Volume 9 | Issue 3 Article 11

1958

Corporations

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fendant for transportation to New Orleans. The suitcase was not delivered to plaintiff upon her arrival, or thereafter. At the time of the purchase of her ticket and also when she checked the suitcase, plaintiff declared no value upon it. Defendant made no extra charge based upon value in excess of $100. No discussion was had between the parties pertaining to the value of the luggage or the insuring of it.

At the time the above took place, defendant had on file with the Civil Aeronautics Board a tariff, which tariff had been duly filed, posted and published as required by the Civil Aeronautics Act. The tariff provided that the total liability of the defendant occasioned by reason of any loss in the delivery of personal property accepted for transportation would be limited to $100 for each passenger unless excess value was declared and an extra charge paid therefor. Plaintiff was unaware of the published tariff and did not read the conditions in small print on her ticket and baggage check referring to limited liability. Held: The limitation of liability is valid; the passenger could recover no more than $100 for the baggage lost by the airline.

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CORPORATIONS

During the past year the Ohio courts have dealt with a wide variety of interesting corporation problems, both of procedure[1] and of substance.[2] Five of these cases are worth special comment, either as examples of the application of familiar rules to unusual situations, or, as in the *Drane* case discussed at the end of this article, as cases which involve complex or developing legal doctrines.

Security Regulation

The Ohio Securities Act, or "blue sky law," expressly provides that a pre-incorporation subscription is a security subject to regulation, and expressly excludes a real estate contract from the definition of security.

[1] Buza v. Kelley Island Co., 138 N.E. 2d 449 (Ohio Ct. App. 1956) (in action by shareholder to assert the dissenting shareholder's remedies granted by OHIO REV. CODE § 1701.85, plaintiff must sue in the county where corporation has its statutory main office, not where the corporation has in fact its principal office).

[2] Spitz v. Volibar Realty Co., 138 N.E. 2d 438 (Ohio Ct. App. 1956) (purchase by corporation of its own shares and debentures valid where no proof that purchase was part of a fraudulent scheme to increase voting control of the management group). Macy v. Ramey, 144 N.E. 2d 698 (Ohio C.P. 1957) (where promoter for corporation makes a contract on behalf of corporation with a third party, third party can revoke contract prior to incorporation — ratification by subsequently formed corporation does not relate back to date of contract).

In *State v. Silverberg*[3] the Supreme Court was faced with a hybrid contract which contained both elements. The defendant entered into a number of contracts in which he conveyed undivided interests in an apartment building. In the same contract the vendor agreed to form a corporation capitalized at the total sale price of the building, and each vendee agreed to convey his interest in the building to the corporation when formed, in return for part of the shares of the corporation. The end result would be a co-operative apartment house in corporate form, with the tenants as shareholders. The defendant vendor was convicted of selling unregistered securities. The Supreme Court set aside the conviction, pointing out that the intent of the Securities Act was to protect investors in a profit making enterprise. Here the contract allowed each subscriber to occupy a specific apartment unit and the overall effect of the arrangement was to provide the vendee with a place to live, rather than a profit. Although the court did not mention it, similar cases from other states have pointed out that if public regulation of this type of contract is desirable, it should be left to the real estate board, rather than to the securities department which is less familiar with the situation.

Corporate Entity

It is commonly stated that the corporate entity will not be disregarded simply because all of the shares are owned by one man. Something further is required, such as co-mingling of assets, failure to follow corporate formalities, undercapitalization, etc. It is well to remember that the general rule just stated is often modified when the state is attempting to disregard the corporate personality as an incident to the exercise of the police power. The recent *Khoury* case is a good illustration of the ease with which the courts look behind the corporation where public safety is involved.[4] Khoury applied for renewal of a liquor license for a bar owned by him as a sole proprietor. Over his objection, the board admitted evidence of liquor law violations at another bar, owned by a corporation, of which Khoury was the sole shareholder. The court held the evidence admissible and sustained the finding of the board that the application should be denied because of the applicant's past record as a violator.

Ownership of Shares

In the *Brownewell*[5] case, the Supreme Court finally settled a problem which has been the subject of dispute in the lower courts. The plaintiff,

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[3] 166 Ohio St. 10, 139 N.E. 2d 342 (1956).

[4] Khoury v. Bd. of Liquor Control, 141 N.E. 2d 787 (Ohio C.P. 1957).

[5] Brownewell v. Columbus Clay Mfg. Co., 166 Ohio St. 324, 142 N.E. 2d 511 (1957).

an Ohio resident, brought suit in an Ohio court in order to impress a constructive trust on shares in an Ohio corporation. The certificates were in the hands of an executor in California. Under the common law rule, for purposes of in rem jurisdiction the share is an intangible located in the state of incorporation, regardless of the location of the physical certificate. A number of Ohio cases decided prior to the adoption of the Uniform Stock Transfer Act recognize this rule, and the U.S.T.A. does not expressly change it. In the *Silberman*[6] case, decided since the adoption of the Act, the court of appeals repeated the common law rule but did not consider the effect of the Act on the problem. In the *Brownewell* case the lower courts held that the overall effect of the Act was to make the certificate negotiable, and thus the situs of the share was California. The Supreme Court affirmed in an able opinion by Judge Bell, which expressly repudiated the *Silberman* decision. Apparently, any action involving ownership of shares, whether legal or equitable, must now be brought in the state in which the certificate is located unless it can be shown that the certificate has been lost or destroyed, in which case the Act provides that an action may be maintained in the state of incorporation.[7]

In Ohio, as in most states with modern corporation codes, it is clear that a director need not be a shareholder.[8] Apparently, some corporations assume that the old rule is still in effect, and issue "qualifying shares" to newly-elected directors who are not already shareholders. In *Central Oil Emulsion Corporation v. Roesch*[9] the corporation was allowed to recover the share after the shareholder ceased to be a director. The court concluded that the share was issued solely because of a mistaken belief that it was necessary to qualify the recipient as a director, and that the shareholder was not intended to become the beneficial owner, in spite of the fact that the shareholder had been paid dividends and allowed to vote his share.

Fundamental Corporate Changes

The *Drane*[10] case raises one of the most difficult and confusing problems in Ohio corporation law; the power of a corporation to amend the articles of incorporation in a manner prejudicial to a shareholder, without

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[6] Silberman v. Silberman, 99 Ohio App. 340, 121 N.E. 2d 838 (1954).

[7] OHIO REV. CODE § 1705.20.

[8] OHIO REV. CODE § 1701.56 (c).

[9] 139 N.E. 2d 88 (Ohio Ct. App. 1956).

[10] Drane v. Lawton Co., 141 N.E. 2d 259 (Ohio Ct. App. 1956).

his consent.[11] The case is difficult to analyze because some of the important facts are not given in the opinion.

To oversimplify a complex problem, the articles of incorporation constitute a contract among the shareholders, and of course a normal contract cannot be modified except by consent of all parties.[12] Indeed, a statute authorizing such a modification by less than all would be in violation of the constitutional rule against impairment of contractual obligations, as interpreted by the *Dartmouth College* case.[13] To avoid the effect of the *Dartmouth College* decision, the states incorporated "reserve clauses" in both the constitutions and general corporation codes, reserving to the state the right to amend corporate charters. A few courts have held that the reserve clause only permits changes by the state in the public interest, but the vast majority, including Ohio, hold that the power of the state to amend may be delegated by statute to a majority of the shareholders. Thus it is held that where a statute authorizes a specific amendment by less than all of the shareholders, each shareholder takes his share subject to the amendment power and assents in advance to the change. In a number of states, including New York and Delaware, the reasoning has been pushed one step further. The argument is that since there is a general amendment statute, each shareholder takes his share in contemplation of the amendment statute as it is, *or as it may become by legislative amendment.* This doctrine has been expressly rejected in New Jersey and some other states, at least where the proposed amendment attempts to affect certain contract rights which are deemed more important than others, and are thus referred to as "vested rights." In states which follow the New Jersey view, most of the cases involve attempts to cancel accrued cumulative dividends, but other contract rights such as voting, cumulative voting, pre-emptive rights and redemption have also been treated as "vested" and beyond the power of alteration in the absence of a very express statute in effect when the corporation was chartered.

The Ohio opinions prior to 1946 indicated that we had adopted the majority or Delaware doctrine, and this same approach is clearly stated in the corporation code. In the *Wheatley*[14] and *Schaffner*[15] cases, the

[11] The best recent article on the problem in Ohio is *Lattin, A Primer on Fundamental Corporate Changes,* 1 WEST. RES. L. REV. 3 (1949).

[12] The rule of no modification without unanimous consent was first applied to the corporate charter by Natusch v. Irving, 47 Eng. Rep. 1196 (1824) which used the analogy of the partnership agreement.

[13] Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819).

[14] Wheatley v. A.I. Root Co., 147 Ohio St. 127, 69 N.E. 2d 187 (1946).

[15] Schaffner v. Standard Boiler and Plate Iron Co., 150 Ohio St. 454, 83 N.E. 2d 192 (1948).

Supreme Court held that accrued dividends, not yet declared, could not be eradicated by amendment where the corporation was chartered prior to 1939, the date of the adoption of a statute which expressly permitted such amendment. At least as to this kind of amendment, the New Jersey rule would apply.

The *Drane* case involves an amendment by vote of a majority of the shareholders so as to change the existing common shares into preferred stock and the preferred into common. The objection was raised by a common shareholder who would lose part or all of his voting rights. The plaintiff shareholder had purchased his shares prior to the enactment of a statute expressly authorizing this change. The court of appeals allowed the amendment, distinguishing the *Wheatley* and *Schaffner* cases by holding that the dividend rights in the latter cases were "vested" while the voting rights of the plaintiff were not. The decision seems directly contrary to the reasoning employed in the two Supreme Court cases, and is a good illustration of the illusory nature of the "vested right" doctrine as a protection for shareholders. There are other and more adequate safeguards for the minority shareholder. The principal devices used to protect the shareholder against abuse of the amendment power are:

(1) The requirement of class voting.[16]

(2) The right of a dissenting shareholder to force the corporation to buy out his interest.[17]

(3) The fiduciary duty of the majority, as tested by an equitable standard of fairness.

In the *Drane* case, the court did not discuss the problem of good faith, and the facts as stated in the opinion are insufficient for a reader to make any evaluation. On reading the *Drane* case I am again impressed with the wisdom of a comment of Professor Norman Lattin of Ohio State University Law School:

> A frank recognition that preferences are contract rights and nothing more, which the reserved power to alter or amend may by subsequent legislation seriously affect, would do much to clarify the law and, at the same time, would release the court's energies for the important function of ascertaining whether the proposed amendment has that fairness which extraordinary power placed in a majority requires.[18]

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[16] OHIO REV. CODE § 1701.71(B).

[17] OHIO REV. CODE § 1701.74. In the *Drane* case the court also held that the plaintiff had no such remedy, as dissenting shareholder's rights are granted only to preferred shareholders.

[18] *Lattin, A Primer on Fundamental Corporate Changes,* 1 WEST. RES. L. REV. 3, 25 (1949).