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The Rights and Liabilities of a Stockholder in a New York Stock Corporation

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The Rights and Liabilities
of a
Stockholder in a New York Stock Corporation

Thesis
presented by

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for the degree
Bachelor of Laws
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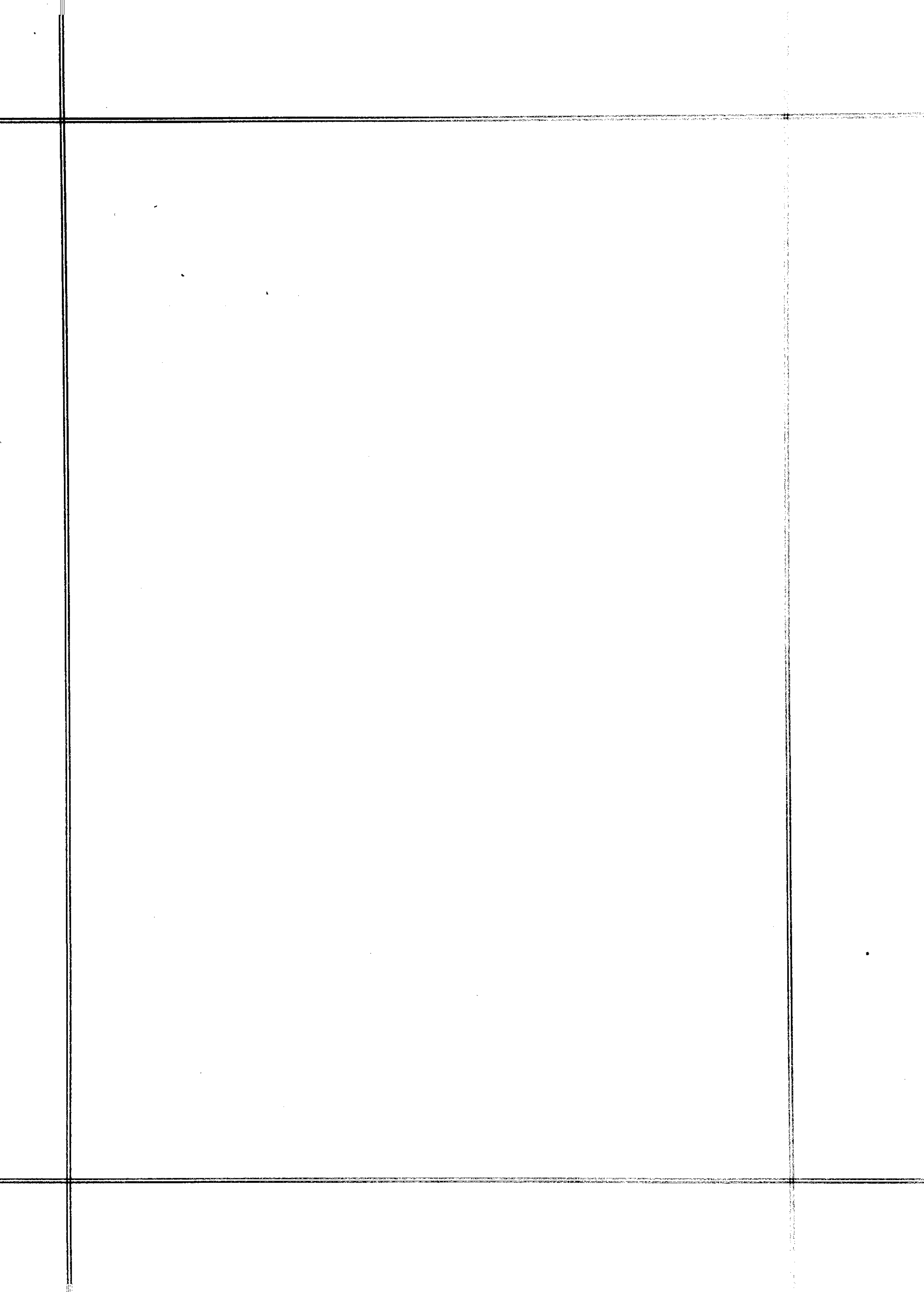

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Part I

Introduction

It is the purpose of the present investigation to inquire into the rights and obligations which persons take upon themselves when they subscribe for stock in a New York Stock Corporation, thereby becoming members of the corporation. We are not to refer to the methods and conditions expressed

in the contract of subscription except so far as to be assured that the subscribers in conforming to certain formalities become bona fide shareholders. Our chief purpose is to ascertain and specify the relationships that arise after it is determined that the parties concerned are stockholders.

With the growth and developement of civilization, new inventions and appliances, improved and altered means of communication, trade and manufacture, there has necessarily grown up a great mass of statutes and legal maxims separate

from the general bulk of the law and designed to apply to the particular organization or institution which brought them forth. This is especially true of the law of corporations. Although the corporation is not the offspring of modern times recent decades have seen it assume an important place in business relations.

Blackstone says "The honor of originally inventing these political constitutions [municipal corporations] belongs to the Romans. They were introduced as Plutarch says, by Numa; who finding, upon his accession the city torn to pieces by the two rival factions of Sabines and Romans, thought it a

prudent and politic measure to subdivide these two into many smaller ones, by instituting separate societies of every manual trade and profession."[1] Blackstone wrote almost entirely of religious and political corporations; for the various forms of stock corporations, and those of banking, railroad, insurance and the like have developed to their present magnitude in comparatively recent years.

It would seem well, therefore, before embarking on the voyage which lies before us to take a preliminary survey of the course over which we are to travel that we may in the beginning understand the nature

[1] Blackstone's Commentaries, Chase's Ed. p. 187

of the corporation itself — that great center from which radiates the business, stock, transportation, insurance and what not subdivisions.

Brown in his Civil Pleading defines a corporation as "A body, created by law, composed of individuals, united under a common name, the members of which succeed each other, so that the body continues the same notwithstanding the change of the individuals who compose it, and it is for certain purposes considered as a natural person." Blackstone considered a corporation in the light of a franchise and ascribed to each individual

"a franchise or freedom".

The object of the law in sanctioning corporations is plainly seen. it is to furnish a means whereby a number of persons may unite and carry out in a body that which neither could effect in his individual capacity. And this legal sanction is not given in order to furnish a better means for these individuals to gain a livelihood or private fortune, although that result incidentally accrues, but that the best interests of the state and public may be thereby subserved.

As between municipal and private corporations we are to deal with

a species of the latter; as between sole and aggregate we are mainly concerned with the aggregate form.

In New York State each private corporation is organized under a general enabling act or by special grant. It has power to embody in its by-laws such regulations as are proper and necessary to carry into effect its corporate objects. Corporate transactions are to be done with an eye single to the attainment of the avowed ends of the organization and are in no case to be retroactive, against public policy, violative of the interests of the stockholders as a body, nor opposed to the laws of

the commonwealth.

Let us now turn to the stock corporation. By the very name we know that the basis of membership is the ownership of a share or shares of stock. A few definitions from the authorities may help us:
"The capital stock", said the Court in the opinion in Burrall v Bushwick[1], "is that money or property which is put into a single corporate fund, by those who by subscription therefor, become members of the corporate body. That fund becomes the property of the aggregate body only".
"A share of the capital stock is

[1] Burrall v Bushwick 75 New York 211

the right to partake, according to the amount put into the fund, of the surplus profits of the corporation; and ultimately on the dissolution of it, of as much of the fund as remains unimpaired, and is not liable for the debts of the corporation." The certificate of a share of stock is akin to a chose in action[1] It may be transferred by endorsement and delivery. It is however but an evidence of the title in the holder of a share or shares of the stock. The transfer is completed by the proper statement and entry on the books of the corporation.

Again "A share of stock represents the interest which a shareholder has

1 Mechanic's Bank v N.Y. and New Haven R.R. Co. 13 New York 599, 627.

in the capital and net earnings of the corporation. The interest is of an abstract nature. x x x Before a dividend has been declared a share of stock represents the whole interest which a shareholder has in the corporation x x x"[1]

[1] Jermain v Lake Shore etc Ry Co., 91 New York p. 492

Part II

Chapter I

The Stockholder and Corporation

Now that we have cleared the way somewhat by obtaining an idea of corporations in general, and stock corporations in particular, let us turn to our subject proper. And first as to the relations between the corporation and the shareholders:

In his contract of subscription the subscriber renders himself liable to pay

the whole amount of his subscription to the corporation, and he is not to be released from the liability thus incurred, without the consent of the corporation. Each subscriber is to pay ten per centum of the amount subscribed for at the time he enters into such agreement.

There seems to be no doubt in this state but that subscription to stock makes one a stockholder in the commonsense of the term, but it is to be noticed that the consent of the subscriber to assume the new relation is necessary. Thus says the Court in a late New York case[1], per Finch, J.: "To establish that relation [i.e. of stockholder and corporation] it must appear that the minds of the

1 Glenn v Garth 133 New York p 31

parties met, that the defendants agreed to be and become stockholders in the corporation with the privileges and responsibilities of that position, and that the corporation accepted them as such. The former could not be put in that position against their will * * * for in that case there would exist no contract relation **"

The same principle holds good where fraud has been practiced upon the subscriber to induce the subscription. He may rescind his assent in such a case and bring suit in a Court of Equity to obtain legal permission to have his subscription annulled.

It is to be born in mind that the subscription does not import an absolute

liability on the part of the subscriber to pay the amount agreed upon at any and all events. The corporation has no right, after the contract of subscription has been closed, to radically or unreasonably alter the corporate business or enterprise, to the manifest detriment and against the wish or consent of the confiding stockholder.

It was conclusively maintained by the Court of Appeals that the shares may be transferred by the original subscribers and that the former holders do not remain liable for calls made after the transfer.[1] As a general rule, the corporation makes a call or an assessment in order to

1 Billings v Robinson 94 New York 415

-ling in the whale or part of the remainder of the subscription. To collect, a call is necessary when it is so stipulated at the time of the subscription, and payments are to be made at the times agreed upon by the Board of Directors. If a subscriber fail to meet the demand made upon him by the corporation his subscription may be forfeited[1] upon the corporation sending him a notice to the effect that such will be the case if he does not meet his obligation within the statutory period of sixty days. On forfeiture the ownership of the stock revests in the corporation[1] and it may then be reissued upon the same terms and conditions as

1 New York Stock Corporation Law § 43

before. It is important to state at this point that, after the forfeiture is made complete by the requisite legal process, the stockholder is no longer liable for the payment of the stock or subject to unpaid calls previously made'.

The New York Stock Corporation Law lays down the rigid rule[2] that a corporation which has failed to meet the just demands made upon it by creditors shall not be allowed to transfer corporate property to its officers, directors or stockholders, except for a full money consideration, nor may any conveyance be made by the corporation or security given by means of its property, during insolvency

1 Wheeler v Miller 90 New York 353
2 New York Stock Corporation Law § 48

or the probability of insolvency for the purpose of furnishing a preference to creditors. Should such unlawful conveyance be made the grantees or assignees must answer to the creditors or stockholders for the whole interest. This prohibition from transferring property under such conditions finds its logical and appropriate corollary in the added provision that the same rule shall extend to attempted transfers or assignments by stockholders of their individual stock in view of the insolvency of the corporation. By statute[1] a stockholder has the right while a mortgage debt is pending foreclosure to pay to the mortgagees for the benefit of the

1 New York Stock Corporation Law § 49

holders of the bonds which were issued by the corporation as security for the mortgage "a sum equal to such proportion of the amount due and secured to be paid by such mortgage [or deed], as his stock in such corporation shall bear to its whole capital stock; and on making such payment he shall to the extent thereof become and be interested in such mortgage or deed and protected thereby."

The right of a stockholder to his stock rests upon a stronger foundation than is furnished by the mere certificate. The certificate is but the evidence of his property or interest in the corporate stock; and on loosing the same

the holder may apply to the corporation for the issue of a new certificate which will present the same evidence of ownership as did the other. There may be instances in which the corporation through its proper officers refuses to grant the request and make out the new certificate. The shareholder's remedy in such a contingency is in the Supreme Court[1], where upon due presentment of the facts, he may obtain an order that the corporation show cause to the Court why another certificate should not be given. Should the facts set forth by the petitioner satisfactorily show to the Court

[1] New York Stock Corporation Law § 50

that he was the real owner of the stock for which he claims the new certificate and that he has accidentally lost the same, or that it has been destroyed or taken from him without his connivance or fraud, the Court will grant an order[1] compelling the corporation to make out a new certificate. The only requirement that is made of the stockholder is that he file a bond in accordance with the directions of the Court, whereby he will be liable to any person for indemnity who subsequently appears to be the true and lawful owner of the certificate.

We shall not pass unnoticed the privilege which is given to a

[1] New York Stock Corporation Law § 51

stockholder of a business corporation who owns as much as five per centum of the capital, if the same be not over one hundred thousand dollars, or three per centum if it be over one hundred thousand dollars[1], of obtaining from the corporation through its treasurer yearly a statement of the status of affairs of the corporation, - as to its liabilities, assets, etc. Such a statement however cannot be required more than once a year!

We said above that a subscriber could annul his subscription were it obtained by fraud. This is true, it should be added only

[1] New York Stock Corporation Law § 52

in case he acts with due desp[illegible].
For it would be manifestly unjust to allow a subscriber to rescind at the eleventh hour, after third persons have entered into contractual relations with the corporation in view of, or from their faith in the subscription which the former seeks to avoid.

A question of considerable importance comes up here as to how great a latitude a corporation has in altering and extending the course of its business. It is not too bold to say that while the corporation may not diametrically change the purpose of incorporation, yet

no stockholder can prevent a reasonable deviation from or increment to the corporate business which is fairly within the scope of the corporate enterprise as expressed in the charter and articles of association. It is not our purpose to go into an extensive discussion of the effects of acts beyond the corporate powers i.e. ultra vires. We should, however, acquaint ourselves with the general stand taken by the Courts as to this, one of the most dangerous tendencies of several classes of corporations.

When the contemplated act is plainly ultra vires any stockholder may

proceed to enjoin the corporation from executing it, as he may if the proposed transaction is fraudulent, in violation of contract, or against public policy. But these restrictive rights vested in the stockholder will not be construed to give him a power to set up his personal whims and caprices against valid and worthy corporate engagements. The corporation as a body has control of the property vested in it and is regarded as assuming the responsibility for its proper use and disposition. (And moreover) the stockholders may combine after organization as

may the subscribers beforehand to regulate and determine the general atitude and policy of the corporation. It was accordingly held by the New York Court of Appeals[1], that an agreement entered into in contemplation of the organization of a corporation "that one of the persons furnishing the capital shall subscribe for the whole stock intended to be taken by the associates, is not illegal and void, as against public policy". And apropos a stockholder may be actuated by and vote according to his own interests on measures brought forward in behalf of the

[1] King v Barnes 109 New York 267

corporation as such[1]. In Gamble v Water Company cited below, Peckham, J., delivering the opinion of the Court said: "In such a meeting each shareholder represents himself and his own interests solely, and he in no sense acts as a trustee of others."

The next matter which closely concerns the stockholder is the division of profits. A stockholder in New York must wait until a dividend is regularly declared. He cannot bring suit beforehand, the power to declare the dividend resting with the directors[2] and

1 Gamble v Water Company 122 New York 91
2 New York Stock Corporation Law § 23

not the stockholders.[1] This is true so long as there is no fraud and refusal on the part of the directors to declare the dividend at the proper time. If there is fraud on their part and they proceed to divert the profits to other purposes they may be enjoined from so doing.[1] In Boardman v the Railway Company the Court laid down the rule that the holders of preferred shares have a prior right to the dividends and to all owing them on prior dividends before the other stockholders can reach the profits, i.e. preferred guaranteed shares

[1] Boardman v Lake Shore etc Railway Co., 84 New York 157

For Penalty for declaring improper dividends see: Jones on Business Corporations p 39

are cumulative.

In Kent v Quicksilver Mining Company[1] it was recognized by the Court that a corporation may at the outset of its existence classify its capital stock, giving privileges to one class not enjoyed by another provided[2] there be no fraud or mistake.

The corporation is to act with due diligence and care in the transfer of shares and in New York if the stock certificate has been forged by a person entrusted with the transfer of stock on its books, that fact does not preclude a bona fide holder

[1] Kent v Quicksilver Mining Company 78 New York 159

[2] New York Stock Corporation Law § 47

for value from recovering thereon.[1] The tendency seems to be to hold the corporation liable whenever it issues stock or transfers it, when the transaction is on its face legal and proper from the standpoint of contracting parties who exercise reasonable diligence. So if the corporation transfers stock against a regulation of the by-laws or on forged orders it is equally bound. In sum and substance therefore it follows that when a certificate is given by the corporation according to law and

[1] Fifth Ave Bank v Forty-second Street Railway Co., 137 New York 231

to all the rules of the corporation it is bound to stand by the same, and cannot avoid it as against one who accepts it in good faith and without notice or suspicion of any irregularity.[1]

No lien attaches in behalf of the corporation on the shares, in the absence of express limitation, whereby it can secure and enforce calls and obligations due it.[2] But where the lien exists by statute such lien is necessarily absolute and it follows the certificate from the original stockholder to

[1] Halbrook v N.J. Zinc Co, 57 New York 616
2 Driscoll v Manufacturing Co., 59 New York 96

the purchasers who are affected with constructive notice[1].

We should not close this investigation into the relations existing between the corporation and the shareholders without giving some attention to the "winding up" of a corporation and ascertaining what are the shareholders' rights in this connection.

We have seen above that a majority of the stockholders could not compel a cessation of the lawful business, nor on the other hand can a minority of the stockholders

1 McCready v Rumsey, 6 Duer (N.Y.) 574

force it to continue business against the wishes and vote of the majority where it is for the best interests of the majority and the corporate enterprise to cease, provided of course there be no resulting fraud.

The shareholders have an interest in the capital stock of the corporation which survives the existence of the corporation as a legal institution. If there are assets after winding up of the corporation they are first open to the payment of the

just debts that are yet outstanding, and expenses.

After these necessary disbursements have been made the remainder must be distributed among the shareholders according to their respective shares. The right to discontinue business and dissolve the corporation rests with the majority of the stockholders[1]. The corporation may cease business and mortgage its property to stockholders as security of their advances. This power, of course, it should be added can be exercised

[1] Skinner v Smith 134 New York 240

only when no statute is contravened and when the rights of third parties already accrued are not injured.

When a corporation is about to be dissolved through the fraud and collusion of its officers or shareholders a single shareholder may apply to the Court to vacate the judgement of dissolution on the grounds that his rights would be invaded and disregarded by such contemplated fraudulent dissolution.[1]

1 People v Hektograph Co., 10 Abbot's N.C. 358

Chapter II

The Stockholder and Officers

The Directors of a stock corporation are authorized by law[1] to select a President, Secretary, Treasurer, and other necessary officers from their number. The latter two need not be members of the body of directors. The Directors may exact security from such officers for the

[1] New York Stock Corporation Law § 27

honest discharge of their duty, and may remove them at their will. Such officers are limited in the scope of their powers to the provisions of the by-laws and express restrictions made by the Board of Directors.

In the election of officers there must be two inspectors at least, who are elected in accordance with the by-laws except for the first election when they are to be appointed by the Directors.

The officers are required by law to issue, during January as of the first day of that month an annual report.[1] This report

[1] New York Stock Corporation Law § 30

is to contain a statement of the amount of the capital stock, debts, assets, etc, which report must be signed by a majority of the Directors. On failure to sign this report the directors become liable for all the debts owing by the corporation both at the time the report should have been made and thereafter individual directors being liable for debts existing at the time of the failure to comply with the statute, and those subsequently accruing during his term of office.[1]

But such liability does

[1] Quarry Co v Bliss 27 New York 297

not extend to debts arising after he ceased to be a director

The New York Stock Corporation Law provides for the election of Directors by a plurality vote of the stockholders[1]. Each Director is required to own at least one share of the stock. There is no discrimination as to sex in eligibility to election as Director. As many as two of Directors must be residents of this state. As many as three but not more than thirteen of the stockholders shall constitute the Board of Directors

Now the authority of the

1 New York Stock Corporation Law § 20

directors is well-nigh exclusive, viz. they are in law the duly authorized agents of the corporation, and the validity of their acts does not rest upon ratification by the stockholders unless such limitation on their powers is expressly laid down by statute or so prescribed in the by-laws. Accordingly so long as their acts are in the legitimate scope of the corporate business and are not fraudulent they cannot be questioned by the stockholders. Gray, J., speaking for the Court said:

[1] Beveridge v N. Y. E. R. R. Co., 112 New York 1

"Within the chartered authority, they [the directors] have the fullest power to regulate the concerns of a corporation, according to their best judgment, and contracts which the corporation could legitimately make come within the ordinary powers of corporate management." Citing authority[1] and speaking to the case further the Court said: "What we hold here is that a contract for the leasing of one railroad to another is within the original powers of a board of directors to make; because

[1] Leslie v Lorillard 110 New York 536

it is a power conferred upon the corporation by the Legislature. * * *."

Nevertheless while clothed with this extensive power of acting for and representing the corporation within the purview of the charter the directors are not supposed to take the part of any particular stockholder or class of stockholders. In fact their acts must be done in behalf of all the stockholders without fear, favor, or prejudice for any.[1] And the directors are not only bound to act in good faith[2], but

1 Chase v Vanderbilt 62 New York 307
2 Brinckeroff v Bostwick 88 New York 52

they cannot in opposition to the manifest will of the stockholders practically bring about a dissolution and terminate the corporation's existence by disposing of the property so that it does not subserve the interest and purpose of the corporate enterprise, and in this case the fact that they acted in good faith is not a satisfactory defense or excuse.'

There is no doubt but that the directors have power to transfer assets to pay a debt owing by the corporation

1 People v Ballard 134 New York 269

in the absence of objection by any stockholder; and there is authority for the statement that the fact of surrender of its corporate rights and franchises by vote of the shareholders and not by that of the directors does not avoid the surrender if the disposal of the property is brought about when the corporation is free from debt, when the acts do not amount to a breach of any other corporate duty, and do not contravene any vested rights.[1]

If, as suggested above,

[1] Webster v Turner 12 Hun 264

the board of directors have no right to transfer the assets when such transaction would inure to the detriment of creditors, it naturally follows as good law that such transfer, even with the consent of the stockholders under similar conditions would not be valid[1].

It seems hardly necessary to add to the foregoing that stockholders who object to any action decided upon by the Trustees should act promptly if they are to stay its execution. For

[1] Cole v Iron Company 133 New York 164

in the absence of proof to the contrary a board of directors will be presumed to be exercising their proper powers and performing their customary duties.

The directors are the proper officers to determine as to the payment of dividends, for the benefit of the stockholders! They are ever to keep in mind the rights of creditors and the obligations of the corporation and to have the same properly adjusted before a dividend is declared. Should the

[1] Williams v W. U. Tel. Co., 93 New York p 192

directors decide to declare a dividend on funds which are not surplus profits every director taking part in the unauthorized transaction and giving his consent thereto is liable severally, and jointly with the others for the full amount thus distributed, on demand of either the corporation or the aggrieved creditors or both[1].

Dividends when declared upon the stock of the corporation are the property of the persons who are stockholders

[1] New York Stock Corporation Law § 23

at the time the dividend is declared. The corporation stands in the place of the stockholders, i e represents them as a single body, and accordingly up to the time of the declaration the assets belong to the corporation. On a dividend being declared the profits belong no longer to the corporation as such, but become apportioned among the respective stockholders of record. The corporation through its officers is really but a trustee of the surplus profits

and holds them solely for the benefit of the stockholders.[1]

By the New York Stock Corporation Law[2] directors and other officers except of monied corporations are prohibited from making loans of funds belonging to the corporation to a stockholder. Neither are the officers allowed to discount notes of stockholders or to receive the same in whole or part payment of a stock subscription. The penalty for a violation is a joint and several one among the officers recorded as

1 Jermain v Railway Co 91 New York at p 492
2 New York Stock Corporation Law § 25

consenting to the transaction.
The law continues[1] "if a stockholder shall be indebted to the corporation, the directors may refuse to consent to a transfer of his stock until such indebtedness is paid, provided a copy of this section is written or printed upon the certificate of stock."

We have accordingly deduced the general doctrine that members of a corporation cannot refuse to submit to reasonable and proper regulation and supervision on the part

[1] New York Stock Corporation Law § 26

of the board of directors acting within the scope of their powers. Therefore we are led to consider this rule of law to be an important guaranty to the minority stock holders, i. e. this right to have the business so intrusted to the directors executed solely on lines of corporate policy and not in accordance with the wishes of a majority of the stock holders necessarily.

We have thus far held out the principle that the

stockholders may not interfere with the acts done by the board of directors so long as they keep within the radius of their authority.

But the case is much different when the act in question is unauthorized or grossly unreasonable, and not in accord with good corporate management. The remedy of the dissenting stockholder or stockholders is to bring an action in the corporate name to restrain the accomplishment of the act. Naturally many close

questions arise as to just what acts may be restrained: assuredly none which a majority of the stockholders consent to and which are manifestly not beyond the powers and functions of the directors. But if it be fraudulent, in open violation of official duty and good faith, or ultra vires, the action against the trustees may be maintained by any stockholder bringing suit in the name of the corporation.

The shareholders may

sue personally in Equity in these cases only when it is shown that the corporation has neglected or refused to bring the suit; and that the doing of the contemplated act would work a lasting and substantial hardship on the stockholder.[1] Under such circumstances the stockholder may himself bring the suit joining the corporation as a party defendant.

It is also quite well settled that when the control of the corporation is vested

[1] Greaves v Gange 69 New York 433

in unfaithful or irresponsible officers, a request to whom, to proceed in suit against the directors would be useless, then the action may be brought by the stockholder without averring a previous request to the corporation to sue.

The restraing suit is of cause to be brought in a Court of Equity, and should ostensibly be brought on behalf of all the stockholders. Such manner of bringing the action; i.e. on behalf of all the stockholders

is founded on the fact = that the directors are virtually the trustees of each and every holder of stock, and their duty to perform every act which is required by the charter and by-laws not only to effect the result of the corporate enterprise but to protect and concede the stockholders' rights. In a word whatever duty the officers owe the corporation directly, such duty they owe indirectly to the stockholders composing the corporate body.

We are not in all this

discussion going to forget that the stockholders and officers have reciprocal rights and duties. Indeed if the directors in pursuance of the corporate undertaking, with the knowledge and consent of the shareholders become personally liable for acts which were not strictly within their official capacity, the benefits of which are accepted by the shareholders, the latter will not be allowed to deny the directors fair reimbursement for the amount

of loss they have respectively sustained. The directors will generally have access to the corporate funds for the amount of their expenditures or liabilities.

Chapter III

The Stockholder and Creditors

As a general rule the shareholder's liability to creditors attaches and extends to that amount of stock for which he has subscribed but has not paid in. This is so in all cases where the corporation is not liable for debts over and above the amount

of capital stock specified in the articles of association.

The creditor therefore is justified in insisting in a case where liability for corporate indebtedness is expressly stated to extend only to the amount of the capital stock

First: that the shareholders meet the obligations which they owe to the corporation, i.e. pay to it the sums of their respective subscriptions; and

Second: that the shareholders as among themselves and in dealing with third persons act in good faith

and not expend the capital in channels calculated to render it impossible to meet the payment of the just debts of the creditor.'

There seems to be no question as to the liability of the holder of stock for the unpaid balance or instalment, and therefore that his liability to creditors cannot be avoided through a secret agreement between him and the corporation or its agents releasing him from the unpaid portion

In Tuckerman v Brown a case quite in point a note was

1 Taylor on "Private Corporations," p678 § 700
New York Revised Statutes Chap. 18, Tit 3. § 19 [illegible] 5.
Morgan v N. Y. and Albany R.R. Co., 10 Paige (N.Y.) 290

-quien to raise the capital stock of the corporation to the amount required by statute. It was secretly arranged that after the commissioners had passed upon the sufficiency of the capital stock, the corporation would accept a note of less value for the original one. The Court, affirming the judgment of the lower Court[1], held that the maker of the note of greater value was still liable therefor even though the agreement for substitution had technically been carried into effect, for such a transaction

1 Tuckerman v Brown 33 New York 297

amounted to a fraud upon creditors and was void from its inception. Therefore the surrender and destruction of the larger note did not alter the situation.

Such a rule seems to me to eminently fair to all the parties. The stockholder holding himself out as having paid his subscription and thereby furnishing an inducement for the creditor to deal with the corporation should upon the ordinary principles of misrepresentation be estopped from asserting

a liability for a smaller amount. It is the capital with which creditors are concerned. The capital stock forms the basis of corporate credit in business dealings.

Unless it be expressly stipulated the creditors cannot insist on the payment by the subscriber of cash when he is in a position to give its equivalent but not the money itself. The stockholder may pay for his shares in property or services if they are reasonably worth the amount of stock that is

set apart to him in return. So long as he gives fair consideration for his stock he runs no danger of having a judgment obtained against him on that score, but if it is manifestly inadequate he is not so secure.

At this stage arises the old familiar trust fund doctrine. Let us be careful to distinguish between the technical and the liberal use of the term "trust fund" Now the idea that the capital stock constitutes a trust fund for the benefit

of creditors means simply that it is equivalent to a representation to the public that the corporation has that amount of funds, and that persons dealing with the corporation may do so with the assurance that they are secured thereby and to that extent. The fund is not in the strict sense a trust fund, for if it were a person could not deal safely with the corporation because of the existence of the trust. But we know that a person who deals with a corporation

experiences no greater risk in regard to a trust relation than in dealing with an individual. The expression as used in this connection forms merely an analogy, a figure of speech, a convenient term to denote the fact that the funds are held for the payment of the debts of the corporation.

The creditors' remedies are of a two-fold nature:

First,- An action at law to recover a judgment against the corporation for

damages.

Second, - A bill in equity against the stockholders to reach the amount of their unpaid subscriptions.

Before proceeding in equity against the stockholders the creditor must first exhaust his legal remedies against the corporation, viz. obtain a judgment against it, after which execution is to be levied and if it is returned unsatisfied in whole or in part his next step may be in equity. When he comes to sue

the stockholders as such he must do so on behalf of the other creditors who desire to be joined, and the corporation is to be made party defendant.

The trust-fund doctrine is rarely invoked before the corporation becomes insolvent because up to that time the creditor has his legal remedy against the corporation.

As we have stated before the shareholders are bound to preserve and apply the corporate funds to those

ends specified in the charter or articles of association.

They may not divert them to the injury of the confiding creditor. In case of such diversion under the guise of dividends when the corporate indebtedness remains outstanding or under other circumstances showing bad faith on the part of the corporation the creditors may recover such funds from the shareholders who have received them knowing the distribution to be against the rights

of creditors.

We may well ask ourselves "Who are shareholders, i.e. such that may be held liable to creditors?" Naturally enough the presumption is that all persons who are recorded on the books of the corporation as owners of stock are shareholders in this sense, and it is but the usual rule of law to place the burden on the defendant to show that he is not a stockholder in the corporation. He may show that the entry on the books was

fraudulent or made through mistake provided it was not under circumstances which would amount to notice to him of the registry of his name as a stockholder. On the other hand if the defendant is the real owner of the stock he cannot maintain the defence that the shares were entered on the books in the name of another. If he accepts the benefits accruing from them he must take the responsibility of ownership.

Finally let us remember

that a transfer of shares in defraud of creditors will not be upheld, as where the stock-holder becoming aware that the corporation is insolvent transfers his shares to an irresponsible party. It is only just that the transfer be set aside for the benefit of the creditors, and this is in accordance with the general attitude of the Courts towards fraudulent conveyances.

Chapter IV

The Stockholders themselves

We will now investigate the relations existing among the several stockholders of the corporation. We have in some measure touched upon this side of our subject in Chapter One, entitled "Relations between the Stockholders and the Corporation"

considering the majority of the shareholders as representing and constituting the corporation as far as the acts of the corporation are concerned. The majority of the holders of stock must needs control the affairs and determine the policy of the body corporate, but nevertheless the individual and minority member is none the less a component part of the organization and is amenable to the rules and regulations governing the

corporation as a whole. The two chief rights or classes of rights among the several stockholders are

First.- A right to participate in the benefits of owning stock as against all the others or the majority representing the corporate management; and

Second - The right to demand that the other stockholders fulfill the obligation which they may owe to the corporation in the matter of subscriptions, and also that they assume

and bear their proportionate share of the burden and responsibility

Another phase in which we may regard the rights and inter-relations of stockholders to group themselves is that of successive ownership arising from transfer. The rights and duties here in question are those between prior and subsequent holders and not as between the stockholders as such at any one time.

Naturally where a right is in question or a grievance

is to be redressed in the former case the stockholder has first to make a demand on the corporation, provided it has not reached the stage of insolvency, to take such remedial action as in his case is urgent and proper. Of course if the corporation refuses to do its duty and take the necessary measures of relief the stockholders may sue one another making the corporation a party defendant.

In the latter group of relations which exist between

prior and subsequent holders, rights of assignment and transfer; etc arise as where the purchaser of shares calls upon the seller to guarantee his ownership and make a complete transfer.

As a general rule each stockholder coming into the corporation does so on the assumption that every other stockholder will pay his subscription and stand his share of responsibility and liability. This excludes the right to make secret arrangements with the

promoter whereby the subscriber is to be liable for but a fractional part of his subscription. As elsewhere painted out in the case of creditors doing business with the corporation so in the assignment and transfer of stock great injustice may be done if such a condition of things be tolerated.

A shareholder may not terminate his connection with the corporation without due notice and just cause the only reason given

being his personal whim or preference. Inasmuch as he has become a stockholder, the other stockholders have a right to insist on his remaining in the corporation with all the duties and liabilities pertaining to such position until the proper officials steps are taken to give him a release. A release however would not be granted, and justly not, whenever third parties have contracted with the corporation on the faith of his membership therein.

A shareholder has a right to demand an impartial administration of their duties by the Board of Directors. He may insist that dividends be paid to him as promptly as to the other shareholders, provided of course that he has fulfilled all the duties he owes the corporation Nor may the corporation impose any liability on the stockholder which proves to be different from or greater than that existing at the time of his subscription,

and which now reasonably attaches thereto.

In case of a suit against a stockholder for the payment of a corporate debt on his several liability and he pays the entire debt which is over and above the amount of his stock he has a right to enforce contribution from the other shareholders.

In regard to relations existing between successive holders of stock the laws of personal property have application. In the case of Baltzen v Nicholay,[1] which was an action to

1 Baltzen v Nicholay 58 New York 467

recover damages for an alleged breach of a contract for the sale of five hundred shares of stock, the Court through Andrews, J., said:
"** The recovery cannot be upheld. There was no payment on account of the purchase of the stock, and no delivery; and no memorandum in writing of the sale was shown to have been made by the auctioneer."
The Statute of Frauds was pleaded. The Court, continuing:
" The waiver by the defendant of the deposit of a part of the purchase money required by

the conditions of sale * * * did not estop him from showing that there was no actual payment on the contract without which the statute is not satisfied, where the fact of payment is relied upon to take a contract out of it"

Not only do the provisions of the Statute of Frauds cover the sale and transfer of stock, but Equity in certain cases will interfere and enforce a contract of sale made without a writing. A suit was brought in equity[1] to compel the performance of an

[1] Johnson v Brooks 93 New York 337

alleged oral contract. The judgment of the Court was that the defendants transfer to the plaintiffs certain shares of the capital stock of a corporation and bonds. In affirming the judgment of the Court below, Danforth, J., speaking for the Court of Appeals said:

" While it may be conceded that in general a Court of Equity will not take upon itself to make such a decree where chattel property alone is concerned, its jurisdiction to do so is no longer to be doubted; and it is believed that no good reason

exists against its exercise in any case where compensation in damages would not furnish a complete and satisfactory remedy.

The certificate of stock is quasi-negotiable and the legal title may be transferred by assignment. The holder stands in the position analogous to that of the owner of a chose in action.[1] Commissioner Earl who delivered an opinion in that case said that stocks are articles of commerce and that the dealings in them every day of the

[1] Leitch v Wells 48 New York 585

year far surpass in value the dealings in any other species of personal property.

The right to receive the dividends as declared is an important one inasmuch as they constitute practically the sole return to the stockholder for his investment. The dividend belongs to the stockholders of the corporation who are such at the time of the declaration.[1]

[1] Jermain v Lake Shore etc Railway Co., 91 New York 483

Part III

Conclusion

We have endeavored to review in their order the different relations that arise between the corporation, officers, and creditors with the stockholders. It might not be amiss before concluding the discussion to touch briefly on the character of the liability of the stockholder

under our statutes. It appears safe to conclude that it is not the same as that of partners or guarantors.

There is an essential difference between the liability of the partner and that of the stockholder.

A partner when he becomes a member of the firm is not bound for acts done and contracts made previously[1]. They were not made in his behalf therefore he will not be held to have ratified them. But the case of the stockholder is just the reverse. The corporate

[1] Lindley on Partnership 389

acts are done in contemplation of the probability that there will be a succession of stockholders who in turn are to become clothed with the liabilities as well as the privileges cast off by their respective transferers. The persons dealing with a corporation are presumed to have notice that the shares are in process of transfer or at all events that they are liable to change hands at any time. Therefore these contracting parties cannot set up the defense that they dealt with

the corporation on the faith of the credit furnished by the stockholders who have ceased to be such since that time.

By the transfer then the transferee assumes the rights and responsibilities which formerly belonged to his transferer.

An important provision under our New York Statute is "that the stockholders of every stock corporation shall jointly and severally be personally liable to its creditors, to an amount equal to the amount of the stock held by them respectively,

for every debt of the corporation until the whole amount of its capital stock issued and outstanding at the time such debt was incurred shall have been fully paid."[1] Also the stockholders in a New York Stock Corporation are liable jointly and severally for the payment of all services rendered for the corporation of a manual nature, such as are furnished by day laborers, servants, and employees other than contractors. The Court of Appeals[2] has held the term employees

does not include persons

1 New York Stock Corporation Law § 54
2 Wakefield v Fargo 90 New York 213

who are engaged by the year and who receive a stated salary, as for instance, a bookkeeper. Nor does the term "general manager" come under this description. The above was held under another statute.

It has been a pleasure to note the growing liberality which has characterized the legislators and judges of New York in handling and determining the difficult questions that cluster about the corporate relations. The strict rule making the stockholders liable for the wages of the manual laborer who

spends his time and furnishes his services for the corporation is in accord with a broad policy, early enunciated, of protecting the rights and interests of all persons connected with the corporation either as a servant or an investor.

One might at first be led to believe in looking over the record of repeal legislation that New York is not soon to arrive at a settled position in the government of corporations. Yet all in all it would seem that a safe and secure ground-work has been laid

and we may reasonably hope for healthy developement along this line. Surely New York, the Empire State, first as she is in population, wealth and trade in all the sisterhood, cannot afford to recede or long remained on doubtful ground in a field so closely affecting her material interests and prosperity.

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