DISSENTING STOCKHOLDERS AND AMENDMENTS TO CORPORATE CHARTERS

(Continued from May Issue.)

USE OF THE RESERVED POWER TO ENABLE THE MAJORITY TO TO MAKE AMENDMENTS.

This general discussion of the extent of the legislative power to amend where such power has been reserved has been indulged in merely for the purpose of furnishing the ground work for the consideration of the problem with which we are directly concerned, namely, how far, if at all, the legislature may, under the reserved power, confer upon the majority or some other percentage of the stockholders, or on the directors, the power to accept or adopt amendments which will be binding on dissenting stockholders.

The courts have given a number of different answers to this question. Some judges and text writers have explicitly stated that, provided the amendment is one which the legislature could validly impose upon the corporation, it may be offered to the majority for acceptance regardless of the wishes of the minority. In an early Massachusetts case [66] this result was reached on the ground that the charter is a contract between the corporation and the state and that, if both parties consent to its modification, dissenting shareholders cannot complain. This method of putting the case would seem to be plainly erroneous in that it ignores the fact that the charter is a contract between the stockholders *inter se,* as well as, under the doctrine of the *Dartmouth College* case,[67] a contract between the state and the corporation. The reserved power, in authorizing changes in the contract between

[66] Durfee v. Old Colony & F. R. Co., 5 Allen 230 (Mass., 1862).
[67] *Supra* note 17.

the state and corporation, necessarily authorizes as incidental thereto changes in the contract between stockholder and stockholder. It still remains to be determined, however, whether the power is not limited to changes imposed by the legislature as distinguished from changes merely authorized by it. The case referred to does, indeed, while indicating no very clear comprehension of this difficulty, suggest as a solution of it the theory discussed in an earlier portion of this article, that the stockholder has impliedly consented to such amendments as the majority and the state may agree upon. As is there pointed out, any such implied agreement is pure fiction.

Mr. Morawetz, on the other hand, meets the difficulty in another way. A so-called optional amendment is, he says, in reality a compulsory amendment, for the legislature's statement that a certain amendment may be made by the majority can be construed as a statement that it shall be made if the majority vote for it.[68] This does not seem to cover the case, which is quite common today, in which the legislature does not provide for any particular amendment, but gives the majority the right, which they did not possess when the corporation was formed, of amending the charter in any way that they may desire with regard to certain of its provisions, such for example, as that fixing the capitalization of the corporation.

Furthermore, it is submitted that, although verbally accurate, it is not a fair statement of the substantial effect of such an amendment. An amendment which depends for its adoption on the will of the majority is not in substance a compulsory one. There is, indeed, an element of compulsion in the case, but the compulsion is not to amend the charter, but to adopt the rule of majority control in place of the rule of unanimous consent. The real problem is whether the reserved power enables the legislature to make this change.

A majority of the courts, including the Supreme Court of the United States, have held or assumed that it does—that the

[68] MORAWETZ ON PRIVATE CORPORATIONS (2d ed. 1886) §§ 405, 1111.

power to amend includes the power to offer amendments to the majority.[69] On the other hand, some courts[70] and text writers[71] have vigorously insisted that there is a vital difference between amendments imposed by the state and amendments offered to the majority.

The argument is expressed in various ways. Thus, it is

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[69] There seems to be no square decision of the United States Supreme Court to this effect, but in Polk v. Mutual Reserve Fund Association of N. Y., *supra* note 28, the reserved power to amend was held to make valid a statute giving the directors power to amend. This decision was clearly foreshadowed by the language used and the results reached in the earlier cases. In Miller v. New York, *supra* note 39, a compulsory amendment granting additional voting rights to one stockholder was upheld, the court not relying on the fact that the amendment was compulsory but saying that the reserved power "may be exercised, and to almost any extent, to . . . secure the due administration of its affairs so as to protect the rights of stockholders" (p. 498). In Looker v. Maynard, *supra* note 39, the reserved power was held to justify a law permitting a stockholder who should desire to do so to cumulate his votes. In a sense this statute may be regarded as a compulsory amendment since it applied automatically to all corporations. Its practical effect, however, was to confer upon each stockholder the power to determine whether the voting rights which he should exercise at any particular time should be those conferred upon him by the original contract between the stockholders or those granted by the amendment.

For typical state decision upholding amendments offered to the majority, see Durfee v. Old Colony & F. R. Ry. Co., *supra* note 66; Lord v. Equitable Life Assurance Society, *supra* note 63; Randal v. Winona Coal Co., 206 Ala. 254, 89 So. 790 (1921); Market St. Ry. v. Hellman, 109 Cal. 571, 42 Pac. 225 (1895); Perkins v. Coffin, 84 Conn. 275, 79 Atl. 1070 (1911); Buffalo & New York City R. Co. v. Dudley, 14 N. Y. 336 (1856); Hale v. Cheshire R. R. Co., 161 Mass. 443, 37 N. E. 304 (1894); Somerville v. St. Louis Mining & Milling Co., 46 Mont. 268, 127 Pac. 464 (1912); Winfree v. Riverside Cotton Mills, 113 Va. 717, 75 S. E. 309 (1912); Germer v. Triple-State, etc., Co., 60 W. Va. 143, 54 S. E. 509 (1906).

The language of some of these decisions may be objectionable either because it does not clearly recognize that there is a contract between the stockholders *inter se* as well as a contract between the corporation and the state, or because it does not explicitly state that the legislative power to authorize the majority to amend is not unlimited. Such criticisms do not, however, impair the value of these cases as the decisions that the reserved power permits amendments offered to the majority as well as amendments imposed on the corporation.

[70] Dow v. Northern R. R., *supra* note 28; Avondale Land Co. v. Shook, 170 Ala. 379, 54 So. 268 (1911), but *cf.* Randle v. Winona Coal Co., *supra* note 69; Zabriskie v. Hackensack & N. Y. R. Co., 18 N. J. Eq. 178 (1867); Mills v. Central Ry. Co., 41 N. J. Eq. 1, 2 Atl. 453 (1886); *In re* Newark Library Ass'n, 64 N. J. L. 217, 43 Atl. 435 (1899); Allen v. Francisco Sugar Co., 92 N. J. Eq. 431, 112 Atl. 887 (1921), but *cf.* Berger v. U. S. Steel Corp., 63 N. J. Eq. 809, 53 Atl. 68 (1902); Woodfork v. Union Bank, 3 Cold. 488 (Tenn. 1866); Garey v. St. Joe Mining Co., 32 Utah 497, 91 Pac. 369 (1907); Kenosha, R. & R. I. R. Co. v. Marsh, 17 Wis. 13 (1863).

The language of some of these cases would seem to indicate that a compulsory amendment which affected merely the rights of the stockholders *inter se* would have been deemed equally invalid.

[71] See COOK, CORPORATIONS (8th ed. 1923) § 501.

said that the power is reserved for public purposes and that the fact that the amendment was offered to the majority instead of imposed shows that the legislature did not have any public purpose in mind, but was merely gratifying the wishes of the majority.[72] It is further said that the reservation authorizes changes in the contract between the corporation and the state and does not authorize changes in the contract between the stockholders, except in so far as changes in the latter contract result incidentally from changes in the former, and that authorizing the majority to amend is changing the contract between the stockholders rather than the contract between the corporation and the state.[73]

The definition of public purpose which the above argument implies would seem to be too narrow. Changes in the charters of corporations generally affect only a limited class of persons. Thus, for example, changes in stockholders' liability affect only the stockholders and the creditors, and benefit only the latter.[74] The stockholders of a corporation are frequently as numerous as its creditors, and their rights are of as great public importance as are those of the latter class. In fact, the distinction between preferred stock and unsecured bonds often amounts to very little in practice. If the legislature believes that the veto power which the theory that a charter is a contract between the members gives to the holder of a single share is unfair to the majority, legisla-

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[72] "It should be restricted to those amendments only in which the state has a public interest. Any attempt to use this form of amendment for the purpose of authorizing a majority of the stockholders to force upon the minority a material change in the corporation is contrary to law and the spirit of justice." *Ibid.*

Similiar statements are not uncommon in the decisions. It is submitted that the real question is whether there may not be, in some cases at least, a sufficient public interest in the substitution of the rule of majority control for the rule of unanimous consent.

[73] "This power was never reserved upon any idea that the legislature could alter a contract between a corporation and its stock subscribers, nor for the purpose of enabling it to make such alteration." Paine, *J.*, in Kenosha, R. & R. I. R. Co. v. Marsh, *supra* note 70, at 17.

"It was to avoid the rule in the Dartmouth College case, not that in Natusch v. Irving, that the change was made," Chancellor Zabriskie in Zabriskie v. Hackensack & N. Y. R. Co., *supra* note 70, at 186.

[74] It is universally agreed that the legislature can, under the reserved power, increase the liability of the stockholders. Sherman v. Smith, 1 Black 587 (1862); Williams v. Nall, 108 Ky. 21, 55 S. W. 706 (1900); Bissell v. Heath, 98 Mich. 472, 57 N. W. 585 (1894); Allen v. Scott, 104 Ohio 436, 135 N. E. 683 (1922).

tion designed to limit that veto power can as fairly be said to be passed in the public interest as can legislation affecting the rights of creditors.

Nor is the argument that permissive changes are not within the amending power, as not being primarily changes in the state's contract, particularly persuasive. Although the *Dartmouth College* case [75] was the principal cause of the insertion of the amending power in corporate charters, the power reserved is not in terms the power to amend the contract with the state, but the power to amend the charter or the corporation laws. While the rule which grants the minority a veto power with respect to changes is a rule derived from the law of contracts and the law of partnership, it is one which is read into the charters and into the general corporation laws. No one doubts that the power to make alterations in the charter could be bestowed on the majority at the outset. If, therefore, the contention made earlier in this article, that the internal organization of a corporation is a part of its charter contract with the state, be admitted, it necessarily follows that the rule of amendment by majority vote prescribed by such a charter would be a part of the charter contract with the state. Where nothing is said in the charter, the common law rule of no change except by unanimous consent prevails; but this rule, which is assumed to be impliedly adopted in the charter unless the charter says otherwise, is as much a part of the charter contract as any modification of the common law rule in the charter would be.

Moreover, as previously stated, a so-called optional amendment is in reality compulsory, in that it is a compulsory substitution of the rule of majority control for the rule of giving each stockholder a veto power. If, then, so-called optional amendments are invalid, it is not because of their alleged non-compulsory feature, but because the legislature cannot use the amending power for the purpose of enlarging the rights of the majority, but only for the purpose of enlarging the rights of outsiders. A doctrine which assumes that the majority stock-

[75] *Supra* note 17.

holders are the only class which the legislature is debarred from protecting under the reserved power is so clearly undesirable from a practical standpoint that it would take much stronger theoretical arguments in its favor than have thus far been brought forward to justify its adoption.

The rule of unanimous consent, applied to corporations with a large number of shareholders who are strangers to each other and some of whom are likely to exercise any veto power which they may possess for the unrighteous purpose of compelling their associates to buy them out at an extravagant price, is a rule of doubtful desirability. It is true that in the absence of any reserved power, the courts are not justified in making any very large inroads on this rule, as to do so would not only violate settled principles of the law of contracts, but run the risk of doing a real injustice to a minority stockholder whose objection to the change is *bona fide*. The situation is, however, materially altered where the legislature has reserved power to amend the charter, or, as is more commonly the case today, to amend the corporation law. The rule of unanimous consent is part of the corporation law. Presumptively, therefore, the legislature has reserved the right to change this rule, and the stockholder, in investing in the corporation, has made his investment knowing that this rule, like other rules of corporation law, is subject to change. The rule itself is one which does not work satisfactorily in practice, as is shown by the fact that most modern corporation laws expressly give the majority broad powers of making amendments. There is, therefore, no sufficient reason for giving an unnaturally strict construction to the reserved power in order to prevent the legislature from using it for the purpose of modifying, to some extent at least, the rule of unanimous consent.[76] Whether the legislature

[76] If this view be sound, the offer of an amendment to the majority cannot fairly be attacked as an invalid delegation of the power of the legislature to the majority. The legislature can undoubtedly leave the provisions of the charter to be determined by the unanimous consent of the stockholders without thereby delegating any legislative power. In fact, it necessarily does so to a large extent where it provides for incorporation under general laws. Whatever objections may be made to the legislative substitution of the rule of majority control for the rule of unanimous consent, such substitution does not involve a delegation of legislative power.

should be allowed to do away with this rule altogether is another question which will be discussed hereafter.

Under this view, the fact that the adoption of an amendment is optional with the majority does not necessarily either justify or condemn it. We must, as in the case of compulsory amendments, determine its validity by considering the character of the amendment in question, as the power of the legislature to offer amendments to the majority is, like its power to impose amendments, subject to implied limitations. The property of the stockholder cannot be confiscated, nor can he be dragged into a totally different enterprise from the one in which he intended to invest.[77] The exact scope of these limitations cannot be stated, since, if this view of the amending power be taken, the limitations on it are necessarily such as cannot be reduced to fixed rules. It would seem, however, that the limitations, while of the same general character as those that exist in the case of compulsory amendments, are not precisely the same.[78] In imposing compulsory amendments, the legislature properly considers the interests of the state and of persons other than the corporation and its stockholders. The majority stockholders, on the other hand, are not charged with the duty of protecting the state or outsiders, and for them to accept an optional amendment increasing, for

[77] There seem to be no decisions of the United States Supreme Court holding an optional amendment invalid, but the decisions of that court clearly imply that this power, like the power of imposing compulsory amendments, is not without limit. Thus the language used in Looker v. Maynard, *supra* note 39, a case dealing with an amendment which was optional in the sense that it gave to each stockholder a privilege of cumulating his votes if he so desired, and in Wright v. Minn. Mutual L. Ins. Co., 193 U. S. 657 (1904), a case dealing with a power of amendment granted to the majority at the outset, clearly indicates that the power is not unlimited. In Polk v. Mutual Reserve Fund L. Ass'n, *supra* note 32, the decision in the Wright case was followed, the court saying that it made no difference in the legal situation whether the amending power was conferred upon the majority at the outset or was granted to them subsequently by legislation under the reserved power.

There are a large number of state cases, some of which are cited in note 70 *supra*, in which particular optional amendments have been held invalid. Most of these decisions are, however, based on the theory that optional amendments (unless so trivial in character that they would be valid if no reserved power existed) are always invalid. Such cases are of little value as indications of the extent to which the legislative power to offer amendments to the majority is subject to implied limitations in courts in which the existence of such a power is conceded.

[78] But see *contra*, MORAWETZ, PRIVATE CORPORATIONS (2d ed. 1886) § 1111.

example, the rate of taxes which the corporation should pay might be regarded as making an unreasonable donation of the corporation's assets in violation of the minority's rights. Such a situation is not, however, likely to arise.

On the other hand, the internal management of private corporations is a matter with which the legislature has little concern. It may properly decide some general principle, such as that the rule of unanimous consent to changes ought to be limited, but there would under ordinary circumstances [79] be little occasion for it to make detailed changes in such matters as the number of directors. Permission to the majority to make such changes should be sustained without regard to the question whether a compulsory amendment with reference thereto would be upheld.[80]

What the property rights of shareholders which cannot be taken away by amendment are is by no means clear. An amendment which would discriminate unfairly between stockholders would presumably be held invalid. There is, indeed, considerable difference of opinion with regard to the question how far the power of control which is vested in the majority stockholders imposes upon them a fiduciary obligation toward the minority, but it is well settled that it does impose upon them certain obligations of good faith. Thus, for example, they cannot deal with the property of the corporation in such a way as to give themselves an unfair advantage over the minority,[81] nor can they enact by-laws which discriminate against the minority.[82] There is no reason to doubt that any power to make amendments which the legislature could confer upon them would be held to

[79] In Miller v. New York, *supra* note 39, the leading case upholding a compulsory amendment of this sort, the circumstances were peculiar. The amendment conferred additional voting power on a city—a subdivision of the state—and the facts were such as to make the city fairly entitled to such additional voting power as a matter of justice.

[80] It may well be that a minority stockholder cannot object to a compulsory amendment if the same amendment could have been offered to and accepted by the majority. It does not necessarily follow that there may not be amendments which would be valid if offered to the majority but would, if compulsorily imposed, be open to legal attack by the corporation as distinguished from the minority stockholders.

[81] See MACHEN, MODERN LAW OF CORPORATIONS (1908) §§ 1306-1308.

[82] See *ibid.* § 715.

be subject to the limitation that such an amendment must not be discriminatory as between stockholders of the same class.[83]

Nor could the majority pass an amendment which would have the effect of depriving the stockholders of their interest in the corporation.[84] Nor, under ordinary circumstances, could they amend the charter so as to deprive any stockholder of his voting rights, since to do so would deprive him of the means of protecting his interests.[85] Whether they might be permitted to make an amendment authorizing assessments on fully paid stock, either for the purpose of paying debts or for the purpose of increasing the capital, is not wholly clear. Such assessments may be for the business advantage of the company, but so to increase the stockholder's contribution to the capital is to make a radical change in the contract.[86] It is true that the legislature may increase his liability to creditors,[87] but removing his immunity

[83] Where there are different classes of stock, it is practically impossible to issue additional stock without affecting the existing classes of stockholders in a somewhat different way. Thus, if a corporation which has preferred and common stock, issues second preferred stock, the effect on the holders of what thereby now becomes first preferred stock is clear gain, in that the assets are increased without affecting their preference, while the effect on the common stockholders is less clearly beneficial. Such an issue may, however, be a reasonable method of obtaining additional capital and not mere wanton discrimination. It would seem probable that many courts would construe the reserved power as authorizing the enactment of a law permitting the majority to issue such new classes of stock.

[84] See Lord v. Equitable Life Assurance Society, *supra* note 69. In Close v. Glenwood Cemetery, *supra* note 39, the court upheld an Act of Congress amending the charter of a cemetery corporation so as to limit the earnings of the stockholders and give the control to the lot-owners. Granting that the powers of a state legislature are no greater than those of state legislatures where power to amend is reserved, the case is nevertheless not an authority for the broad proposition for which it might seem to stand, as the court said that the purpose of the act of incorporation was not to create a land company but to establish a cemetery for a semi-public purpose, with exemption from taxation.

[85] See Lord v. Equitable Life Assurance Society, *supra* note 69. See Looker v. Maynard, *supra* note 39, in which an amendment sanctioning cumulative voting was upheld, is not *contra*. It may be argued that such an amendment has an injurious effect on the control which the majority can exercise. Minority representation on the board of directors does not, however, deprive the majority of control. Furthermore, except where one stockholder owns a majority of the stock, any stockholder may at any time find himself in the minority and hence find cumulative voting to his advantage.

[86] An amendment conferring the power to make assessments was held valid in Garey v. St. Joe Mining Co., *supra* note 70. See also Enterprise Ditch Co. v. Moffitt, 58 Neb. 642, 79 N. W. 560 (1899). *Contra:* Gardner v. Hope Insurance Co., 9 R. I. 194 (1869); Somerville v. St. Louis Min. & Milling Co., *supra* note 69.

[87] See note 74 and cases cited.

from personal liability to the latter is somewhat different from compelling him to make further payments not immediately needed to pay debts. Moreover, as above stated, it does not necessarily follow that the majority can be given power to make any amendment which the legislature could make.[88]

It has been held that an amendment authorizing the issue of preferred stock is valid.[89] Although the effect of such an amendment is to place common stockholders in an inferior position, the results reached in these cases would seem to be sound. The ordinary corporation has implied power to mortgage, and the effect on a common stockholder of an issue of preferred stock is hardly more serious than is the effect of mortgage bonds.[90] It would seem, however, that, if the preferred stock

[88] If the legislature determines that it is undesirable to allow business to be carried on without some sort of stockholders' liability, it could of course under the reserved power repeal the charters of all existing corporations in order to make its new policy effective. In spite of the fact that the addition of a shareholder's liability is a substantial alteration of the pre-existing situation, it may well be thought unreasonable to give every stockholder a right to compel dissolution where the legislature is unwilling that business be carried on any longer without such liability. It is less clear that, where the legislature has no objection to limited liability, the majority ought to be permitted to exact further contributions from an unwilling minority. Furthermore, the rule permitting increase in shareholders' liability was established at a time when doing business with unlimited liability was looked upon as a special legislative favor. Hence, the courts were as reluctant to find that it had been irrevocably granted as they are to find that an exemption from taxation is irrevocable. This argument would seem to be entitled to less weight today when corporations with limited liability can be formed under general laws by any one. The rule that such a change may be made is, however, too firmly settled to be any longer doubtful. At least one court has extended the rule to cases where the amendment creates a stockholders' liability as to pre-existing debts. Davis v. Moore, 130 Ark. 128, 197 S. W. 295 (1917). This seems more doubtful as its effect is to confer on existing creditors a right not granted them by their contracts and not, it would seem, justified by any considerations of public policy.

[89] Randle v. Winona Coal Co., *supra* note 69; Hinckley v. Schwarzschild & Sulzberger Co., 107 App. Div. 470, 95 N. Y. Supp. 357 (1905).

[90] On this ground some courts have held that the majority may accept an amendment authorizing preferred stock even when there is no reserved power to amend. City of Covington v. Covington & Cincinnati Bridge Co., 10 Bush 69 (Ky. 1873); Rutland and B. R. Co. v. Thrall, 35 Vt. 536 (1863). These cases would seem erroneous, however, at least if the preferred stock has any voting power. To create a new class of stock which is preferred to the old stock and consequently has interests different from those of the old stockholders is to alter materially the terms on which the old stockholders invested. Even if the old stockholders' right of pre-emptive buying of the new stock is secured to them, the result is to force them to increase their investment or permit their original position to be radically altered. Even if the preferred stock has no voting power, it differs in theory from a bond in that, as a general rule, it cannot be paid, although it is true that the date of payment of a bond may be remote. See Kent v. Quicksilver Mining Co., 78 N. Y. 159 (1879).

has voting rights, the issue ought not to be permitted to be made without giving the common stockholders pre-emptive rights to subscribe thereto.[91]

A recent Alabama case [92] sustains the legislative right to authorize an amendment changing common stock with a par value to preferred and common stock with no par value. It is hard to see how the removal of the dollar sign from the stock could injure the stockholders, and the plaintiff's complaint that the new stock was to be issued at an inadequate price could be and apparently was met by allowing a right of pre-emption.

There are also a number of cases dealing with changes in the nature of the business. While it is frequently said, even by courts that give a wide scope to the reserved power, that the changes must "be consistent with the scope and object of the act of incorporation," [93] there are several decisions upholding the

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The differences between preferred stock and bonds are thus so substantial that an amendment providing for preferred stock can hardly be supported as authorizing merely an immaterial change in the method of borrowing money. It does not follow, however, that the change is so fundamental that the legislature cannot, under the reserved power, authorize a corporation which has power to borrow to issue preferred stock.

[91] Where the statute simply authorizes the issue, the cases are unanimous in holding that the stockholders have an implied right of pre-emption. Stokes v. Continental Trust Co., 186 N. Y. 285, 78 N. E. 1090 (1906), in which the earlier cases are reviewed. The question whether the legislature could, under the reserved power, authorize a new issue and at the same time deprive the old stockholders of their pre-emptive privilege or authorize the majority to do this does not seem to have arisen.

[92] Randle v. Winona Coal Co., *supra* note 69.

[93] This language, first used by the United States Supreme Court in Shields v. Ohio, *supra* note 65, has been repeated by that court in a number of cases, including the recent case of Chicago M. & St. P. R. Co. v. Wisconsin, *supra* note 59, a case in which the amendment was held invalid. This language and the substantially similar language used in Close v. Glenwood Cemetery, *supra* note 39, has also frequently been repeated by state courts. See, for example, Arkansas Stave Co. v. State, 94 Ark. 27, 125 S. W. 1001 (1910); New York Cent. & H. R. R. Co. v. Williams, *supra* note 54. It might be argued that this language is applicable only to cases in which the legislature is trying to force a compulsory amendment on the corporation, but the principle would seem broad enough to invalidate amendments which, although optional as to the majority, enable that majority to change the corporate purpose to one wholly at variance with the original scheme over the protest of the minority. In Wright v. Minnesota Mut. L. Ins. So., *supra* note 77, the court recognized by way of dictum that even where the power to make amendments was granted to the majority by the original charter, the power to make changes in the original purposes is not unlimited. In Polk v. Mutual Reserve Fund L. Asso. of N. Y., *supra* note 32, the court said that the scope of the amending power is substantially the same where the amending power is granted to the majority, or, as in that case, to the directors, by subsequent legislation enacted under the reserved power.

right of majority stockholders to accept statutes providing for the enlargement [94] or consolidation [95] of railroads or other corporations [96] which seem to go rather far in the direction of authorizing fundamental changes.

There is, however, ground for contending that the changes authorized are, at least in the case of railroads and other public service corporations, less fundamental in fact than they may appear to be in theory. Even at common law it is by no means clear that the majority cannot sell all the assets of a corporation without regard to its financial condition, provided that the sale is made to strangers and for cash.[97] However this may be, there would seem to be no reason to doubt that the legislature may, under the reserved power, authorize the majority to make such a sale,[98] unless, indeed, we are to adopt the minority view that the reserved power covers only compulsory amendments.

A consolidation differs from such a sale in that it is not a transfer for cash, but a transfer of the assets to another corporation for stock of the latter to be exchanged for stock of the former. Its effect, if valid, is thus to force a dissenting stockholder to go into a new enterprise or to find a purchaser for his

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[94] Buffalo & N. Y. City R. Co. v. Dudley, *supra* note 69; Durfee v. Old Colony & Fall River R. Co., *supra* note 66 (enlargement by leasing connecting line).

[95] Hale v. Cheshire R. R. Co., *supra* note 69; Market St. Ry. Co. v. Hellman, *supra* note 69. *Contra:* Kenosha, R. & R. I. Co. v. Marsh, *supra* note 70; Mowrey v. Indianapolis & Cincinnati R. Co., 4 Biss. 78 (C. C. 1866), *semble*. See also Dow v. Northern R. R., *supra* note 28.

[96] McKee v. Chautauqua Assembly, 130 Fed. 536 (C. C. A. 2d, 1904), relating to a non-stock corporation and apparently based on certain special facts which appeared in the case. Colby v. Equitable Trust Co., 124 App. Div. 262, 108 N. Y. Supp. 978, affirmed 192 N. Y. 535, 84 N. E. 1111 (1908), (consolidation of trust companies); Winfree v. Riverside Cotton Mills, *supra* note 69 (consolidation of manufacturing companies). But *cf.* Allen v. Francisco Sugar Co., *supra* note 70 (lease of substantially all the property of sugar raising corporation).

[97] Allen v. Ajax Min. Co., 30 Mont. 490, 77 Pac. 47 (1904), upholding under reserved power statute authorizing directors, when authorized by holders of two-thirds of stock, to sell all the assets, and providing for appraisal and purchase of shares of dissenting stockholders.

[98] See E. H. Warren, *Voluntary Transfers of Corporate Undertakings*, 30 HARV. L. REV. 335 (1916). Since the date of that article, the Supreme Court of the United States has added its dictum to the weight of dicta denying the right of the majority to sell where the corporation is prosperous. Geddes v. Anaconda Copper Mining Co., 254 U. S. 590, 595 (1919). There are, however, few actual decisions which so hold.

stock. The first alternative is plainly unjust to the dissenting stockholder, unless we can fairly say that he ought to have contemplated that the reservation of power to amend might place him in this position, and it scarcely seems reasonable to say that he ought to have anticipated that the reserved power might be used to change completely the nature of his investment. The second alternative may be objected to on two grounds: first, that the stockholder has no assurance that he can find a purchaser who will buy his stock at a fair price; and secondly, that he does not wish to sell, and objects to an amendment by which those who have approved the consolidation retain their interest in the corporate assets, while he, being unwilling to embark on what is in law, and to a large extent in fact, a new enterprise, is forced to sell out and abandon his interest in those assets.

The first objection is not serious, since there is good authority for the proposition that a dissenting stockholder has the right to bring a bill in equity for the purpose of compelling the corporation to purchase his stock at its fair value. In some of the cases in which this rule has been laid down, the consolidation statute did not purport to give the dissenting stockholder any such remedy.[99] In other cases it gave a remedy which was either inapplicable to the situation[100] or inadequate.[101] The remedy in equity was, nevertheless, held to exist.

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[99] Lauman v. Lebanon Valley, *supra* note 15. *Cf.* Koehler v. St. Mary's Brewing Co., 228 Pa. 648, 77 Atl. 1016 (1910).

[100] Barnett v. Philadelphia Market Co., 218 Pa. 649, 67 Atl. 912 (1907). The date of incorporation of the company is not given, so that it is not clear how far, if at all, the consolidation statute depended on the reserved power for its validity.

[101] Winfree v. Riverside Cotton Mills, *supra* note 69. In Germer v. Triple State, etc., Co., supra note 69, majority stockholders, purporting to act under the authority of legislation enacted under the reserved power, voted to sell all the corporate assets for stock of another company. They seem to have contemplated voting at a subsequent meeting on a proposition that their corporation be dissolved and the stock of the new corporation distributed to the stockholders in exchange for their stock in the old one. A minority stockholder sought an injunction against the sale and proposed dissolution. The court denied relief, holding the sale valid and apparently assuming that the dissenting stockholders could be compelled to take the stock in the new corporation. If the court meant to deny their right to receive cash, it is submitted that the case is erroneous.

The general rule is that in case of dissolution or sale the minority cannot be compelled to receive anything but cash or readily marketable securities. Geddes v. Anaconda Copper Mining Co., *supra* note 98.

The only substantial objection which the dissenting stockholder can make is, therefore, that since the reserved power does not authorize the legislature to permit the majority to drag him into a new enterprise, it ought not to be construed as authorizing the legislature to confront him with the alternative of going into a new enterprise or giving up his interest in the business. Where the corporation is engaged in public service, it would seem that this objection ought not to be sustained. In such a case there is no doubt that the legislature could provide for the taking of the interest of the dissenting stockholder by eminent domain.[102] We have seen that even where the legislature has omitted to make provision for the purchase of dissenting stockholders' interests, the courts are prepared to supply that omission. That being true, an act providing for the consolidation of railroads or other public service corporations, should be sustained without regard to whether the act expressly provides for valuation and purchase of the minority's shares.

Where the consolidated corporations are not engaged in public service, the question is more doubtful. The power of eminent domain probably does not extend to such a case, and the consolidation act must, therefore, depend for its validity wholly on the reserved power to amend. Although this power is in terms unlimited, it does not authorize amendments which are inconsistent with the object of the original charter nor those which impair rights that have vested thereunder. It can hardly be doubted that the effect of these limitations on the amending power would be to invalidate a consolidation act which sought to compel dissenters to accept stock in the consolidated corporation. If, however, the act provides for valuation and purchase of the dissenters' shares, or if the courts are prepared to read such a provision into it, its effect on the minority is somewhat less harsh. Compelling them to go into a new enterprise or to sell out is not so injurious to them as compelling them to go in without the option of selling. There is, none the less, a

[102] Spencer v. Seaboard Air Line Co., 137 N. C. 107, 49 S. E. 96 (1904); Black v. Delaware & R. Canal Co., 24 N. J. Eq. 455 (1873). See also Gregg v. Northern R. R., 67 N. H. 452, 41 Atl. 271 (1893). *Cf.* Offield v. N. Y. N. H. & H. R. Co., 203 U. S. 372 (1906).

good deal of unfairness in forcing the minority, who desire that the original enterprise continue, either to consent to a change or to turn over their share of the assets to the majority, and the element of unfairness is not entirely removed by the provision that the minority shall, if forced to sell out, be entitled to receive a fair value for their stock. Whether the unfairness is sufficient to bring the statute within the implied limitations on the reserved power, and hence to invalidate it, would seem to be a debatable question. Apart from those states, like New Jersey, in which the courts take an unusually restricted view of the scope of the reserved power,[103] such authorities as exist support the proposition that such consolidation acts are valid.[104]

The logical consequence of these decisions, assuming them to be good law, would seem to be that in practically every case in which a dissenting stockholder objects to the exercise by the majority of an amending power granted them by legislation under the reserved power, the minority's sole remedy should be a valuation and sale of their stock. The consolidation cases indicate that even in the case of an amendment which is so drastic that the dissenting stockholder need not consent to remain a member of the corporation under the amended charter, he is not entitled to an injunction, and there would seem to be no reason why the same rule should not be applied to other kinds of radical changes. An exception might, however, be made where the amendment is unfair to a certain class of stockholders and is adopted for the purpose of forcing stockholders of that class to sell out.[105]

Such is the situation where the minority have already paid for their stock. Where they have not yet paid, it is generally held that they may set up the adoption of an invalid amendment

[103] See Zabriskie v. Hackensack & N. Y. R. Co., *supra* note 70 (injunction against acceptance of amendment authorizing extension of railroad; Dow v. Northern R. R., *supra* note 28 (injunction against adoption of amendment providing for lease of railroad); Allen v. Francisco Sugar Co., *supra* note 70 (injunction against leasing all property of corporation under authority of legislation subsequent to incorporation).

[104] See cases cited in note 96.

[105] See Colgate v. United States Leather Co., 75 N. J. Eq. 229, 67 Atl. 657 (1907).

as a defense to liability on their subscriptions.[106] There are, indeed, a few cases which take the position that the stockholder ought not to gain an advantage from the fact that his subscription is still unpaid, and hold that the subscriber must pay for his stock, his proper remedy being an injunction against the adoption of the amendment, or against the use of the privileges which the proposed amendment would confer on the corporation.[107] If, however, our conclusion that, where the charter is subject to the reserved power, the dissenting stockholders are not entitled to an injunction, is correct, the doctrine of these cases is clearly inapplicable to the reserved power situation. If a stockholder has paid for his stock, his only remedy is to compel the corporation, to repurchase it. If he has not yet paid for his stock, there is no reason for compelling him to pay for something which he has a right to get rid of.

Reviewing Power of the United States Supreme Court in Cases Relating to the Reserved Power.

If the above analysis is correct, the limitations on the reserved power which exist, do so, in the main, as a matter of construction of that power and not as a matter of constitutional law.[108] It might seem to follow that the decision of a state court

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[106] Courts like the United States Supreme Court which have taken a liberal view as to the power of the legislature to offer amendments to the majority, are not often confronted with the problems, since they usually find it possible to uphold the amendment as against dissenting stockholders. Where, however, no power to amend is reserved, or where the case arises in a state which takes a narrow view of the scope of such a power, there are a large number of cases supporting the rule that a dissenting stockholder is released from liability on his subscription. See, for example, Kenosha, R. & R. I. R. Co. v. Marsh, *supra* note 70; Snook v. Georgia Imp. Co., 83 Ga. 61, 9 S. E. 1104 (1889), both holding the rule to be applicable despite the existence of the reserved power. For similar holding where no power to amend was reserved, see Hartford & New Haven Co. v. Crosswell, *supra* note 5; McClay v. Junction Ry. Co., *supra* note 15; Clearwater v. Meredith, *supra* note 6 (dictum).

[107] Hays v. O., O. & F. R. V. R. R., 61 Ill. 422 (1871). See also Pac. R. R. v. Hughes, 22 Mo. 291 (1855). This doctrine has the approval of Mr. Cook. Cook, Corporations (8th ed., 1923) § 502, note 4.

[108] As pointed out earlier, some constitutional restrictions do exist even under this view. The amendment or change in the corporation law must be within the scope of legislative power and it must not violate constitutional rights. The existence of certain constitutional rights may, however, be negatived by an acceptance of a charter which is subject to the reserved power.

with regard to the scope of that power is merely a decision as to construction of a state statute and that it is accordingly one which the United States Supreme Court has no power to review.

The Supreme Court has, however, assumed, apparently without question, that it has power to review state decisions holding particular amendments to be authorized under the reserved power, and has occasionally reversed such state decisions.[109] Although the existence of such a power of review may appear at first sight to be inconsistent with the view of the reserved power which has been set forth above, there is in reality no inconsistency. A charter granted subject to the reserved power is, according to the theory which we have adopted, a contract between the legislature and the incorporators—a contract which contains an agreement by one party that the other party shall have the power to modify it. This power to modify or amend, reasonably construed, gives the legislature power to make only such amendments as "will not defeat or substantially impair the object of the grant or any right vested under it." [110] Such being the case, the charter does confer some contractual rights which, like other contractual obligations, are protected by the contract clause of the federal constitution. A state decision holding that a particular right is not of this character may be so worded as to be in form a construction of the charter contract rather than a decision on a question of constitutional law. So, however, may a decision with regard to any contract. The Supreme Court long ago realized that if the state courts were to have the final word with regard to the existence and construction of contracts, they could in all contract cases prevent a review by the Supreme Court by holding that no contract existed to be impaired, or by giving a contract which was admitted to exist an unreasonably strict construction, and then holding, what might well be unquestionably correct, that the contract so construed was not impaired by

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[109] L. S. & M. S. R. Co. v. Smith, *supra* note 59; Stearns v. Minnesota, *supra* note 47; Duluth & Iron Range R. Co. v. St. Louis Co., *supra* note 47; Chicago, Milwaukee & St. P. R. Co. v. Wisconsin, *supra* note 59; Superior Water, Light & Power Co. v. Superior, *supra* note 58.

[110] Close v. Glenwood Cemetery, *supra* note 39 at 476.

a statute which plainly would impair it if the contract were given a more natural construction.

In order to make it impossible for state courts thus to escape from the restrictions imposed by the contract clause, the Supreme Court early established the rule that it will itself determine whether or not a contract exists [111] and what is its proper construction.[112] This doctrine is equally applicable to state decisions construing the reserved power. A corporate charter is protected by the constitution from alteration except within the limits of the reserved power. A state decision unduly extending those limits is in effect a decision permitting the charter contract to be impaired. Consequently, such a state decision is reviewable. It would seem, however, that there is an exception to this rule in a case where the reserved power had been given an unusual construction prior to the time when the plaintiff's contractual rights accrued. In such a case that construction would enter into the plaintiff's contract and become a part of it.[113]

State decisions unduly extending the reserved power are, therefore, reviewable. What of state decisions which unduly restrict that power and, accordingly, hold invalid as impairing the charter contract statutes which the United States Supreme Court would regard as valid? Prior to 1914 the Supreme Court plainly could not have reviewed such decisions, as they do not deny any federal right, but err, if at all, in overthrowing a valid state statute because of an erroneous belief that it is repugnant to the federal constitution.[114] Since 1914, however, the Supreme Court has had power to review by *certiorari* state decisions which invali-

[111] Jefferson Branch Bank v. Shelby, 1 Black 436 (1862). The rule there laid down has been frequently applied.

[112] Bridge Proprietors v. Hoboken Co., 1 Wall. 145 (1864). "If it were not so, the constitutional provision could always be evaded by the State Courts giving such construction to the contract, or such decision concerning its validity, as to render the power of this court of no avail in upholding it against unconstitutional state legislation." Delmas v. Merchants' Mutual Ins. Co., 14 Wall. 661 (1872).

[113] See note 60. It may, however, be contended that the important date is that on which the corporation was created rather than that on which the plaintiff acquired his rights. See note 121.

[114] The Judiciary Act of 1789 provided for review of state decisions only where the state court had denied a claim of federal right. 1 STAT. 73, 85-6. This limitation continued until 1914.

date state statutes by giving too broad a construction to some portion of the federal constitution.[115] It is not, however, entirely clear that the Supreme Court would regard the reserved power cases as cases of that class. It is true that the state court has held a state statute invalid as impairing the obligation of a contract and thus violating the federal constitution. There is, however, no doubt that the charter contract would, apart from the reserved power of amendment, be a binding contract between the members, which no state legislature could impair; nor is there any doubt that a state statute authorizing the majority to amend that charter would impair the obligation of that contract if no reserved power exised. Hence the only real problem involved in the case is as to the meaning and effect of the reservation. The state court has given the power reserved to the legislature by the state constitution or by a state statute a restricted meaning, and accordingly has held that it has no effect on the case. The court's decision, therefore, is in form at least a decision having to do solely with the construction of a state constitution or statute. It may be argued, however, that it is in substance a constitutional decision. By erroneously restricting the scope of the reserved power, the state court has erroneously treated the stockholders as having contract rights which they do not possess, and hence has erroneously invalidated the statute, on the ground that it impairs these rights. It may be said that this amounts to giving the contract clause too broad a scope, just as a state decision erroneously holding that there is no contract may amount to a decision giving the contract clause too narrow a scope. It may be said further that while the United States Supreme Court has discretion to refuse to review any constitutional case where the federal constitution has been given too wide a scope instead of too narrow a one, its exercise of that discretion ought to depend on considerations of substance, and that it ought not to deny petitions for

[115] 38 STAT. 790 (1914); U. S. COMP. STAT. (1918) § 1214. This enlargement of the jurisdiction of the United States Supreme Court was due principally to a desire to make possible a review of ultra-conservative state decisions construing the due process clause of the Fourteenth Amendment, such as the well-known decision in Ives v. So. Buffalo Ry., 201 N. Y. 271, 94 N. E. 431 (1911). See Felix Frankfurter, *The Business of the Supreme Court of the United States—A Study in the Federal Judiciary System*, 39 HARV. L. REV. 1046-1057 (1925).

review in this class of cases merely because the state decision might be regarded technically as one construing the state constitution or statute rather than one construing the contract clause, provided that the practical effect of this state decision is to invalidate under the contract clause important state legislation which is in the opinion of the Supreme Court a valid exercise of the reserved power.

It may be doubted, however, whether the Supreme Court will take any such view of the matter. There is real danger that, if the Supreme Court could not interfere, the state courts would out of undue friendliness to state legislation use their power of construing state contracts in such a way as to enable the state to impair these contracts by legislation. Hence, there is practical need in such cases for the Supreme Court to reserve to itself the power to construe the contract. The danger that state courts may unreasonably find that the state has made a contract not to legislate in a certain manner, while real, is one which the Supreme Court is much less likely to regard as serious. Despite the recent amendment to the judicial code, it is still true that the primary function of the Supreme Court is to prevent state courts from denying federal rights, not to prevent them from erroneously finding that such rights exist. There are, however, no decisions on the point.

Federal Charters Granted Subject to Amendment or Repeal.

The provision of the federal constitution forbidding impairment of the obligation of contracts does not apply to Congress.[116] Hence, even when no power to amend or repeal is reserved, a congressional act amending the charter of a federal corporation could be attacked only on the ground that it violated some other provision of the federal constitution, such as the due process clause.[117]

[116] "No *state* shall . . . pass any . . . Law impairing the Obligation of Contracts." U. S. Const., Art. I, § 10.

[117] "No person shall . . . be deprived of life, liberty, or property without due process of law." U. S. Const., Amendment V.

Either to make such an attack impossible, or in order to give warning to the incorporators not to regard their charter privileges as permanent, or because of a failure to realize that its charters were not protected by the contracts clause, Congress has, as a general rule, inserted an amendment or repeal clause in federal charters. There would seem to be no doubt that the powers of Congress to amend a federal charter under such circumstances are substantially the same as those of a state legislature which has reserved the power to amend.[118] We have seen that, according to the Supreme Court, a state may under such circumstances make any amendments which are consistent with the object of the original grant and do not impair vested property rights. Where Congress has reserved to itself the power to amend, its powers must be no less broad. On the other hand, they could hardly be treated as being broader without sanctioning a deprivation of property in violation of the due process clause.

In all the cases which have arisen relating to federal corporations, the Court has assumed that the problem is identical with that presented in case of corporations which owe their existence to a state legislature. In deciding the federal corporation cases, it has cited and quoted from cases involving state corporations, and in deciding cases of the latter sort it has frequently cited and quoted language from the two important federal corporation cases, the *Sinking Fund* cases,[119] and *Close v. Glenwood Cemetery*.[120]

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[118] Unlike the state legislatures, which possess general legislative powers, Congress possesses legislative powers with regard to certain subjects only—interstate commerce, for example. It would be possible, therefore, for an amendment to a federal corporation's charter to be invalid as relating to a subject with which Congress has no power to deal, although a similar amendment to a state corporation's charter would be valid.

[119] *Supra* note 49. In that case the court said that "whatever rules Congress might have prescribed in the original charter for the government of the corporation in the administration of its affairs, it retains power to establish by amendment."

There is nothing to show that the court intended by this statement to indicate that Congress possesses wider powers than the state legislatures in this respect, and the language has sometimes been quoted in cases involving state corporations. It is submitted that the language is inaccurate and inconsistent with the results reached in other Supreme Court cases. When a charter is granted originally, its acceptance is optional, and the legislature may therefore impose the most severe conditions without injustice to any one. An amendment radically modifying pre-existing rights is a very different matter.

[120] *Supra* note 39.

None of the federal corporation cases deals specifically with the question with which we are primarily concerned—the rights of minority stockholders—but it can safely be assumed that the rights of such stockholders are the same as they would be if the corporation were chartered by the state, except in so far as stockholders in corporations organized under the laws of certain states, such as New Jersey, may be able to take advantage of the peculiarly restricted interpretation which the courts of those states give to the reserved power.

Rights of Minority Stockholders Under Charters Giving the Majority Power to Amend.

As stated earlier in this article, most modern corporation laws contain a provision conferring upon the majority, or some other fraction of the stockholders, the right to amend the charter or articles of incorporation. Even where a corporation is organized under such a statute, the question previously discussed as to the scope of the reserved power may still arise, as the legislature may, by subsequent legislation, seek to confer upon the majority the right to make a certain kind of amendment which was not covered by the corporation law in effect at the time when the corporation was formed. It is probably true, however, that in most states the power of amendment conferred on the majority by existing corporation laws is so broad that legislation conferring new powers of amendment upon them will become increasingly infrequent. The result will be that most cases in which minority stockholders seek to have an amendment made by the majority declared invalid will not involve any problem as to the scope of the reserved power, but simply the question of the proper construction of the power which the corporation laws existing at the time when the corporation was organized confer upon the majority.[121]

[121] It may be argued that a stockholder is bound by all the provisions of the corporation laws which existed when he purchased his stock even though these provisions were not in effect when the corporation was incorporated, and there has not at any time been an acceptance of them by the stockholders. In Allen v. Francisco Sugar Co., *supra* note 70, the New Jersey court declined to adopt this view of the matter, on the ground that the contract between the stockhold-

The statutes of the various states are by no means uniform in the extent to which they authorize the majority to make amendments, and no attempt will be made here to discuss such special problems as are raised by the particular provisions of the various statutes.[122] There are, however, a number of states in which the amending power is given to the majority in terms as general as is commonly the case with regard to the power of amendment reserved to the legislature.[123] We have seen that

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ers could not well be treated as meaning one thing in the case of one stockholder and something different in the case of another. This objection seems a serious one.

[122]Some statutes expressly limit amendment to those which do not fundamentally change the original purpose. See COLO. COMP. LAWS (1921) § 2276; OHIO GEN. CODE (Page, 1920) § 8719; TEX. REV. CIV. STAT. (1925), Art. 1314. Some of them, while granting the amending power in broad general language, exclude particular amendments such as those changing the preferences of existing stockholders. See ILL. REV. STAT. (1925) c. 32, § 61; IND. ANN. CODE (1924) Art. 23, § 28; VA. CODE ANN. (1924) § 3779.

On the other hand, some statutes expressly or by clear implication permit amendments of a very drastic sort. Thus, for example, the Delaware statute provides for a change in the preferences of stock already issued, provided a majority of the preferred stockholders approve the change. DEL. REV. CODE (1915) §§ 1915-2101 as amended by 29 DEL. LAWS (1917) c. 113. See Peters v. United States Mortgage Co., 13 Del. Ch. 11, 114 Atl. 598 (1921). See also statutes permitting changes in the corporate purposes cited in the next note.

[123] (a) Some statutes simply authorize the majority or the holders of some large percentage of the stock to amend without stating what amendments they may make. See FLA. REV. GEN. STAT. (1920) § 4087; IOWA CODE (1924) § 8360; IND. ANN. STAT. (Burns, 1926) § 4828 (but see § 4837 which provides for putting in the articles express restrictions on the amending power, the effect of which may be to negative the existence of any implied restrictions). The statutes of Missouri and Nebraska provide for the filing of amendments, but do not state how or by whom amendments shall be made or to what they may relate. See MO. REV. STAT. (1919) § 9736; NEB. COMP. STAT. (1922) § 467.

(b) Some statutes express the amending power in broad general language similar to that in which the legislative power to amend is generally reserved. See KAN. REV. ANN. STAT. (1923) c. 17, § 215 (may amend by a two-thirds vote "the charter in any of its parts"); KY. STAT. (Carroll, 1922) § 559 (may amend by a two-thirds vote "any of the articles"); MICH. COMP. LAWS (1915) § 11334 (may amend articles by a two-thirds vote "in any manner not inconsistent with the acts under which the corporation may be organized"); OKLA. COMP. STAT. (1921) § 5306 (may amend "in any particular competent to have been inserted in the original articles").

(c) Many statutes provide for various kinds of amendments, including those changing the nature of the business or the powers or purposes of the corporation. See ALA. CIV. CODE (1923) § 6982 ("changing the nature of its business"); CAL. CIV. CODE (1923) § 362 ("to alter or repeal any provision . . . relative to the purposes for which the corporation is formed, or to set forth additional power or purposes"); DEL. REV. CODE (1915) § 1940 ("either by addition to its corporate powers and purposes or diminution thereof, or by substitution of other powers and purposes in whole or in part"); ILL. REV. STAT. (1925) c. 32, § 59 (may change "the purpose for which such corporation was formed"); MD. ANN. CODE (Bagby, 1924), Art. 23, § 28 (permits "the addition to or

even those courts which, like the Supreme Court of the United States, have held that the reserved power authorizes the legislature to confer the amending power on the majority have made clear, by dictum if not by decision, that there are implied limitations on the kind of amendment which the legislature may authorize the majority to make. Despite the fact that the amending power is in terms unlimited, the courts have felt that it should not be construed to authorize amendments which would destroy or seriously impair the property rights of the minority or force the latter into a radically different enterprise. By joining a corporation whose charter is subject to amendment, the individual stockholder has impliedly consented to permit his rights under the charter to be modified substantially either by the legislature directly or by legislative bestowal of an amending power on the majority. The purpose of the amending power, is, however, to enable the original enterprise to be modified in ways which may seem necessary either to protect the outside public or to enable the enterprise to function in a manner which the majority of the investors therein regard as more efficient. Its purpose is not to enable the property rights of the corporation or of individual stockholders to be swept away, nor to permit the enterprise to be transformed so radically as to bring about, not a mere modification of its original scheme and purpose, but the substitution of something essentially different.

Where the amending power is conferred upon the majority at the outset in language equally broad and equally vague,[124] the

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diminution of the corporate purposes and powers, or the substitution of other purposes and powers"); MASS. GEN. LAWS (1921) c. 156, § 42 (may by a two-thirds vote "change . . . the nature of its business"). N. J. COMP. STAT. (1910) Corporations, § 27 (may by a two-thirds vote "change the nature of its business"); N. Y. CONS. LAWS (Cahill, 1923) c. 60, § 35 (permits a corporation "to extend, limit, or otherwise change its purposes and powers," but no corporations organized under a special law may "change the general character of its business"); WIS. STAT. (1925) § 180.07 (by a two-thirds vote may "modify or enlarge its business or purposes" . . . "but no corporation without stock shall change substantially the original purposes of its organization").

[124] It may be difficult to determine in any particular case whether the language of the statute is sufficiently vague and general so that the court would be justified in reading implied restrictions into it. A court should not find it difficult to do so where the language is of the sort contained in the statutes cited in paragraph (a) of note 113. Even in the case of such statutes as those cited in paragraph (b) of note 113, the statutory language, although apparently con-

same reasons exist for implying limitations on it. Here again the minority have agreed to allow changes to be made by the majority, and here again it may be said that the purpose of conferring this power on the majority is to permit them to make changes which further the original enterprise and adapt it to changing conditions, rather than amendments which in effect destroy it and substitute something else for it, or amendments which destroy important rights which the stockholders or some portion of them have obtained under it.

Such being the case, the decisions which deal with the implied limitations on the power of amendment which can be conferred upon the majority under the reserved power should be persuasive, if not controlling, authority as to the implied limitations on the power of amendment conferred upon the majority by a statute existing at the time of incorporation, but conferring the amending power in general language similar to that in which the reserved power is normally expressed.[125] There is little authority on the point, but there are two decisions of the Supreme Court which lend considerable support to this view. In *Wright v. Minnesota Mutual Life Ins. Co.*,[126] the court held that an amendment clause in the original charter authorizes the majority to make an amendment changing the kind of insurance policies which a mutual insurance company is authorized to issue. In *Polk v. Mutual Reserve Fund L. Ass'n of N. Y.*,[127] the Court held the doctrine of the *Wright* case to be equally applicable where the law existing at the time when the corporation was formed conferred no amending power on the majority but did

ferring broad powers of amendment, is not materially different from that in which the reserved power is generally phrased, and accordingly may properly be held to be subject to similar implied limitations. Even where the statute, like those cited in paragraph (c) of note 113, expressly authorizes changing the nature of the business or powers, it is possible that a court might feel justified in holding that only non-fundamental changes are intended to be permitted. The language of most of the statutes cited in that section is, however, rather difficult to reconcile with any such proposition, especially where, as in New York and Wisconsin, the statute contains a proviso to the effect that certain corporations may not make fundamental changes.

[125] Of course this proposition is true only with respect to those authorities dealing with the limitations on the reserved power which concede the legislative right under such reserved power to offer amendments to the majority.

[126] *Supra* note 77.

[127] *Supra* note 32.

confer such a power on the legislature, the legislature being authorized in such a case to confer upon the majority stockholders, or a majority of the directors, the power to make an amendment similar to that made in the *Wright* case.

In answer to the contention that the two situations were distinguishable, the court said:

> "It is immaterial whether the power to alter the charter is reserved in the original act of incorporation, or in the articles of association under a general law, or in a constitution in force when the incorporation under a general law is made, as in the case at bar." [128]

The language just quoted is not very satisfactory, in that it does not indicate any appreciation by the court of the fact that in the one case the power is reserved to the legislature, while in the other case it is conferred upon the majority, but it seems reasonably clear from other portions of the opinion that counsel for the plaintiffs relied upon such a distinction, and that the court held and intended to hold that there was nothing in the distinction.

The actual holding of the *Polk* case is, it is true, merely that the legislature may under the reserved power offer to the majority the same sort of amendments which the majority might enact where the power of amendment was originally vested in them. If, however, as the Supreme Court's language indicates, the two situations are from a legal standpoint substantially identical, it should equally follow that the amending power of the majority, where the power is conferred upon them at the outset, by a statute which confers the power in general terms and does not specifically authorize the particular amendment in question, is limited in the same manner as it is where power to amend is conferred upon them by subsequent legislation under the reserved power.

There is, however, one case in which the two situations may possibly be distinguished. In some states in which the corporation laws confer a broad power of amendment upon the major-

[128] p. 326.

ity, the statutes provide that any dissenting stockholder may compel the corporation to buy his stock at an appraised value.[129] We have already seen that the tendency of the courts which give a liberal construction to the reserved power is to hold that the minority stockholder's rights are in general limited to obtaining the fair value of his stock, even where the amendment is so drastic that he cannot be compelled to remain in the corporation. The cases which support such a rule are not, however, very numerous, and it is by no means impossible that some courts would hold that where the legislature attempts to authorize fundamental changes under the reserved power, the minority are entitled to an injunction against the acceptance of such an amendment.

Where the statute in existence at the time of the formation of the corporation authorizes the majority to amend, and expressly confers upon the minority the right to compel a purchase of their stock, the argument for holding that this is intended to be the sole remedy which the minority shall have, without regard to the fundamental character of the amendment, would seem to be somewhat stronger than in the case where the amendment is provided for by legislation enacted under the reserved power. In the former situation, the stockholder in going into the corporation is specifically informed by the statutes of the fact that he has a particular remedy in case of amendments which are distasteful to him. If the statute had said expressly that he was to have no other remedy under any circumstances, there would be no doubt that the statute, which is part of the contract between the stockholders, would be controlling on this point. The only question is, therefore, whether it can fairly be said to mean that the particular remedy which it provides is exclusive.

The reserved power situation is somewhat different, as the language of the reserved power provision itself does not con-

[129] Such a provision is very common in statutes authorizing consolidation. See FLETCHER, CYCLOPEDIA CORPORATIONS (1919). § 4799. New York gives a dissenting stockholder a similar right where the amendment modifies his preferential rights. N. Y. CONS. LAWS (Cahill, 1923) c. 60, § 38 (11). The Massachusetts law divides amendments into two classes, minor ones which require only a majority vote, and major ones which require a two-thirds vote. Dissenters are given the right to compel purchase at an appraised value whenever the amendment is of the latter sort. MASS. GEN. LAWS (1921) c. 156, § 46.

tain any reference to compulsory purchase of the stock of dissenters. The problem in such a case is whether the broad language of the reserved power ought to be regarded as authorizing the legislature, by statutes subsequently enacted, to impose upon dissenting stockholders the alternative of withdrawing their objections or withdrawing from the enterprise. In view of the willingness which the courts appear to show to construe the reserved power thus broadly, the attempt to distinguish the reserved power situation from that existing where the majority are given power to amend at the outset and the statutes then existing provide for compulsory purchase, may not be particularly important. It is submitted, however, that even if a court should hold that in the reserved power cases the minority's rights are not limited to an appraisal and sale, the same court might properly hold that in the other situation such remedy is exclusive.

Cases where the corporation laws provide for appraisal and sale are, however, somewhat exceptional [130] and do not affect

[130] Where the statutes in existence at the date of incorporation plainly authorize consolidation or other fundamental changes by majority vote and make no provision for purchase of dissenters' shares, the courts hold that dissenters are not entitled to compel purchase of their shares. Jones v. Missouri Edison Electric Co., 135 Fed. 153 (E. D. Mo. 1905) (consolidation); Mayfield v. Alton Ry. Gas & Elec. Co., 198 Ill. 528, 65 N. E. 100 (consolidation). Nor are dissenters in such a case entitled to set up the making of the fundamental changes as a defense against calls. Nugent v. Supervisors of Putnam County, 19 Wall. 241 (1874) (consolidation); Port Edward, etc., Ry. Co. v. Arpin, 80 Wis. 214, 49 N. W. 828 (1891) (increase in capital).

As indicated in notes 100 and 101, *supra,* several courts have taken a different view where the consolidation is authorized under the reserved power. In Nugent v. Supervisors of Putnam County, *supra,* the court cited with approval the case of Bishop v. Brainerd, 28 Conn. 288 (1859), which held that where a consolidation effected by majority vote was confirmed by legislation enacted under the reserved power a stockholder of the old corporation who had not paid his subscription had become a debtor to the new corporation, thus, apparently, treating consolidations under a power reserved by the legislature and consolidations under a power granted to the majority at the outset as identical.

If that view be correct, the cases cited in notes 100 and 101, *supra,* giving the minority a right to compel a purchase of their stock in cases where the consolidation is authorized by legislation under the reserved power, must regarded as in conflict with the cases cited herein. It is submitted, however, that the two situations are distinguishable. The reserved power does not authorize radical changes, and a consolidation with no option to dissenters to get out is plainly a radical change. On the other hand, the statutes in existence at the time of incorporation may expressly authorize the majority to make radical changes. If they do, dissenting stockholders have no legal ground for complaint.

Moreover, it is by no means clear that Bishop v. Brainerd, *supra,* should be regarded as an authority for the proposition that where consolidation is

the proposition that the majority's power of amendment is, where granted to them at the outset in vague, general language, normally subject to substantially the same restrictions as have been judicially declared to exist in the case of amendments offered to the majority under the reserved power. Unfortunately, this proposition does not help us much in deciding concrete cases. Most of the decisions invalidating amendments offered to the majority by the legislature under the reserved power have been rendered by courts which deny that the reserved power authorizes the legislature to confer any amending power whatever on the majority. Such decisions are, accordingly, of no value as applied to a case where the amending power is expressly conferred on the majority by the original act of incorporation. On the other hand, those courts which, like the United States Supreme Court, have construed the reserved power as applicable to amendments offered to the majority, as well as those imposed on the corporation, have rarely, if ever, found that the particular amendment offered to the majority was invalid as falling within the implied limitations on the amending power.

These courts have, indeed, told us by way of dictum that in such cases the power of amendment which can be conferred upon the majority is not without limit, and some of them have told us that in the case of certain drastic changes, such as consolidation, the courts will imply a right in the minority to compel the purchase of their stock without regard to whether the statute expressly confers such a right. The language of the cases is so vague as to be of comparatively little help in enabling us to decide what amendments are to be regarded as of such a drastic character. Nevertheless, in spite of their vagueness, they

effected by the majority under sanction of legislation which derives its force from the reserved power, a dissenting stockholder is liable to the new corporation on his subscription. The action in that case was a garnishment proceeding by a creditor of the old corporation against a subscriber to its stock. He alleged that since the consolidation had not been unanimously approved, it was void and the subscribers still debtors to the old corporation. The court denied his claim treating the consolidation as valid and the defendant subscriber as a debtor of the consolidated company. There is nothing in the case to indicate that the defendant subscriber had objected to the consolidation, so that the rights of dissenting stockholders were not directly involved. The plaintiff's argument was that since there were dissenters the consolidation was void. This the court denied, but the case does not decide anything more than that..

are not without importance in connection with the present problem, since they indicate that even where there are no express restrictions on the power of making amendments, objecting stockholders are not necessarily wholly at the mercy of the majority. Amendments designed to make reasonable alterations in the corporate machinery or to enlarge the corporate purposes so as to adapt them to changing business conditions, the majority are free to make. The power which the rule of *Natusch v. Irving* applied to corporations, allowing minority stockholders to obstruct merely for the purpose of being bought off at an extravagant price, has been done away with by modern statutes, which confer the amending power on the majority; but these statutes need not and should not be construed as empowering the majority to embark the minority on radically new enterprises unless they confer that power in unambiguous language, and hence give the minority a clear indication of what may happen to their investment.

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