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Notes and Comments

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NOTES AND COMMENTS

TREASURY STOCK IN ITS RELATION TO EARNED SURPLUS

During the last decade business corporation acts have been amended in several states so as to effect more and better safeguards for the stockholders and creditors. One of the noticeable restrictions for this purpose is that placed on the exercise of the right of a corporation to acquire its own stock. The general tenor of such restriction in several of the acts is to the effect that a corporation cannot reacquire its own stock if the payment made for such reacquisition is greater than the earned surplus of the corporation at the time of the reacquisition.

Using earned surplus as a measuring stick to determine the possibility of legal reacquisition of shares, however, offers little protection to anyone unless some corresponding provision is made to restrict the use of the earned surplus after the stock has been reacquired.

An attempt is made in several of the acts to restrict the use of such earned surplus, but the phraseology used in the acts does not provide clearly the restrictions which the authors apparently contemplated. By way of specific illustration, certain sections of the Business Corporation Act of Illinois are analysed below and applied to a set of assumed situations insofar as they affect the question under consideration.

In Section 6 thereof is found the following language relative to acquiring treasury shares, to-wit: "A corporation shall have power to purchase, take, receive, or otherwise acquire, hold, own, pledge, transfer, or otherwise dispose of its own shares, *provided* that it shall not purchase, either directly or indirectly, its own shares when its net assets are less than the sum of its stated capital, its paid-in surplus, any surplus arising from unrealized appreciation in value or revaluation of its assets and any surplus arising from surrender to the corporation of any of its shares, or when by so doing its net assets would be reduced below such sum."[1]

Section 2(m) of that statute says that the term "net assets," when used for the purpose of determining the right of a corporation to purchase its own shares and of determining the right of a corporation to declare and pay dividends and the liabilities of directors therefor, "shall not include shares of its own stock belonging to such corporation."[2]

It also defines "stated capital" to mean, at any particular time, "the sum of (1) the par value of all shares then issued having a par value and (2) the consideration received by the corporation for all shares then

[1] Ill. Rev. Stat. 1941, Ch. 32, § 157.6. Despite such limitation a corporation may purchase its own shares, by a further provision contained in the same section, for the purpose of (a) eliminating fractional shares; (b) collecting or compromising claims of the corporation, or securing any indebtedness to the corporation previously incurred; (c) paying dissenting shareholders entitled to payment for their shares in the event of a merger or consolidation or a sale or exchange of assets; or (d) effecting the redemption of its preferred shares as otherwise permitted by the act.

[2] Ill. Rev. Stat. 1941, Ch. 32, § 157.2(m).

issued without par value, except such part thereof as may have been allocated otherwise than to stated capital in a manner permitted by law, and (3) such amounts not included in clauses (1) and (2) of this paragraph as may have been transferred to the stated capital account of the corporation, whether upon the issue of shares as a share dividend or otherwise, minus such formal reductions from said sum as may have been effected in a manner permitted by law."[3]

Since the only portion of net worth excluded in Section 6 is earned surplus or some reservation thereof and since net assets exclude treasury stock, the essence of Section 6 is that treasury stock cannot be acquired if the cost thereof is greater than the earned surplus in the aggregate at the time of purchase.

For the purpose of illustrating the effect of Section 6 relating to the purchase by a corporation of its own shares, assume that the following balance sheet is prepared on a given date:

I

ASSUMED BALANCE SHEET OF A CORPORATION

Net Assets including no Treasury Stock	$600,000	Capital Stock:		
		Common, par	$200,000	
		Preferred, par	100,000	$300,000
		Paid-in Surplus		100,000
		Unrealized Surplus from Appraisal		100,000
		Surplus from Surrender of shares (Donated Surplus)		50,000
		Earned Surplus		50,000
	$600,000			$600,000

Assume further that very soon after the preparation of Balance Sheet I, the corporation acquires at par $50,000 par of its own shares. The following balance sheet would then be prepared:

II

BALANCE SHEET ASSUMING TREASURY STOCK COMMON IS ACQUIRED TO EXTENT OF EARNED SURPLUS

Net Assets other than Treasury Stock	$550,000	Capital Stock:		
Treasury Stock Common	50,000	Common, par	$200,000	
		Preferred, par	100,000	$300,000
		Paid-in Surplus		100,000
		Unrealized Surplus from Appraisal		100,000
		Surplus from Surrender of Shares (Donated Surplus)		50,000
		Earned Surplus		50,000
	$600,000			$600,000

Net assets as defined in Section 2 (m) now are only $550,000, which is equal to all items of Net Worth except Earned Surplus. Therefore, the purchase of the treasury stock was legal.

[3] Ill. Rev. Stat. 1941, Ch. 32, § 157.2(k).

With respect to dividends, Section 41 of the statute says the board of directors of a corporation may declare and the corporation may pay dividends on its outstanding shares in cash, property, or its own shares, subject however to the following limitations, to-wit:

"(a) No dividend shall be declared or paid at a time when the corporation is insolvent or its net assets are less than its *stated capital,* or when the payment thereof would render the corporation insolvent or reduce its net assets below its *stated capital.*

"(b) Dividends may be paid out of paid-in surplus or surplus arising from the surrender to the corporation of any of its shares only upon shares having a preferential right to receive dividends, provided that the source of such dividends shall be disclosed to the shareholders receiving such dividends, concurrently with payment thereof. The limitations of this subparagraph shall not limit nor be deemed to conflict with the provisions of this Act in respect of the distribution of assets as a liquidating dividend.

"(c) No dividend, except a dividend payable in its own shares, shall be declared or paid out of surplus arising from unrealized appreciation in value, or revaluation, of assets.

"(d) No dividend payable in its own shares shall be paid in shares having a preference as to dividends over the shares upon which such dividend is paid, unless the payment thereof be authorized by the articles of incorporation."[4]

In accordance with the limitations thus found in Section 41(a), it would seem that a cash dividend could be declared to the extent of the earned surplus of $50,000. Such declaration and payment would reduce the "net assets" to $500,000 which is not below the stated capital of $300,000 (par). In such case and other similar ones, it seems, therefore, that cash dividends could be declared legally from earned surplus to the full extent thereof even though the total amount of such earned surplus has served as a measuring stick to determine the legality of *purchase* of treasury stock. In any given case, however, the court might consider that the probable intent of the draftsmen was such as to justify interpreting the statute as a whole to mean that the purchase restriction is to be continued until retirement.

If dividends were declared from the $50,000 surplus and were paid in cash, the balance sheet would then appear as in III, though it should be borne in mind that if the preferred stock is participating two-fifths of the $50,000 would be paid to preferred stockholders and three-fifths to common stockholders.[5]

[4] Ill. Rev. Stat. 1941, Ch. 32, § 157.41. Italics added.

[5] The reason for such division would lie in the fact that the dividend base would be arrived at as follows:

Common stock outstanding	$150,000
Preferred stock outstanding	100,000
Dividend base	$250,000

III

Net assets other than Treasury Stock	$500,000	Capital Stock:		
		Common, par	$200,000	
Treasury Stock Common	50,000	Preferred, par	100,000	$300,000
		Paid-in Surplus		100,000
		Unrealized Surplus from Appraisal		100,000
		Surplus from Surrender of Shares (Donated Surplus)		50,000
	$550,000			$550,000

Thus cash dividends have been declared and paid from earned surplus without reducing "its net assets below its stated capital," and without violating the provisions of Section 6 relative to the purchase of the corporation's own shares, even though the original $50,000 earned surplus served as a measuring stick for the purchase of $50,000 par of treasury stock at par and also as the basis of the declaration of $50,000 in dividends payable in cash. Was it not the intention of the authors of the corporation act under review to make it impossible to use $50,000 for the purchase of treasury stock and simultaneously another $50,000 for the payment of a cash dividend declared out of earned surplus unless the earned surplus, before executing these two transactions, was at least $100,000? If such was not the intention, why is any restriction necessary relative to the purchase of one's own stock as that prescribed in Section 6?

Is it not probable that the authors of the Act had an idea in mind which should have been expressed as follows: "No dividend *payable in cash or property* shall be declared or paid at a time when the corporation is insolvent or its net assets are less than *the sum of its stated capital, its paid-in surplus, any surplus arising from unrealized appreciation in value or revaluation of its assets and any surplus arising from surrender to the corporation of any of its shares,* or when the payment thereof would render the corporation insolvent or reduce its net assets below *such sum.*"[6]

The phraseology of Section 41(a) of the Act would doubtless provide the safeguards and restrictions contemplated by its authors in the case under consideration if the Paid-in Surplus, Unrealized Surplus from Appraisal and the Surplus from Surrender of Shares (Donated Surplus) were first used as bases for the declaration of dividends in accordance with Section 41(b) and (c).[7]

Assume, for example, that with Balance Sheet II as a starting point, a dividend on preferred stock has been declared and paid to the extent of the Paid-in and Donated Surplus. Balance Sheet IV would then result.

[6] The language represents a revision of Section 41(a) of the Business Corporation Act, Ill. Rev. Stat. 1941, Ch. 32, § 157.41(a), the new material being indicated by italics.

[7] Ill. Rev. Stat. 1941, Ch. 32, § 157.41(b) and § 157.41(c).

IV

Net Assets other than Treasury Stock	$400,000	Capital Stock:		
		Common, par	$200,000	
Treasury Stock:		Preferred, par	100,000	$300,000
Common	50,000	Unrealized Surplus from Appraisal		100,000
		Earned Surplus		50,000
	$450,000			$450,000

This reflects the use of $150,000 of assets (cash) and the elimination of Paid-in Surplus $100,000 and of Surplus from Surrender of Shares $50,000.

Assume, as the next of a series of nearly simultaneous transactions, that in accordance with Section 41(c) a stock dividend payable in common stock is declared from and to the extent of unrealized surplus from appraisal. The resulting balance sheet would be:

V

Net assets other than Treasury Stock	$400,000	Capital Stock:		
		Common, par	$300,000	
Treasury Stock:		Preferred, par	100,000	$400,000
Common	50,000	Earned Surplus		50,000
	$450,000			$450,000

A dividend could not now be declared from Earned Surplus because such declaration would reduct Net Assets below stated capital. Net Assets are now exactly equal to stated capital.

It would seem from this analysis that in order for Section 41(a) to become effective in accomplishing its intended purpose it is necessary in some cases to exhaust all classes of surplus other than earned surplus. It is difficult to believe that this is the type of procedure or the method of safeguard which the authors of the act contemplated with respect to the use of earned surplus as a measuring stick for the acquisition of treasury stock. Should not Section 41(a), then, be modified if the type of safeguard is desired which it seems the act was intended to create?

HIRAM T. SCOVILL*

CIVIL PRACTICE ACT CASES

COURTS—APPELLATE JURISDICTION—WHETHER OR NOT ILLINOIS SUPREME COURT HAS JURISDICTION OF APPEAL TAKEN IN CASE WHERE CLAIMS INVOLVING A FREEHOLD ARE COMBINED WITH SEPARATE MONETARY DEMANDS—In *Borman* v. *Oetzell*[1] the plaintiff combined a claim in equity to set aside certain deeds to land with an action at law against a notary public to recover damages for alleged false certificates of acknowledgment placed thereon by such official. Upon motion of the notary public, that part of the complaint stating the law action was dismissed for failure to state a cause of action. The balance of the proceeding was eventually heard, but the chancellor

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1 382 Ill. 110, 46 N.E. (2d) 914 (1943).

found for the remaining defendants because of plaintiff's failure to maintain the burden of proof. Plaintiff appealed directly to the Illinois Supreme Court from both such rulings on the ground that a freehold was involved. After deciding that the equity claim was unsupported and that the decision thereon had to be affirmed, that court then transferred the appeal insofar as it concerned the claim against the notary public, to the appropriate appellate court on the ground of a lack of jurisdiction to pass on the issues raised thereby.

While the Illinois Civil Practice Act permits the joinder of distinct claims in one suit, whether against different parties or whether the several claims be of different nature,[2] still it should not be assumed that, when so joined, the suit proceeds as if but one cause existed. Not only should the several claims be stated in separate counts,[3] but separate trials may be required thereon, particularly if a jury trial has been demanded on the legal issues which may have been combined with equitable ones.[4] Separate judgments, moreover, may be granted on the several claims, either at the same time or at different times.[5] The act is, therefore, carefully designed to preserve the identity of the several claims, and the trial court, even though it hears the causes collectively, should likewise observe such distinctions.

Since the jurisdiction of the reviewing courts in Illinois is restricted and direct appeal may be taken only to the appropriate tribunal, it would follow that the mere consolidation of separate claims in one suit should not authorize a different method of review than would be permitted if the claims had been presented in separate actions. In *Antosz* v. *Goss Motors, Inc.*,[6] it was held that a combination of independent monetary demands by separate plaintiffs could not be aggregated so as to produce the jurisdictional amount required for review by the Illinois Supreme Court. In the instant case it has now been determined that the fact of a combination of a claim involving a freehold, upon which a direct appeal to the Supreme Court would lie,[7] with a separate monetary demand confers no jurisdiction on that tribunal over the latter claim merely because it happens to be litigated in the same suit.[8] The court also indicated that, since the original record cannot be in two places at the same time, the appellant should secure a certified copy of so much of the record as related to the cause being transferred and use that in place

2 Ill. Rev. Stat. 1941, Ch. 110, § 168.

3 Ill. Rev. Stat. 1941, Ch. 110, § 167 (1) and § 259.11.

4 Ill. Rev. Stat. 1941, Ch. 110, § 168(1) and § 259.11.

5 Ill. Rev. Stat. 1941, Ch. 110, § 174(1).

6 378 Ill. 608, 39 N.E. (2d) 322 (1942), noted in 20 CHICAGO-KENT LAW REVIEW 174.

7 Ill. Rev. Stat. 1941, Ch. 110, § 199(1).

8 The court distinguished Kronan Building & Loan Ass'n v. Medeck, 368 Ill. 118, 13 N.E. (2d) 66 (1938), on the ground that the counterclaim therein pertained to the same subject matter and involved a freehold. Presumably, if the counterclaim involves an entirely separate transaction from the matter contained in the plaintiff's action, two appeals might be necessary if the appellate requirements for the two claims were different.

of the original record. Presumably, had separate appeals been properly taken, separate records would have been prepared.[9]

Left undecided was the question as to whether the appeal from the judgment dismissing the complaint as to the legal cause was improper as being taken too late.[10] That order was clearly a final judgment from which an appeal would lie,[11] and, since the trial court may enter several final judgments when separate claims are compounded in one suit,[12] the finality of each separate judgment so rendered should in no way be affected by the fact that the court retains jurisdiction of other claims still undecided. It would, therefore, seem to follow that the mere pendency of the other claims should have no effect on the operation of the statute regulating the time of taking an appeal. Section 50(2) of the Illinois Civil Practice Act, in fact, expressly provides that: "Any party aggrieved by any such judgment may have a review thereof as herein provided, even though said cause remains undisposed of as to other parties."[13] As a consequence, it would seem that the delay attendant upon the determination of the other issues in the case might well defeat the transferred appeal in the instant case, or any other appeal taken under similar facts.

W. F. ZACHARIAS

CREDITORS' SUIT—STATUTORY PROVISIONS—WHETHER STATUTORY PROVISION FOR CITATION TO DISCOVER ASSETS ABOLISHES JUDGMENT CREDITOR'S RIGHT TO RESORT TO A CREDITOR'S BILL—After judgment had been obtained in a suit for the enforcement of the constitutional liability of a bank stockholder, and after execution on such judgment had been returned unsatisfied, a new proceeding was begun by the successful plaintiff in the former suit in the form of a creditor's bill to set aside certain allegedly fraudulent conveyances all in conformity with the Chancery Act.[1] Defendant moved to dismiss such suit on the ground that Section 73 of the Illinois Civil Practice Act, as supplemented by Rule 26A of the Illinois Supreme Court,[2] had provided a specific remedy in the nature of a citation to discover

9 Ill. Rev. Stat. 1941, Ch. 110, § 259.36 provides for a praecipe in which appellant shall designate "what parts of the trial court records are to be incorporated in the record on appeal." Separate praecipes would seem essential, particularly in the case of simultaneous appeals.

10 Since the Illinois Supreme Court transferred the appeal on that issue, it properly refrained from passing thereon for, lacking jurisdiction, it would lack authority to decide that point.

11 Though decision on the motion striking the pleading would not be final, Hayes v. Caldwell, 10 Ill. (5 Gilm.) 33 (1848), the judgment dismissing the suit would be.

12 Ill. Rev. Stat. 1941, Ch. 110, § 174(1).

13 Ill. Rev. Stat. 1941, Ch. 110, § 174(2). Though apparently designed to cover the situation of separate parties, as in the instant case, no apparent reason exists for not applying the same rule when the parties are the same but the claims are separate.

1 Ill. Rev. Stat. 1941, Ch. 22, § 49.

2 Ill. Rev. Stat. 1941, Ch. 110, § 197 and § 259.26A.

assets, which remedy should have been resorted to as the sole and exclusive one. The trial court sustained such motion and dismissed the suit, but such judgment was reversed, in *Barrett* v. *Daly*,[3] when the Illinois Appellate Court for the First District held that the remedies were cumulative, particularly since the legislature had, by apt language, indicated an intention not to make the new remedy of citation to discover assets displace other methods provided by law.[4]

A creditor's bill was a proceeding known to the ancient equity practice[5] and would, therefore, be a part of the law of Illinois, even in the absence of a statutory enactment expressly adopting the common law of England.[6] To avoid any doubt on this score, Section 49 of the Chancery Act was adopted which, with its predecessors,[7] reiterated a description of the creditor's bill as it existed in former day and expressly sanctioned its use. Such statute must have been well-known to the legislature when, in 1941, it amended the Civil Practice Act so as to make the remedy of supplemental citation proceedings, long available in the Municipal Court of Chicago,[8] equally available in the other courts of record in the state. Repeal by implication is not favored in Illinois,[9] and the Civil Practice Act itself expressly declares that it shall not apply to actions regulated by special statute.[10] It is not surprising, therefore, to find that the two remedies were held to be cumulative.

Even if this were not enough to preserve the remedy of the creditor's bill, it might be noted that Section 49 of the Chancery Act was modified subsequent to the adoption of the Civil Practice Act[11] by making minor changes in the language thereof to conform to the new terminology of the reformed procedure. At that time the legislature might well have destroyed the remedy had it seen fit to do so. Further evidence of legislative intent not to destroy former remedies, unless expressly so stating, may be found in the fact that, in 1936, it was decided that a stockholder's liability suit was a cumulative and additional remedy to those provided by the statute regulating banks and

[3] 319 Ill. App. 169, 48 N.E. (2d) 717 (1943).

[4] Ill. Rev. Stat. 1941, Ch. 110, § 197(1), reads: "This Act shall not be deemed to affect the enforcement of judgments or decrees or proceedings supplementary thereto, by any methods now or hereafter provided by law."

[5] Ballentine v. Beall, 4 Ill. (3 Scam.) 203 (1841); W. G. Press & Co. v. Fahy, 313 Ill. 262, 145 N.E. 103 (1924).

[6] Ill. Rev. Stat. 1941, Ch. 28.

[7] Ill. Rev. Stat. 1941, Ch. 22, § 49, appears to be a consolidation of R. S. 1845, p. 97, §§ 36-7.

[8] Ill. Rev. Stat. 1941, Ch. 37, § 424.

[9] Cadwallader v. Harris, 76 Ill. 370 (1875); People v. West Englewood Trust & Sav. Bank, 353 Ill. 451, 187 N.E. 525 (1933).

[10] Ill. Rev. Stat. 1941, Ch. 110, § 125.

[11] The effective date of the Civil Practice Act was January 1, 1934: Ill. Rev. Stat. 1941, Ch. 110, § 218. The Chancery Act, § 49, was amended June 27, 1935: Laws, 1935, p. 248.

banking.[12] The instant decision, therefore, merely applies the same reasoning to the use of the creditor's bill, although the contrary view might be held elsewhere.[13]

Any decision other than the one rendered in the instant case would have been most unfortunate, for while the citation proceeding under Section 73 of the Civil Practice Act may serve to discover assets in the hands of the judgment debtor or in the hands of third persons so as to be subject to attachment or garnishment, it would prove futile against fraudulent conveyances, transfers in trust, and the like. Relief against the latter must necessarily still be had through the use of the creditor's bill. While the Civil Practice Act covers a large field, it does not, and should not, supersede any of the specific statutory remedies which may exist at the same time.

G. MASCHINOT

12 Elkin v. Diversey Trust & Savings Bank, 363 Ill. 160, 1 N.E. (2d) 844 (1936).

13 That such is not the universal rule is indicated by the fact that Pennsylvania has a statute providing that statutory remedies are exclusive of all others. See Act of March 21, 1806, Pa. Laws 558, § 13, 46 Pa. Stat. § 156, and Bickley v. Pennsylvania Public Utility Commission, 148 Pa. St. 399, 25 A (2d) 589 (1942). Idaho and Nevada, on the other hand, presume that a statutory remedy for a previously existing one is cumulative, but the legislative intent is held controlling and will be inquired into: Blaine County Canal Co. v. Hansen, 49 Ida. 649, 292 P. 240 (1930); Seaborn v. First Judicial District Court, 55 Nev. 206, 29 P. (2d) 500 (1934). In Maine and North Carolina, procedures established by specific statutes are held to exclude the common law remedies: Jameson v. Cunningham, 134 Me. 134, 183 A. 131 (1936); Rigsbee v. Brogden, 209 N.C. 510, 184 S.E. 24 (1936).