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A Primer on Fundamental Corporate Changes*

Norman D. Lattin

From the first beginnings of the business corporation formed under general legislative acts, rigid concepts of contract, property and constitutional interdiction which had reached partial or complete fruition in their own limited fields and which had found expression in cases involving the early corporation created by legislative act or executive grant, were accepted and further developed. In the realm of major corporate alterations, this was particularly true. Trouble came from two chief sources. The first was an analogy derived from a rule of partnership law which required unanimous action of the partners to alter the contract of partnership. The second came from the famous and still frequently cited case of Trustees of Dartmouth College v. Woodward, which established the doctrine that the corporate charter constitutes between the state and the corporation a contract which is protected by the impairment-of-the-obligation-of-contracts clause of the Federal Constitution.

The corporation involved in that famous case was an eleemosynary educational one which had been formed by a grant of the King

*Webster's Collegiate Dictionary (5th ed. 1947) defines "primer" as "A book, originally a prayer book, used in teaching children to read or spell; hence, an elementary textbook." The object in writing this article is to simplify, as far as is possible in a limited space, this difficult and confusing field so that students may be able to grapple with their casebook problems more adequately than in the past, and that lawyers who have not learned their way around in this portion of the law may find some aid in a simplified statement. There is need for much more of this attempt at simplification, even if not entirely adequate, in all branches of the law. As to the "prayer book", there is also some need for prayer on behalf of some bewildered judges who have added to the confusion because of a lack of comprehension of the basic principles in this realm. This is also offered as a supplication to them. No attempt has been made to document this article more than was necessary to cover the high spots.
in 1769 when New Hampshire was a colony of Britain. The New Hampshire legislature passed three acts to amend the corporate charter. The most important of these was enacted in 1816. Among other things, it increased the number of trustees from twelve to twenty-one and created a board of overseers of twenty-five persons with power to inspect and to control the acts of the trustees. The appointment of the additional trustees was to be by the governor, and the board of overseers was to be composed of the governor, his council and twenty-one others appointed by him. The effect, of course, was to take from the original trustees and their successors, who, under the King's grant, were empowered to fill all vacancies within their own body, the authority which had been vested in them and to give to the political authority a control which, even today, is rarely as complete in the case of state universities.\(^1\)

The circumstances were unusually attractive for a court to use its entire arsenal of judicial techniques to save the day for Dartmouth, and analogies of legislative grants of property were among them. In support of the rule, Mr. Justice Story, who wrote a concurring opinion, in part argued thus: "This language (the court had quoted from Fletcher v. Peck, 6 Cranch (10 U. S.) 87, at p. 136) is perfectly unambiguous, and was used in reference to a grant of land by the Governor of a State under a legislative act. It determines, in the most unequivocal manner, that the grant of a State is a contract within the clause of the constitution now in question, and that it implies a contract not to reassume the rights granted. A fortiori, the doctrine applies to a charter or grant from the king."\(^2\) In the process of determining that a grant of corporate powers was similar, in effect, to a grant of land made by the legislature, the court did not ignore the position of the donors who had contributed the funds with which Dartmouth College was to

\(^1\)The leading case is Natusch v. Irving, 2 Coop. T. Cott 358, 47 Eng. Rep. 1196 (1824), Gow on Partnership, Appendix VI, p. 398. A partnership for carrying on a life insurance business was formed. Parliament later made it lawful for such a partnership to underwrite marine insurance and a majority of the partners favored this. Lord Eldon held that unanimous action was necessary to alter their contract.

\(^2\)Wheat. (17 U.S.) 518 (1819). "This is plainly a contract to which the donors, the trustees, and the crown (to whose rights and obligations New Hampshire succeeds) were the original parties. It is a contract made on a valuable consideration." Chief Justice Marshall, at pp. 643-44.

\(^3\)As Chief Justice Marshall put it: "The whole power of governing the college is transferred from trustees appointed according to the will of the founder, expressed in the charter, to the executive of New Hampshire." Id. at 652.

\(^4\)Id. at 682-83.
be run; in fact, they too were considered "original parties" to this contract.\(^5\) Thus was inferentially infused, if unconsciously, the suggestion that those who contribute to corporations of a different stamp—the shareholders of today—have a stake in this contract with the state which comes within the protection of the Constitution.

The police power, that ever pervading force kept in reserve to further whatever changing policy requires, was necessarily excepted from the application of the impairment-of-contract principle. Furthermore, Chief Justice Marshall, who wrote the main opinion, suggested that the contract bound the crown in a manner not permitting "violent alteration in its essential terms"\(^6\)—an idea which, in somewhat different forms of expression, turned up later to aid (not measurably it is true) the extension of corporate powers not yet authorized by statute when less than all shareholders were agreeable to the contemplated change. This was some concession, at least, and certainly an innovation if looked at from the rule of partnership law which required unanimous action for change of the partnership articles. As one able writer has stated, "... It would astonish the bar to be told that one who signs articles of partnership impliedly agrees that the majority of his associates may amend without his consent provided that the amendments are not fundamental in character."\(^7\) But the court in the Dartmouth College case was not thinking in terms of business corporations operating under articles of incorporation which incorporators could file and thereby accomplish corporateness upon formal compliance with a statute. Nor did it have in mind shareholders and their contracts, whatever they might be. Its problem was a narrower one. It was thinking of a grant—a gift—by the crown of powers to be a body corporate and to carry on as an educational institution in the manner there provided without interference by the state except where the police power warranted interference or where "violent alterations" in the "essential terms" of the grant were not attempted.

The decision itself had far reaching implications, demonstrating clearly the dangers apparent if reservations were not made by the state at the time of incorporation. Mr. Justice Story pointed to a solution in these words: "When a private eleemosynary cor-

\(^5\)See note 2 supra.
\(^6\)Id. at 651.
\(^7\)E. Merrick Dodd, Dissenting Stockholders and Amendments to Corporate Charters, 75 U. of Pa. L. Rev. 585, 589 (1927).
poration is thus created by the charter of the crown, it is subject to no other control on the part of the crown, than what is expressly or implicitly reserved by the charter itself. Unless a power be reserved for this purpose, the crown cannot, in virtue of its prerogative, without the consent of the corporation, alter or amend the charter, or divest the corporation of any of its franchises, or add to them, or add to, or diminish, the number of the trustees, or remove any of the members, or change, or control the administration of the charity, or compel the corporation to receive a new charter. This is the uniform language of the authorities, and forms one of the most stubborn, and well-settled doctrines of the common law."8 Though such reservations to amend had been made in some charters prior to the time of this decision,9 they were not common. The impact of the decision resulted in the placing of clauses reserving the right to amend and repeal in charters of corporations created by legislative grant and presently the placing of similar clauses in constitutions or statutes.10

From the simple statement by Mr. Justice Story, anyone but a lawyer steeped in the folklore of judicial opinion might have assumed that the major problems of corporate change were over, provided his dictum should be followed.

Our layman who had read Story's opinion might have argued something like this: Once the charter or the constitution or statute provides that the state may amend or repeal charters or the law under which corporateness is derived, this becomes a part of the contract of the corporation with the state and, necessarily, with the shareholders who are in reality the corporation. Since the legislature might have used its police power before the Dartmouth College case, the court must have meant that a reservation of the power to amend or repeal would permit change which formerly could not be made because of the impairment-of-contracts clause. Such power to change, our layman might well conclude, may also have reference to the shareholders themselves and their contracts for, in reality, they are the corporation—the corporate personality being created for quite different purposes, chiefly for convenience in carrying on business in this form. Thus, if a statute gives a majority or some other proportion of the shareholders, or of the voting shareholders, authority to make fundamental changes

9Dodd, supra note 7, at 592.
10Ohio Const. Art. XIII, § 2 (1851): "Corporations may be formed under general laws; but all such laws may, from time to time, be altered or repealed."
in the business or in the contracts of the shareholder with his company (which is in reality himself and his fellow shareholders) any court should hold that, they having agreed to this by purchasing stock in a company already subject to change, consented in advance to whatever authorized change came later.

Our layman, if informed on property law, might add that there may be cases where a contract right has somehow or other obtained the status of a property right (as in the case of a dividend declared out of a proper surplus) which the shareholder's limited consent did not cover and that, consequently, a further consent would be necessary to divest him of this interest. His lawyer would tell the shareholder that his property right could not be divested without due process of law and would cite another constitutional provision to this effect. And our layman, if posed with a problem involving material change in a corporation having several classes of stock, whether that change related to one in corporate purposes, or of capital structure, or of relative rights between shareholders, would no doubt answer that the analysis above is the only practical way of taking care of the multitude of interests involved. If pressed with hypothetical cases he might place some restrictions upon what changes could be made without unanimous consent, perhaps insisting upon a showing that the circumstances be such as to indicate that the change was necessary or advisable and made in good faith, that sacrifices to be incurred must be equally borne by all, that is be fair; and, if he knew of modern appraisal statutes, he might even venture an opinion that these were meant to give those shareholders who were disgruntled the value of their shares without impeding the remaining shareholders in carrying on thereafter.

What actually happened after Mr. Justice Story's dictum had become incorporated into state constitutions or statutes cannot be stated with the clarity desirable in a matter of such practical importance. There was at first a struggle with the basic problem of whether the reservation to amend or repeal should be confined to changes in which the state had a vital interest—this looks like an exercise of the police power—and the usual manner of statement referred to such changes as being ones made in the contract between the state and the corporation. This, of course, was in line with the direct holding in the Dartmouth College case.11 There

11See the leading case of Zabriskie v. Hackensack & N.Y.R.R., 18 N.J. Eq. 178 (1867). The Ohio court has recently quoted with apparent approval the following from 13 FLETCHER, CYCLOPEDIA CORPORATIONS § 5776, p. 86 (Perm. ed. 1943): "The true view is that the power to alter, amend or re-
were, it should be added, many decisions postdating that case which described corporate charters as constituting contracts between the state and the corporation, between the corporation and its shareholders, and between the shareholders \textit{inter sese}.\textsuperscript{12} If the view is taken that the power to amend extends only to the contract between the state and the corporation, or, in words of a leading case accepting this view, that "neither the words nor the circumstances, nor apparent objects for which this provision was made, can, by any fair construction, extend it to giving a power to one part of the corporators as against the other, which they did not have before,"\textsuperscript{13} the question immediately arises as to the possible limits of the power. If this is a "reservation to the state, for the benefit of the public, to be exercised by the state only,"\textsuperscript{14} it might well be argued that many important contractual rights of shareholders with the corporation and among themselves, given a proper setting, become vested with a public interest in which the state is concerned.\textsuperscript{15} Thus, it might be possible, on the facts of a given case, to see a public interest though the legislation purports to interfere with, or permits some named proportion of the shareholders to act in a manner which interferes with contract rights of vital personal interest. Naturally, no complaint can be made to changes large or small which were specifically authorized at the time of the formation of the corporation, for these provisions definitely became a part of each shareholder's contract with his company.

On the other hand, while it was no doubt true that the power to amend or repeal corporate charters was not reserved by the state for the purpose of abolishing the necessity for unanimous repeal charters is reserved by the state 'solely' for the purpose of avoiding the effect of the decision in the \textit{Dartmouth College} case . . . that the charter of a corporation is a contract between the state and the corporation within the constitutional prohibition against laws impairing the obligation of contracts, and that the purpose of the reservation is to enable the state to impose such restraints upon corporations as the Legislature may deem advisable for protection of the public. Such power is not reserved in any sense for the benefit of the corporation, or of a majority of the stockholders, upon any idea that the Legislature can alter the contract between the corporation and its stockholders, nor for the purpose of enabling it to do so." Matthias, J., in \textit{Wheatley v. A. I. Root Co.}, 147 Ohio St. 127, 142-43, 69 N.E.2d 187, 195 (1946).


\textsuperscript{13}Zabriskie v. Hackensack & N.Y.R.R., 18 N.J. Eq. 178, 186 (1867).

\textsuperscript{14}\textit{Id.} at 185-86.

\textsuperscript{15}This is convincingly expressed in \textit{Davis v. Louisville Gas & Electric Co.}, 16 Del. Ch. 157, 163-64, 142 Atl. 654, 657 (1928).
action in case of fundamental corporate changes, a principle based on the analogy of the rule in partnership law—the rule of *Natusch v. Irving*¹⁶—, there was nothing to prevent an interpretation in accord with the lead given in the *Dartmouth College* case that there were other contractual rights involved besides those of the state and the corporation. In fact, Mr. Justice Story in pointing to a solution did not speak with a definiteness that demonstrated he was thinking of a remedy for but one of these. Besides, constitutional or statutory reservations of the power to amend or repeal are, under liberal guidance as in other cases, subject to be moulded to fit circumstances not considered at the time of their promulgation. Fortunately, when the corporation was formed subsequent to the enactment reserving the power to amend or repeal, the great majority of the courts considered the reservation of the power a part of the shareholder's contract.¹⁷ And no distinction was made between legislation which purported to amend directly and that which gave to a named proportion of the shareholders the right to do the same. The effect of such holdings was to give flexibility to a business carried on in the corporate form and to make it pos-

¹⁶See note 1 supra. "It was to avoid the rule in the Dartmouth College case, not that in *Natusch v. Irving*, that the change was made. The words limit the power to that object." Zabriskie v. Hackensack & N.Y.R.R., 18 N.J. Eq. 178, 186 (1867). But see McNulty v. W. & J. Sloane, 184 Misc. 835, 843, 54 N.Y.S. 2d 253, 261 (1945): "The very essence of the reserved power of the Legislature is to enable it to change preferential rights of the different classes of stock in a corporation."

¹⁷The leading authority is *Durfee v. Old Colony & Fall River R. R.*, 5 Allen (87 Mass.) 230 (1862). Bigelow, C.J., at pp. 245-46, 246-47, in part, said: "The real contract into which the stockholder enters with the corporation is, that he agrees to become a member of an artificial body which is created and has its existence by virtue of a contract with the legislature, which may be amended or changed with the consent of the company, ascertained and declared in the mode pointed out by law. Having, by virtue of the relation which subsists between himself and the corporation as a holder of shares, assented to the terms of the original act of incorporation, he cannot be heard to say that he will not be bound by a vote of the majority of the stockholders accepting an amendment or alterations of the charter made in pursuance of an express authority reserved to the legislature, and which by such acceptance has become binding on the corporation. . . ."

"It was urged, as a grave objection against the doctrine above stated, that it puts the minority of the stockholders of a corporation entirely within the control of the legislature and a majority of the stockholders, and that there would be no limit or restraint placed on the exercise of the power, so that corporations might be diverted to purposes and objects wholly foreign to those for which they were originally established, and stockholders might be made to participate against their will in undertakings which they never contemplated and which they deemed inexpedient or ruinous. If this be so, it is a consequence of which no stockholder can reasonably complain, because it is a result which flows from the contract into which he has voluntarily entered."
sible, when the capital structure was in need of overhauling, to accomplish this without the unanimous consent of the owners of the business. While still the owners, the shareholders had implicitly agreed to the use of the democratic process of rule by the majority to accomplish in a practical business world what was often difficult and at times impossible.

But the story does not end here, for statutes were not always explicit on the matter of how far the designated majority might go in voting changes which were highly fundamental and which, frequently, did damage to some groups of shareholders without apparent damage to others. Furthermore, there was in legislation permitting large corporate change in more specific language the danger that majorities might use their power to further their own interests, and this happened frequently enough to be the basis for holdings which placed equitable limitations upon the broad powers given to majorities. Similar equitable results were reached in the application of statutes with broad but non-specific provisions for corporate change by a process of reasoning which denied the designated majority powers which were not clearly stated or spelled out. And occasionally a court, forgetting or ignoring, or perhaps

18 Solution of the problem is further complicated by the fact that any device the use of which is desirable in proper cases for the elimination of burdensome preferential rights of preferred stockholders may be used in other cases, without regard to corporate needs and for the sole benefit of the common stockholders. Desmond, J., in Davison v. Parke, Austin & Lipscomb, Inc., 285 N.Y. 500, 506-07, 35 N.E. 2d 618, 621 (1941).

19 See, for example, Berle, Corporate Powers as Powers in Trust, 44 Harv. L. Rev. 1049 (1931); Berle and Means, The Modern Corporation and Private Property (1933), c. vii, Corporate Powers as Powers in Trust, particularly p. 267 et seq.; Lattin, Equitable Limitations on Powers of Majority Stockholders, 30 Mich. L. Rev. 645 (1932).

20 Good examples from many in the books are Breslav v. New York & Queens Electric Light & Power Co., 249 App. Div. 181, 291 N.Y. Supp. 932 (1936), aff'd without opinion, 273 N.Y. 593, 7 N.E. 2d 708 (1937), where the power "to classify or reclassify any shares" was held not to include the power to make non-redeemable issued shares into redeemable ones, the court in a dictum calling such rights vested property rights. But see Davison v. Parke, Austin & Lipscomb, Inc., 285 N.Y. 500, 35 N.E. 2d 618 (1941), where the statutory power to effect changes in previously authorized shares without par value, including a classification and reclassification of shares and permitting the altering of preferences of outstanding shares was held not to include the power to eliminate accrued, undeclared dividends and sinking funds although the court considered such contractual rights were not vested rights. After the statute was amended so as to permit specifically the elimination of accrued, undeclared dividends, the court sanctioned retroactive elimination in McNulty v. W. & J. Sloane, 184 Misc. 835, 54 N.Y.S. 2d 253 (1945).

On the other hand, see Johnson v. Bradley Knitting Co., 228 Wis. 566, 280 N.W. 688 (1938), where the court permitted, by proper shareholder vote, the reduction of dividend rate on first preferred shares from 7% to 5%, changing
not being cognizant of the effect of prior decisions, defined the shareholder's contract with his company and his fellow shareholders as including only those powers to change which existed in the charter or by statute at the time he acquired his shares. This added to the confusion of an already difficult field of law which, if followed to its logical end, would require a tracing of shareholder status in each individual case in order to make a determination of what powers then existed.\(^{21}\)

While the difficulties up to the present point of discussion were formidable, a significant misconception cropped up which created  

of ratio of net quick assets to the par value of outstanding first preferred from 120% to 60%, reducing the percentage of profits to be set aside annually as a first preferred sinking fund from 3% to 2%, and increasing the authorized issue of common shares from 20,000 to 50,000 without giving the present common shareholders their preemptive right, by virtue of a statute providing, "180.07(1) Any corporation organized for any of the purposes authorized by this chapter, may, by a vote of two-thirds of all the stock outstanding, and entitled to vote . . . amend its articles so as to modify or enlarge its business or purposes, change its name or location, increase or diminish its capital stock, change its officers or its directors, or provide anything which might have been originally provided in such articles." The last clause was stressed by the court as the basis for permitting the above changes. The corporate amendment also purported to authorize the directors to declare and pay a dividend of $20 per share of preferred stock to be paid in convertible dividend warrants to be accepted in discharge of accrued dividends. The court refused to go along with this and gave the complaining shareholders judgment for their back dividends in cash. There were three dissenting judges who argued: "Fundamental changes in contract rights by amendment of a charter are not authorized by a statute unless such authority is expressly given. Blanket language in a statute does not authorize such changes." (Fowler, J., dissenting, at p. 585, original report.) This agrees with Desmond, J., in Davison v. Parke, Austin & Lipscomb, 285 N.Y. 500, 35 N.E. 2d 618 (1941): "The individual preferred stock investor has bargained for certainty in his return, and may not be deprived of his bargain without express statutory authority." \(^{16}\) at 506, 35 N.E. 2d at 621. And: "With regard to the preferential rights here in question the intention of the Legislature is manifest in its failure expressly to provide that these rights may be taken away without the consent of each stockholder." \(^{16}\) at 509, 35 N.E. 2d 622-23.

\(^{21}\)See, for example, the statement by Matthias, J., in Schaffner v. Standard Boiler & Plate Iron Co., 150 Ohio St. 454, 460, 83 N.E. 2d 192, 195 (1948), quoted at p. 23, this article, and the discussion following it. This view gives a large measure of stability to the shareholder's contract which, of course, is important. But it is questionable whether, given circumstances which indicate that some violence must be done to existing shareholders' rights in order to save the corporation and with it the various classes of shareholders, creditors and employees, a formula so drastic is warranted. To obtain new capital, there may be justification for drastic amendments. But one should not be too naïve about this matter, for in a large number of cases where the difficulty involved cumulative dividends the amendment contemplated little more than an early opportunity for the common shareholders to obtain dividends when, if accrued dividends could not be wiped out, they would have to wait indefinitely for them. The writer has not found that the Ohio courts have actually taken the position which Judge Matthias posits in his statement in the Schaffner case.
more confusion. If specific authority existed for the change authorized by the required percentage of corporate owners, courts, according to their views as to just when the statutory provisions became a part of the shareholders' contracts, would permit all manner of change except that which they classified as a change of "vested property interests." The bulk of recent cases expressing this idea is composed almost entirely of cases in which the power of amendment has been used to eliminate accrued dividends under the usual cumulative preferred share contract. The cases arising under the Delaware statute, since Delaware had taken the position of the majority of the courts that statutory authorization of corporate change became a part of the shareholder's contract by virtue of the reservation of the power to amend or repeal, not depending upon the time when his stock was acquired but only upon the time the corporation got its existence, have had much influence when cases have arisen under other statutes more or less similar. The first problem arose out of facts which showed that the broad statutory amendment to Section 26 of the Delaware General Corporation Law had been enacted subsequent to the formation of the company and the issue of its shares. Taking his cue from an earlier case, Chief Justice Layton, who wrote the opinion, reviewed the leading cases involving major corporate changes and reached two conclusion: (1) that accumulated dividends on the cumulative preferred stock were a "fixed and vested right, having the nature and character of a debt" which came under the protection of the due process clause, and (2) that, "quite apart from the constitutional question involved," Section 26 as amended authorized only amendments to charters and that "the cancellation of cumulative dividends already accrued through passage of time is not an amendment of a charter." The court stated that there was nothing in the amendment to Section 26 which indicated that it was the legislative intention to make the act retrospective but clearly


24Keller v. Wilson & Co., Inc., 21 Del. Ch. 391, 411, 413, 190 Atl. 115, 124, 125 (1936). It is difficult to go along with the court on this. Contra is Harr v. Pioneer Mechanical Corp. (a Delaware corporation), 65 F. 2d 332 (G.C.A. 2d 1933), cert. denied, 290 U.S. 673, 54 Sup. Ct. 92 (1933) which, of course, under Erie R.R. v. Tompkins, 304 U.S. 64, 58 Sup. Ct. 817 (1938), must follow the Delaware law. On whether it may perhaps be effective today, see p. 17, this article. Also contra is McQuillen v. National Cash Register Co., 27 F. Supp. 639 [June
intimated that had the legislature done so the case would have been decided the other way. In another dictum, the court stated that the cumulative dividend preference could be eliminated for the future by corporate action in accordance with the amendment to Section 26 which, as has been stated, came after the corporation was formed and the stock issued. Were it not for the very strong accent on vested property rights, the case could be passed by as another instance where the legislature, having failed to delineate sufficiently its specific intentions, would not be given further aid by the court in filling out a doubtful area.

Shortly thereafter the Delaware court had before it a case with just the facts to round out the opinions on the elimination of accrued dividends by direct amendment. In Consolidated Film Industries, Inc. v. Johnson, the corporation had been formed after the amendment to Section 26. This time, too, Chief Justice Layton wrote the opinion—making it doubly clear that the shareholder's right to accrued dividends under his contract was one which "ought to be regarded as a fixed, contractual right, not to be diminished or cancelled against his consent, but to be recognized and protected," and that there was nothing in the statute which indicated that application might be retroactive. Furthermore, he added, "Many interrelations of the State, the corporation, and the shareholders, may be changed. But he, who contends that the State has conferred a power upon corporations, by charter amendment, to change such a substantial contractual right as the right to dividends on cumulative preferred stock accrued under the contract through time, should be able to point to statutory language so clear and precise as to permit of no reasonable doubt that a retrospective operation was intended." Thus there is the inference that had the statute specifically spelled out a retro-

(D.C. Md. 1939), aff'd, 112 F. 2d 877 (C.C.A. 4th 1940) which concerned a Maryland statute somewhat different from that of Delaware and, perhaps, can be reconciled on that basis.


26Id. at 416, 197 Atl. at 493. In referring to his opinion in Keller v. Wilson & Co., Inc., 21 Del. Ch. 391, 190 Atl. 115 (1936), he stated: "In the Keller case, at the time of the organization of the corporation and the acquirement of the preferred shares thereof by the complainant, the law did not permit the abrogation of dividends on cumulative preferred shares accrued through passage of time, and we held that the amendment of 1927 conferred only a power which, when exercised, enabled a corporation to change the status of shares and rights of owners thereof speaking from the time of the accomplishment of the appropriate corporate action, but that the language of the amendment did not point to retrospective operation." Id. at 416, 197 Atl. at 492-93.
spective application, the court would have permitted the elimination of accrued dividends. This, however, is difficult to follow, for, if his right is a property one, the shareholder must either have waived it or had it divested by legal due process. That he has impliedly waived his rights not to have his contract subsequently impaired is not the same thing as waiving rights which, in some manner or other, have acquired the label of property—such, for example, as dividends declared out of a proper fund. If the preference disturbed is not a "vested" property right, then the shareholder's implied agreement backed up by the state's reservation to amend or repeal corporate charters can be legitimately interpreted, as suggested by Chief Justice Layton, to cover retrospective, as well as prospective, preferences provided only the legislature has made this clear.

The difficulty with an analysis which classifies accrued undeclared dividends as a property right different from other contractual rights of a preferred shareholder has not gone unnoticed in some recent decisions of importance. The New York Court of Appeals saw the fallacy of such a distinction in Davison v. Parke, Austin & Lipscomb: "So it seems that only confusion results from saying that 'vested rights' are not within the contemplation of the statute. All preferential rights of stockholders are in a sense vested. They are all property rights founded upon contract. The right of priority in the distribution of corporate assets on dissolution is no less vested than the right to be paid dividends for past years out of contingent future profits. The inadequacy of the 'vested rights' test is further demonstrated by the fact that new stock may be issued with preferential rights to the assets of the corporation upon dissolution and to dividends superior to the preferential rights of the then outstanding shares . . . . even superior to the right of preferred stockholders to dividends in arrears . . . . The judicial problem is not whether a particular preferential right is vested or not, but rather what was the legislative intent as to it." These words

27 See Goldman v. Postal Telegraph, Inc., 52 F. Supp. 763 (D.C. Del. 1943), where the amendment destroyed the dissolution preference of non-cumulative preferred shares. Wrote Leahy, Dist. J. (p. 769): "If we must enter the realm of the implied, then the language of the present Chief Justice of Delaware certainly indicates that if Sec. 26 had specifically authorized the amendment in the Consolidated Film case, there could be no constitutional objections to such amendment. I do not think the Delaware courts have left in doubt what position they would take in disposing of the constitutional question in the instant case."

28 285 N.Y. 500, 509, 35 N.E. 2d 618, 622 (1941), Desmond, J., writing the opinion.
were later used as a basis for the Supreme Court of the same state in deciding that the statutory authorization to eliminate accrued dividends, when taken advantage of by the stated majority of shareholders in a corporate amendment, may be used to eliminate dividends already accrued under the preferred shareholder's contract. "To characterize dividends, accumulating through lapse of time, but never declared, as a 'vested' interest is but to argue from a conclusion," wrote Justice Shientag; and further, "Whenever the court was of the opinion that certain rights of stockholders could not be interfered with, they characterized those rights as 'vested'." Here, then, is a bald recognition that courts reached their conclusion by the application of "gastronomic jurisprudence" first and rationalized upon how the conclusion was arrived at afterward, a feat not unusual in the law and elsewhere, as has often been demonstrated.

But, in most of those jurisdictions recognizing the "vested interest" theory, the courts were soon pressed with attempts to avoid its application by several indirect devices which were meant to strong-arm dissenting shareholders into submission.

A prior preferred stock would, when possible, be authorized and dividends would be payable first to the new issue. Sufficient inducements would be given the shareholders of the cumulative preferred with accrued dividends to assure the success of the plan. Those who refused to go along with the majority would find themselves holding the old stock but unable to insist upon payment of their accrued dividends before the new prior preferred shareholders received theirs. Other preferences, such as preferences upon dissolution, might also be given the new prior preferred to make it

30Id. at 841, 54 N.Y.S. 2d at 259. The present writer recommends that those who are confused in this matter of the application of reserved powers to later legislation as applied to corporations formed between the reservation and the statute study the opinions in the two New York cases (i.e., Davison v. Parke, Austin & Lipscomb, Inc., and McNulty v. W. & J. Sloane). These opinions have the clarity which most in this field lack. And see the superb analysis in BALLANTINE AND STERLING, CALIFORNIA CORPORATION LAWS (1949 ed.), c. xiv, which indicates that California has the breadth of view of New York and Delaware but with more protection to minorities.
31High minded sentiments were sometimes used in supporting the conclusion. See Keller v. Wilson & Co., Inc., 21 Del. Ch. 391, 412, 190 Atl. 115, 124 (1936).
so attractive (and the old cumulative preferred so undesirable) as to encourage the "voluntary" exchange.

Another indirect method of eliminating accrued dividends was to bypass the rigid prohibition against elimination by direct amendment and to use the merger and consolidation provisions of the statute. This was sometimes done by merger into a subsidiary previously formed for other purposes or by the formation of a subsidiary for the very purpose of merging with it to eliminate accrued dividends. The shareholder had no choice but to take stock in the corporation into which the one in which he held shares with accrued dividends merged. For all practical purposes, the effect of these indirect methods was to force the dissenting shareholder against his will to give up his stock with its accrued but undeclared dividends for what was offered him. The same fuss was not made about vested property interests, though they must exist as thoroughly in such cases as where direct methods are used to wipe them out. Had shareholders consented in advance to their destruction in case of merger or consolidation and not in case of elimination by direct amendment? It seems doubtful that they consented here if they did not consent to the elimination by amendment directly destroying their right. As Judge Biggs aptly states in the Hottenstein case: "If the right is a vested right of property, protected by constitutional guaranties the holder can be as little deprived of it by merger or consolidation under Section 59 as by reclassification under Section 26. If the terms of the contract between the preferred stockholder and his corporation cannot be changed by any charter amendment, the preferred stockholder is entitled to the protection of the Contract Clause, Section 10, Article 1 of the Federal Constitution. If the intervening complainant in the case at bar is being deprived of a vested right in property in violation of the provisions of the Fourteenth Amendment to the

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\[\text{3}\] Federal United Corp. v. Havender, 24 Del. Ch. 318, 11 A. 2d 331 (1940). Said Layton, C.J., at p. 335, 11 A. 2d at 339: "Consequently, in a case where a merger of corporations is permitted by the law and is accomplished in accordance with the law, the holder of cumulative preference stock as to which dividends have accumulated may not insist that his right to the dividends is a fixed contractual right in the nature of a debt, in that sense vested and, therefore, secure against attack. Looking at the law which is a part of the corporate charter, and, therefore, a part of the shareholder's contract, he has not been deceived nor lulled into the belief that the right to such dividends is firm and stable." See also Langfelder v. Universal Laboratories, Inc., 68 F. Supp. 209 (D.C. Del. 1946), aff'd, 163 F. 2d 804 (C.C.A. 3d 1947); Anderson v. International Mineral & Chemical Corp., 295 N.Y. 343, 67 N.E. 2d 573 (1946). In Hottenstein v. York Ice Machinery Corp., 136 F. 2d 944 (C.C.A. 3d 1943), a corporation was specially created for the purpose of merging one in trouble with accrued dividends.
Constitution of the United States, the court below should have granted the injunctive relief sought by the appellant." However, the court was obliged (not reluctantly, it appears, for Judge Biggs felt that these were not vested property rights) to accept the law as laid down in the Havender case and bluntly stated that this decision amounted to a repudiation of the principles laid down in the Keller and Consolidated Film Industries cases, if "shorn of rationalization," and that "Havender broke Keller's back,"—strong language which seems to mean that this court, at least, believed that the Delaware decisions would no longer stick to the "vested property" concept after the holding in Havender. Of course, vested property rights, though constitutionally protected, may be waived in advance if a waiver can be shown. But this is a quite different thing from impliedly consenting to contractual changes authorized by successive statutory provisions which are read in, as a part of the shareholder's contract because of the state's reservation of the power to amend or repeal corporate charters. Judge Biggs' argument is inherently sound and his conclusions justified. In fact, when Chief Justice Layton suggests that, were the statutory provision clear in showing an intent to permit the elimination of dividends in arrears, an amendment to the articles to this effect would be respected though it had a retroactive effect, he impliedly assumes that the so-called vested interest is simply another contract right of the shareholder, over which the state has retained its power to change; either this, or that the power to amend or repeal includes the power to divest property interests, an argument which has had no acceptance and which should gain no recognition without showing the shareholder's unequivocal consent.

From what has been said, it appears that Delaware and New York, both with broad statutes permitting major corporate change, are well on their way toward ironing out their constitutional diff-

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34Hottenstein v. York Ice Machinery Corp., 136 F. 2d 944, 950 (C.C.A. 3d 1943). In the court's note 9, p. 949, it is said: "It is difficult for us to perceive why the right to an unaccrued dividend is any less 'vested' than a right to a dividend which has accrued."

3524 Del. Ch. 318, 11 A. 2d 331 (1940); under the doctrine of Erie R.R. v. Tompkins, 304 U.S. 64, 58 Sup. Ct. 817 (1938).

36See note 22 supra.

37See note 25 supra.

38Hottenstein v. York Ice Machinery Corp., 136 F. 2d 944, 950.

39Ibid.

cultics concerning the use of statutory powers as these are granted. "The prevailing view now is, in Delaware and elsewhere, that the discretionary power of the controlling or specified majority is untrammeled by any restriction other than the duty of exercising good faith." There have been from the beginning equitable limitations upon the use of this power by those entrusted with it, of which more will be said later. But the power itself was held to be there to apply to corporations formed after the legislative or constitutional reservation of the power to amend or repeal, whether or not the particular statute conveying the power to change was in existence at the time of the formation of the corporation or came later, whether or not the statute itself imposed the change or a majority of shareholders were given authority to do so by the statute, and whether or not the contract could be said to be one between the state and the corporation or between the shareholder and his corporation. Frequently, appraisal statutes were pointed to for the purpose of bolstering the argument above, the legislature giving the shareholder a means of exit where his interests were in peril, or as an additional argument to support the constitutionality of the legislation giving almost unlimited power to majorities to change the contract relations already existing.

Ohio is one of a still small number of states having an extremely liberal amendment section. By an amendment to Section 8623-14 which became effective on July 24, 1939, the specific power to eliminate accrued, undeclared cumulative dividends was given. While it had been thought that this section was broad enough before its amendment to warrant an interpretation that accrued dividends might be eliminated by shareholder action, Keller v. Wilson & Co., Inc. had indicated that a more specific spelling out of the

41Ballantine, Corporations 656 (Rev. ed. 1946).

42Ohio Gen. Code § 8623-14, especially sub-par. (i) which reads: "... [to] change any or all of the express terms and provisions or designations of issued or unissued shares of any class or series; which change, if desired, may include the discharge, adjustment or elimination of rights to accrued undeclared cumulative dividends on any such class."

43The Ohio State Bar Association Committee on Corporations which framed the provision and was effective in obtaining its enactment took the position that "in principle there is no distinction between changes of rights to dividends accrued in the past and changes operative in the future." The Committee also stated that the then existing § 15 "probably leads to the same result." But doubts had been raised by virtue of Johnson v. Lamprecht, 133 Ohio St. 567, 15 N.E. 2d 127 (1938), Report on Proposed Amendments to the General Corporation Act, Dec. 16, 1938, of the Ohio State Bar Association on Corporation Law, comment following § 14.

44See note 43 supra.
power should be there if a court were to give it retroactive application. Doubt had also been cast in the important case of *Johnson v. Lamprecht*, which cited the Delaware cases, mentioned the "vested right" doctrine, but brushed it aside as being "academic" as the case involved a determination of whether a new class of prior preferred shares could lawfully be placed ahead of the outstanding cumulative preferred which had dividend arrearages. Judge Gorman, who wrote the opinion, held the amendment valid—making the interesting observation that, in case of attempted compulsory annihilation of accrued dividends, "If there is a surplus, the action usually has been enjoined. If, on the other hand, there is a need for additional capital, the corporate necessity for continued existence overshadows the claims of the minority holders to dividends. In determining the questions courts have considered both the equities and the business situation, attempted to weigh and balance them, and then decided the controversy." The acceptance of this view, he thought, could not be upon any basis of a vested right. The business necessity of the case in hand might well be a sound basis for decisions in this field, with, of course, a further requirement of fairness to the shareholders who have to make some sacrifice.

But the course of decision has not run smoothly since *Johnson v. Lamprecht*. In *Wheatley v. A. I. Root Co.* by direct amendment to the articles of incorporation the prescribed majority hoped to eliminate arrearages in dividends of a corporation formed and stock issued prior to the effective date of the amendment to Section 14 which, in specific words, permitted such elimination. In a class action by dissenting shareholders to enjoin the defendants from carrying out the proposed plan of recapitalization and from paying dividends on the common stock until all accruals had been fully paid on the preferred, the trial court held the corporate amendment effective and pointed to Section 72 which afforded the plaintiffs a remedy for the appraisal of their shares as an adequate remedy. The Court of Appeals held that dividends which had accrued prior to July 24, 1939, the effective date of the amend-

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46133 Ohio St. 567, 15 N.E. 2d 127 (1938).

4Id. at 574, 15 N.E. 2d at 130. He cites BERLE AND MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 150, 151 (1933). These authors were not talking of retrospective but of prospective action. Nor were they speaking of undeclared dividends.

ment to Section 14, might not be wiped out but that those which had accrued since that date, up to the time of the amendment to the articles, could be, "inasmuch as amendments to general corporation laws become a part of the charter of a corporation as of the day of their promulgation," and that "this section of the corporation code cannot validly have any retrospective or retroactive effect, but that it may properly and validly be applied prospectively, and this irrespective of when the corporation was organized or when the stock in question was issued or acquired by the holders thereof."40 Of the removal of dividends which had accrued prior to July 24, 1939, the court thought that this would be an impairment of the contracts of the plaintiffs. The Supreme Court differed with both the trial and appellate courts, holding that the accrued unpaid dividends were vested rights to the time of the amendment of the corporate articles and, as no question had been raised concerning the prospective application of the statutory amendment, the court refused to give its opinion as to this. Judge Matthias' opinion, if one may be forgiven for an understatement, is confusing and far from illuminating. He quotes passages from American Jurisprudence and Fletcher, which passages state only the New Jersey, or minority, view on the extent of the reserved power to amend or repeal. Immediately following the quoted passages, he cites cases from the Supreme Court of the United States and from Delaware which are clearly basically contra in philosophy to the New Jersey view50 and which represent the better and weight of authority, alongside of New Jersey and other cases expressing the minority, stating as a preamble, "Many cases may be cited supporting the text, among which are . . . " The facts of the case quite clearly showed that there was existing at the time of the proposed corporate amendment a considerable surplus out of which the corporation, had it decided to, might have paid

40 Ohio App. 93, 98-99, 72 N.E. 2d 482, 485 (1945), opinion by Stevens, J. Washburn, J., dissented in part but not on the manner in which new statutory provisions became a part of the shareholders' contracts. The court also held that the remedy under § 72 was not exclusive "as to such unpaid dividends."

50 See BALLANTINE, CORPORATIONS 648 (Rev. ed. 1946), where he states: "In a few states, such as Idaho and Utah, a strict view is taken that the effect of the reserved power is only to allow the state to impose restraints upon existing corporations in the public interest, and not to authorize permissive amendments changing the contract rights of the shareholders among themselves." See also 1 DAVIES, OHIO CORPORATION LAW 320 et seq. (1942), for a penetrating analysis of the Ohio and other cases on the extent of the reserved power, and Bickel, Scope of the Reserved Power to Amend Corporation Laws—Comment on Wheatley v. A. I. Root Co., 19 OHIO B.A.R. 541 (Jan. 6, 1947), where he tries to reconcile what was held with what was said in this confusing case.
dividends to the cumulative preferred shareholders, that there was no compelling necessity to wipe out the accruals, that the benefit was chiefly to the common shareholders and without the fairness which is expected in such deals, and all in all had the appearance of as fine a case as equity might wish for washing unclean hands. The result of the case was most clearly right, but it could have been supported by decent, clean-cut reasoning along the line which previous Ohio cases had been trending, that is, toward the view expressed in the Court of Appeals that each successive statutory provision authorizing change was immediately incorporated as a part of the contract and it did not matter when the shareholder acquired his shares, whether before the statutory amendment or after it; he had impliedly consented in advance.\textsuperscript{51}

The Supreme Court complicated matters further by bringing into the discussion the suggestion that the reserved power constitutional provision does not differ from Section 1, Article II of the Ohio Constitution, under which authority the General Assembly has the power to alter or repeal any statute thereafter enacted, and also by laboring over Section 28, Article II, which prohibits retroactive legislation or laws impairing the obligation of contracts. The answer is clear, for the reservation of the right to amend or repeal was specifically directed at the corporation, and was aimed at doing the very violence which the constitution would not permit without the consent of the corporation and the shareholder. If Section 28, Article II prohibits the kind of corporate change which does violence to previously acquired contract rights of shareholders, then the reserved power of Section 2, Article XIII is meaningless. The power to amend or repeal is there and the only immediate question is whether the narrow and impractical (in a business sense) view represented by New Jersey be accepted or the broader and perhaps somewhat more dangerous view of Delaware and New York be the choice. Then if the court found merit in a vested interest argument, it could still insist that due process must be met if the interest is to be divested. As already pointed out, it is one thing to hold that the power reserved by the state to amend or repeal must be accepted by the shareholder to include those charter and statutory provisions existing when the corporation issued the shares and those charter changes authorized by future statutes which may, and frequently do, interfere with his former \textit{contractual rights, and quite another thing to hold that, by his  

implied waiver, changes may be made which eradicate vested property interests, whatever these may be.

More fog descended when the recent case of Schaffner v. Standard Boiler & Plate Iron Co. emerged from the quiet sanctuary of the Ohio Supreme Court. There is no statement as to when the corporation was formed, but the shares whose accrued dividends were receiving annihilation were issued on January 1, 1929. The amendment to the corporate articles had been made on February 2, 1939, about six months prior to the effective date of the amendment to Section 14 of the General Corporation Act which specifically gave the power to annihilate. Here, too, there was a surplus which might have been used to pay some of the accrued dividends. Plaintiffs who were holders of shares upon which dividends had accrued and who refused to turn these shares in for a new class offered as a part of the recapitalization scheme brought an action to recover the dividends which had accumulated and to enjoin the corporation from paying dividends (the record showed that dividends had already been paid to the common shareholders) on the common stock until all unpaid cumulative dividends had been paid on the preferred. The trial court rendered judgment for the defendants, dismissing the plaintiffs' petition, which judgment was reversed by the Court of Appeals, the cause being remanded to the trial court "for proceedings in accordance with law." The case next came to the Supreme Court on motion to certify the record of the Court of Appeals and the Supreme Court held that "the amendment, effective July 24, 1939, is not applicable to this case by reason of the fact that the action of the corporation in recapitalizing was completed on February 2, 1939, which was prior to the effective date of that amendment," that the General Corporation Act of 1927 was applicable, for it existed at the date of the issue of the shares, but that there were no provisions "as in effect at that date" which gave a power to eliminate accrued dividends; hence, they could not be eliminated. Since dividends had already been paid to the common shares out of a surplus partially created by the recapitalization, the court further decreed that the preferred shareholders were entitled to their dividends "to the extent that such distribution from surplus was made to holders of the common shares."

Again, the reasoning of the case is more important than the actual holding. Judge Matthias reverted to the Wheatley case

5150 Ohio St. 454, 83 N.E. 2d 192 (1948).
5Id. at 461, 83 N.E. 2d at 196.
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In these words: "It is to be noted that the shares which were involved in the Wheatley case were all issued prior to the General Corporation Act ... which became effective June 9, 1927. The provisions of that act were not applicable to those shares, and, therefore, Section 8623-14, General Code, granting the corporation the right to change the terms of outstanding shares by amendment of the articles of incorporation could not affect those shares."

If he means what he says, no future statute which interfered with a shareholder's contract as determined by charter and statutory provisions at the time of the issue of the particular shares would be valid except with the shareholder's later waiver or, to a limited extent, by the use of the state's police power. But in the next paragraph Judge Matthias clearly states that the "reason" why the amendment to Section 14 could not apply to the Schaffner case is that the amendment had not become effective at the time of the recapitalization in February. Quite obviously that cannot be the "reason" if what he says first is a true statement of the Ohio law. He later turns to the argument that, while the corporation might amend its capital structure, such an amendment must not impair vested rights to receive accrued dividends, then swings into the retroactivity argument stating that retroactive application of Section 14 "would constitute an impairment of the constitutional

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54 Id. at 460, 83 N.E. 2d at 195. But note that Judge Matthias wrote in the Wheatley case, 147 Ohio St. 127, 145, 69 N.E. 2d 187, 196 (1946): "The provisions of the proposed plan, insofar as they undertake a retroactive application of these statutory provisions and thus impair the contract of the preferred shareholders and thereby deprive them of the rights stipulated therein, are invalid. It should be observed that no question relative to the prospective application of these statutes is presented, and, therefore, is not considered or decided." This cannot be reconciled with the quotation to which this note refers. If Judge Matthias had believed the principle set forth, he should have said in the Wheatley case, "These shares having been issued prior to the 1927 statute cannot be affected by any provisions in that statute except those which are non-fundamental in character or in which the state has a vital interest exercisable by virtue of the police power." Marshall, C.J., in Allen v. Scott, 104 Ohio St. 436, 135 N.E. 683 (1922), with whom Matthias, J., had concurrred, saw the fallacy of this argument. The defendants had contended that they were not subject to the provisions of a statute which placed double liability upon shareholders of banking corporations for the reason that when they acquired their shares (and when the corporation was organized) there was no additional liability. Wrote the then Chief Justice: "The principle contended for by counsel for defendants in error would immediately create two classes of corporations, those organized between 1903 and 1913, and those organized before and after that period. This would be conducive to the greatest confusion and would destroy the uniform operation of laws applicable to private corporations." (p. 444) He might also have added that much greater confusion would result if the time when the shares are issued is the controlling factor. See also Stockholders of The Peoples Banking Company v. Sterling, Receiver, 300 U.S. 175, 57 Sup. Ct. 386 (1937).
rights of such shareholders," once more returns to the argument that "statutes in effect at the time the shares were originally issued became a part of the contract of the corporation with its shareholders," and again reverts to one that "there is no constitutional inhibition against the corporation proceeding to amend its capital structure, except so far as such amendment is sought to be applied retroactively." But how can this be if later statutory grants of power may not apply to previous stock issues? The court further held that the cumulative preferred shareholders were not entitled to cumulative dividends after the date of the amendment to the articles (February 2, 1939), that is, those dividends accruing in the future, thus settling the uncertainty as to the extent of the power of amendment under Section 14 as it existed before the amendment of July 24, 1939.

One can only guess at what the court had in mind when it decided these two important cases. The matter of the retroactive application of a corporate amendment authorized by a statute enacted subsequent to the formation of the corporation and that of vested property rights—whatever that vague term may mean—were points of emphasis not easily dismissed. As a matter of fairness, a rule which limited fundamental corporate amendments to those which looked to the future and not to the past, except for emergency action, might have its merits. Likewise, the same result reached by a rationalization that accrued dividends are vested property rights indicates the usefulness of this concept to circumvent action by common shareholders bent on plunder. But some rational basis ought first to be ascertained concerning the nature of the shareholder's contract with his company, the extent of his consent under the reserved power, and the necessities of business carried on in the corporate form. These matters can only be outlined in this paper, with some indication of the manner of approach which, of necessity, must be as practical as the complexity of the problem permits.

First, there is as yet no clear pronouncement from the Supreme Court of Ohio that it has shifted from the majority Delaware to the minority New Jersey point of view on the basic problem of reading into the shareholder's contract successive statutory provisions and the charter amendments empowered by them, though the dicta of *Wheatley* and *Schaffner* are strongly suggestive of the New Jersey doctrine. The opinions prior in point of time to *Wheatley* and *Schaffner*, if read critically, indicate that Ohio had

55150 Ohio St. 454, 461, 83 N.E. 2d 192, 196 (1948).
accepted the Delaware doctrine and the legislative intent to accept this same approach is clearly stated in the General Corporation Act of 1927. Thus, corporations formed before the Constitutional reservation in 1851 of the power to alter or repeal must be treated in accordance with the principle of the *Dartmouth College* case. Those formed after would, by this view, be governed by statutes then existing or later enacted, which statutes would be held (by majority holdings) to be a part of the shareholder's contract with his corporation and among his fellow shareholders as well as between the corporation and the state, with the usual equitable limitations and subject to the due process clause when property interests are divested.

Next, it would seem desirable frankly to recognize, as have some recent opinions, that the ambiguous term "vested property right" is merely a bit of camouflage to reach a result which can be more desirably accomplished by other means. As Judge Learned Hand has stated: "Personally I should not have thought that the cumulative dividends conferred any 'vested' rights, whatever that much abused word may mean. They seem to me to be no more than a right to an increased dividend when any is declared, or at least when there are earnings." 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.

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57For an excellent recent case, see *New Orphans' Asylum of Colored Children of Cincinnati v. Board of Tax Appeals*, 150 Ohio St. 219, 80 N.E. 2d 761 (1948). The doctrine of that case is recognized in Ohio in § 8623-130: "Corporations created before the adoption of the constitution of 1851, which have not, by election or some other act, come to be governed by laws since passed, shall be governed and controlled by the laws then in force, and the valid modifications thereof since and herein enacted." Such a corporation may, however, be governed by the provisions of the General Corporation Act if it accepts the same in the manner set out in Ohio Gen. Code. § 8623-131, or by other corporate action described in this section.


59There is perhaps no better general statement on the matter of fairness than the following: "The reserved power of the corporation to amend its charter
While the judicial approach in the determination of "fairness" has varied and the statutes give little aid in solving this problem, a satisfactory solution rests in the broad powers of the chancellor to prevent inequitable results. Equitable limitations on the power of a majority may be, as some have claimed, "of such an indefinite and nebulous character that they fail to provide the stockholder with anything approaching an adequate remedy against tendencies of a management to overreach," but there is no good reason why able judges without the aid of additional legislation cannot remedy this matter. If, as Professor Ballantine has stated, "In general . . ., except in New Jersey, the courts have not undertaken to review the question of unfairness of amendments even in a case must be so exercised that the result will tend to benefit the corporation as a whole, and to distribute equitably the benefit or the sacrifice, as the case may be, between all groups in the corporation as their interests may appear," BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 267 (1932).

Class voting is frequently required and generally the amendment must be carried by more than a simple majority. See Ohio Gen. Code § 8623-15(4). The Ohio statute raises a presumption that the amendment is "fair and equitable in every respect to all shareholders" and requires "clear and convincing proof" to overcome the presumption. Ohio Gen. Code § 8623-15(9). By § 8623-14, the shareholder, if substantially prejudiced by the amendment, or even though not prejudiced in the cases stated, has his remedy of appraisal and payment under § 8623-72.

In a few states, as in California, a permit from the Commissioner of Corporations is required for the adoption of an amendment making changes in outstanding shares under the Corporate Securities Act as such amendments operate as the substitution of a new security for the old." BALLANTINE, CORPORATIONS 656-57 (Rev. ed. 1946).

There also exists the inherent power of a court of equity, a power limited generally to the test of good faith rather than a test objective in character, a power the exercise of which may be circumscribed, because too often what is an accomplished fact is presented to the court; but it is a significant, restraining influence nevertheless. [Citations omitted.]" Shientag, J., in McNulty v. W. & J. Sloane, 184 Misc. 835, 844-45, 54 N.Y.S. 2d 253, 262 (1945).

See the excellent analysis of the New Jersey and Delaware cases on this important matter in Meck, Accrued Dividends on Cumulative Preferred Stocks, 55 HARV. L. REV. 71, 95-112 (1941). The author demonstrates that the New Jersey rule of fairness in accrued dividend adjustments "seems to revolve about the existence of an earned surplus" at the date of the proposed adjustment.


A judge who understands the realities of the situation need have no hesitation in treating recapitalization plans as in fact what the SEC has called them, "management plans", and not arm's-length bargains between independent groups of common and preferred shareholders. So treating them, he should have no difficulty in holding that it is within the power of an equity court, even in the absence of specific legislation, to subject them to the same sort of objective test of fairness to which reorganization plans are now subjected." Dodd,
of substantial prejudice, short of fraud," the day has come for a return to a more refined conscience on the part of the chancellor, a return to the techniques of Lord Mansfield. The day of majority piracy as well as of minority oppression is in its sunset. As a measuring stick for the chancellor, this statement may well suffice: "Changes in the rights of outstanding shares may be valid if they can be justified as an exercise of fair business discretion in meeting the needs and exigencies of the corporate enterprise. The more urgent the need or the emergency the more drastic the amendment or adjustment which fairness will permit, as in changing preferences and financial arrangements according to what the enterprise can carry. The facts and circumstances of each case will enter into the determination of the validity of the exercise of the power in that case." If guidance of a more definite sort is desired the chancellor may go to the reorganization field for analogies or for a measuring stick with which to test recapitalization amendments. Once it is made clear that recapitalization must not only be done in good faith but also that there is a higher standard than unfairness indicating "fraud", there will at least be the threat that fair and equitable standards must be met in recapitalization by both direct and indirect methods. If the chancellor fails in this the legislature should take over and prescribe that there be prior judicial consent to recapitalization amendments or provide some sort of administrative action to enforce just recapitalizations.

Fair and Equitable Recapitalizations, 55 Harv. L. Rev. 780, 806 (1942). And, later, at p. 817, Professor Dodd states: "Fortunately, however, no case has definitely foreclosed the chance to contend successfully that the problem of recapitalization is essentially the same as that of reorganization, and that the state courts should prevent the enrichment of common shareholders in recapitalizations at the expense of the preferred, just as the federal courts prevent the enrichment of junior interests in Chapter X reorganizations."

Ballantine, Corporations 656 (Rev. ed. 1946).


See Dodd, supra note 63, at 769 et seq., particularly his analyses of the recapitalizations in Keller v. Wilson & Co., Consolidated Film Industries, Inc. v. Johnson, Federal United Corp. v. Havender and Shanik v. White Sewing Machine Corp., and the application of the reorganization test to these cases. Professor Dodd reaches the conclusion that "the facts of these four Delaware cases indicate sufficient doubt as to the fairness of the plans to the preferred shareholders to suggest the need for subjecting reclassification plans to a different sort of scrutiny than they now receive." And see Latty, Fairness—The Focal Point in Preferred Stock Arrearage Elimination, 29 Va. L. Rev. 1 (1942) for a comparable analysis and his conclusions from p. 49 to p. 51. These articles offer much to judges who would see the true picture of what so often happens in recapitalization through shareholder action.