plaintiffs can still amend the petition.

3. Self Interest for Demand Futility.

Plaintiffs have not alleged that the appointed directors committed fraud or took any official action that would result in a direct financial benefit for the appointed directors. The self-interest issue is focused on the claim that the appointed directors took power from the members and then gave themselves superpowers to control DDKS.

For this analysis the court summarizes what appear to be the facts alleged by Plaintiffs; The appointed directors of the board removed substantial governance powers from the members and gave those powers to the board. The exception is the members still have some ability to amend the bylaws, but only if the amendment is pre-screened by the board. The appointed directors of the board gave themselves term extensions, from 4 to now 6 years.

Importantly, the appointed directors of the board gave themselves the unilateral and unconditional power to extend those terms in perpetuity, even if the governor, the commissioner or the members do not want that director retained.

The appointed directors gave the appointed directors almost sole control of the decisions of the board, due to the new board quorum and voting requirements. The 2020 amendments approved by the appointed directors now require at least at least four of the six appointed directors to be at any board meeting to have a quorum. Now, for a ten person board, if all four elected directors but only three appointed directors are in attendance (seven of ten directors) there still is no quorum.

In addition, the 2020 amendments approved by the appointed directors now require not just a majority of the board to adopt a motion, but also require that a majority of the appointed directors must have voted for the action. As stated before, this gives the appointed directors a supermajority power. To take action, if all four elected directors, but only three appointed directors vote in favor, for a total of seven votes, the motion fails due to the lack of at least four appointed director votes.

Effectively, the six appointed members have given themselves the superpower to meet and take action for DDKS without any corporate governance requirement for input or participation of the elected member directors. In fact, no elected directors would be needed to attend a board meeting, just the six appointed directors be in attendance and five appointed directors voting in favor. And because the six appointed directors have given themselves the unilateral and unconditional power to govern DDKS in perpetuity,

no one outside of the six appointed directors, no outside party, can hold the six appointed directors responsible for their actions.

Because of the powers the six appointed directors gave to the board and the super powers the six appointed directors gave to themselves, Plaintiffs argue the majority of the board lack independence to impartially and objectively consider the Plaintiffs' claims that the six appointed directors should sue themselves and to impartially and objectively consider that the majority of the board demonstrated hostility to the Plaintiffs' claims. This allegation was noted in Plaintiffs' petition at ¶¶ 70 and 80.

4. ***Newton v. Hornblower, Inc.***

Plaintiffs argue the court should apply the Kansas Supreme Court's interpretation of the K.S.A. 60-223a(b)(3)(B) demand futility requirement as analyzed in *Newton v. Hornblower, Inc.,* 224 Kan. 506 (1979). In that case, Newton, an owner-director of Hornblower, Inc., filed a derivative lawsuit, claiming two other-owner directors had systematically taken actions financially beneficial to themselves individually and detrimental to plaintiff Hornblower, Inc. After the pre-trial order had been entered, the defendants filed a summary judgment motion on the second amended petition. One theory was the petition failed to comply with K.S.A. 60-223a(b)(3)(B).

In that case, the Kansas Supreme court held that, "No requirement of a demand prior to bring a shareholder derivative action is necessary when the petition recites circumstances showing the demand would be futile." *Newton*, 224 Kan.506 at Syl. 2. The test is whether any set of facts can be shown that would prove the making of the demand would have been futile. *Id.*, at Syl 3. Where the board of directors were themselves accused of self-dealing, demand upon them to sue themselves would be futile. *Id.,* at Syl. 5.

5. ***Aronson v. Lewis.***

Appointed Directors argue that, the mere fact that any board approved a challenged transaction does not automatically connote "hostile interest" and "guilty participation" by those directors, or some other form of sterilizing influence upon them.

See, Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984). (Where officers and directors are under an influence which sterilizes their discretion, they cannot be considered proper persons to conduct litigation on behalf of the corporation.) Were that so, the demand requirements of the rule would be meaningless, leaving the clear mandate of K.S.A. 60-223a(b) devoid of its purpose and substance. *See*, *Id.*

In *Aronson*, the plaintiff challenged a decision of the board. In *Aronson*, the court applied a two part test when considering when a demand has been made on the board and refused. First, the court applied the business judgment test to the board's decision to deny the demand, if demand was made. Next, the court applied its own business judgment to the decision. *Aronson*, 473 A.2d at 813.

However, when considering demand futility, the *Aronson* court applied a different two-part test. In that case, the court makes two inquiries, one into the independence and disinterestedness of the directors and the other into the substantive nature of the challenged transaction and the board's approval thereof. 473 A.2d at 814.

However, the *Aronson* court also stated, "Certainly, if this is an "interested" director transaction, such that the business judgment rule is inapplicable to the board majority approving the transaction, then the inquiry ceases. In that event, futility of demand has been established by any objective or subjective standard." *Aronson*, 473 A.2d. at 815.

6. *UCFW & Participating Food Indus. Empls. Tri-State Pension Fund v. Zuckerberg*

The Delaware court has refined its *Aronson* test to meet the demand futility requirements, adopting a three part test. The Delaware court said:

> To address these concerns, the Court of Chancery applied the following three-part test on a director-by-director basis to determine whether demand should be excused as futile:

(i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand;

(ii) whether the director would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand; and

(iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that is the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.

UCFW & Participating Food Indus. Empls. Tri-State Pension Fund v. Zuckerberg, No. 404,2020, 2021 WL 4344361 at *15-16 (Del. Sept. 23, 2021). The focus was parts i and iii, whether the director received a material personal benefit. The court said, "The refined test "refocuses the inquiry on the decision regarding the litigation demand, rather than the decision being challenged." *Id*., at * 16.

The court said,

The purpose of the demand-futility analysis is to assess whether the board should be deprived of its decision-making authority because there is reason to doubt that the directors would be able to bring their impartial business judgment to bear on a litigation demand. That is a different consideration than whether the derivative claim is strong or weak because the challenged transaction is likely to pass or fail the applicable standard of review.

UCFW, 2021 WL 4344361, at * 16. The court noted that this three part test is not inconsistent with that court's prior decision in *Aronson*. *Id*., at *17. If applied to this case, the *USFW* test would focus on whether Appointed Directors received a material personal benefit and not whether the Appointed Directors will win or lose the derivative lawsuit.

The Appointed Directors argue for the application of the *UCFW* test to the demand futility requirement in this case. If the court applies the *UCFW* test, the

Appointed Directors argue that Plaintiffs have not pleaded or stated any facts that would lead the court to find that the Appointed Directors received any material personal benefit from the 2020 Amendments, i.e., financial benefit, therefore, Plaintiffs have not and cannot meet the requirement of demand futility. In this case, Appointed Directors argue the board took action to prevent the members from taking action, that is, the appointed directors adopted the 2020 amendments to prevent any possibility of passing the members proposed amendments.

7. Applying Kansas or Delaware case law.

The court agrees with the *UCFW* court's final conclusion that the issue for demand futility will not be whether the merits of derivative lawsuit claim are strong or weak, and will be whether the facts demonstrate that there is reason to doubt that the appointed directors would be able to bring their impartial business judgment to bear on the litigation demand.

The difficulty for the court applying the Appointed Directors' argument is two-fold: First, Kansas has not adopted *Aronson* or any of its progeny. *Newton* is still the law of this state. The *Newton* test is simple, whether any set of facts can be shown that would prove the making of the demand would have been futile. *Newton*, 224 Kan at Syl. 3. Where the board of directors were themselves accused of self-dealing, demand upon them to sue themselves would be futile. *Id*., at Syl 5.

Second, the appointed directors approved amendments that went beyond just removing the stockholder powers granted to the members in the 2000 articles. The Appointed Directors gave themselves super majority powers, and gave themselves the power to extend their director terms unilaterally, removing the ability of anyone outside the six appointed directors from replacing them if they did not want to be replaced.

The court agrees that the court has no facts at this pre-answer stage to allow the court to definitively determine, for purposes of summary judgment, what were the Appointed Directors' motives for giving themselves these super powers. But that is not

the test. The *Newton* test is whether any set of facts can be shown that would prove the making of the demand would have been futile.

The court can easily speculate on facts as to the appointed directors' motives for the 2020 amendments, running from malevolent to beneficial, from purely self-interest to purely to benefit the corporation.

The Appointed Directors motives are controverted at this stage of the case, along with all the facts alleged about the Plaintiffs' animosity to the board and the fact that Appointed Directors, not the complete board, met with counsel before adopting the amendments. Then, the appointed directors proposed the 2020 amendments to the entire board without giving prior notice to the elected member directors of these proposed changes.

The court understands the *USFW* test that appears to require an analysis of financial disinterest of the Appointed Directors. By granting superpowers to themselves, meaning these specific Appointed Director defendants who are currently serving directors, there is reason to doubt, for purposes of summary judgment, that the directors would be able to bring their impartial business judgment to bear on a litigation demand, under the broader reading of *Aronson*. Under the *Newton* test, the Appointed Directors have been accused of self-dealing. Therefore, Plaintiffs have demonstrated sufficient demand futility to withstand summary judgment on this issue.

If the appointed directors had not taken the additional steps to give super-powers to themselves, at the expense of the elected member directors, the governor and the commissioner, then the exercise of the court's discretion would be a closer call. The 2020 amendments not only took powers from the members, the 2020 amendments marginalized the power of the elected directors. Appointed Directors cannot reasonably argue the Act required that the appointed directors giving themselves the supermajority powers.

Finally, while not stated in the petition, it is uncontroverted that, prior to the lawsuit, Plaintiffs' attorney sent an 11 page letter objecting to the 2020 amendments. While such a letter from an attorney may not be an exact equivalent to a plaintiff's

demand on the board to make changes, the law may consider that such a letter from attorneys would qualify as a close second for purposes of the demand requirement/ demand futility analysis.

The facts are sufficient to withstand summary motion on the issue of demand requirement and demand futility.

CONCLUSION

I. PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT ON COUNT 1 (LEGALITY OF THE 2020 AMENDMENTS).

The material facts for this motion are merely what is the language of the 2000 DDKS articles and 2019 DDKS bylaws and how were they adopted, and what is the language of the 2020 DDKS articles and 2019 DDKS bylaws and how were they adopted.

For purposes of this motion, the court holds that the 2000 DDKS articles and 2019 DDKS bylaws gave stockholder power to the DDKS members including the exclusive power to amend the DDKS articles and the bylaws. The court holds that neither the Code nor the Act prohibit giving these stockholder powers to the DDKS members. The corporation properly adopted the 2000 DDKS articles and 2019 DDKS bylaws. Therefore, the court holds that the 2000 DDKS articles and 2019 DDKS bylaws are legal and binding on the corporate governance of DDKS.

The 2000 DDKS articles and 2019 DDKS bylaws legally gave exclusive power to the members to adopt amendments to the DDKS articles and bylaws. Therefore, the DDKS board did not have the power to adopt the amendments to the articles and bylaws in 2020. The DDKS board did not obtain member approval to adopt the 2020 amendments to the DDKS articles and bylaws. Because the DDKS members did not approve the 2020 amendments to the DDKS articles and because the DDKS board did not have the power to adopt the 2020 amendments to the articles and bylaws, the 2020

amendments are illegal.

Plaintiffs' Motion for Summary judgment is granted for Plaintiffs on Count I.

II. DEFENDANTS' CROSS MOTION SUMMARY JUDGMENT (COUNT II BREACH OF FIDUCIARY DUTY)

Under Kansas law, the board of directors of a Kansas Nonprofit Dental Service Corporation Act corporation may owe fiduciary duties to the members of that corporation. Therefore, members have standing to bring breach of fiduciary duty claims against the directors for breaching those duties to the members.

Under Kansas law, members of an Act corporation can have standing to bring derivative action lawsuits against the board directors of that corporation for breach of the fiduciary duty to the corporation.

The fact that the court has held that the board of directors did not have the corporate power to adopt the 2020 amendments to the DDKS articles and bylaws does not preclude the members from bringing breach of fiduciary duty claims for the board having illegally adopting those 2020 amendments.

For purposes of summary judgment, Plaintiffs sufficiently represent the interests of the members to have standing to bring the claims in this lawsuit.

For purposes of summary judgment only, the facts are that the six appointed directors adopted amendments to the articles and bylaws that illegally stripped the members of their powers, marginalized or eliminated the need for the elected directors to participate in board decisions, gave the six elected directors supermajority control of DDKS and gave the directors the exclusive ability to extend their terms. For purposes of summary judgment only, these facts are sufficient to allege the six directors acted with sufficient self-interest for the court to not apply the business judgment rule and to

determine the facts of self-interest meet the requirements of demand futility.

The facts as stated in the motions, responses and replies are sufficiently particular in lieu of pleading demand denied or demand futility, when the court considers that Defendants have no yet filed an answer.

Defendants' motion for summary judgment denied on the arguments raised in the motion.

It is so ordered.

E signed

William S. Woolley, District Judge