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United States Steel Bond Conversion

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THE UNITED STATES STEEL BOND CONVERSION.

The litigation growing out of the plan of the United States Steel Corporation to retire $200,000,000 of its preferred stock by issuing bonds therefor has involved many interesting questions under the New Jersey law.

The corporation was formed in 1901 with a capital stock of $1,100,000,000. Of this a little over $500,000,000 preferred stock, "entitled to receive, and the corporation bound to pay," 7 per cent. cumulative dividends, payable quarterly, beginning April 1, 1901, was issued. The act of 1896, under which the corporation was formed, provided that such a corporation might decrease its stock "by purchase at not above par certain shares for retirement"; also that it might purchase such personal property as its business might require. The articles of association also authorized the corporation to issue its bonds in payment for property purchased or acquired, or "in or about its business," and secure them by mortgage upon its property.

March 28, 1902, an act was passed providing: "When the consent of two-thirds in interest of each class of stockholders present in person or by proxy," at a meeting called for the purpose, a corporation "that shall have continuously declared and paid dividends at such rate on such preferred stock for the period of at least one year next preceding the meeting," and whose assets, after deducting the indebtedness, shall be at least equal to the preferred stock, may redeem the same out of bonds or the proceeds thereof, bearing 5 per cent. interest.

April 1, 1902, the directors voted to accept the act of 1902, and to retire $200,000,000 of the preferred stock "to the extent the holders thereof consent thereto," out of bonds to be issued therefor, and directed that a contract for that purpose be made with J. P. Morgan & Co., to become operative after the approval of the stockholders in special meeting. Preferred stockholders were given the privilege of subscribing for the bonds, and paying for them in preferred stock. If all

the bonds were not subscribed for, the bankers were to have the right to take the balance; and a syndicate was formed for that purpose, the commission for which was to be $8,000,000. A stockholders' meeting was called for May 19, 1902, the notice stating that "a syndicate, *including some directors*, which will receive four-fifths" of the commission, had been formed to further the plan. At the meeting 77 per cent. of all the shares were present. Over 76 per cent. of all and over 99 per cent. of the stock present voted for the plan.

Dissenting shareholders immediately brought suit to enjoin carrying out the plan, on the ground that the act of 1902 was a material amendment to the charter, which impaired the contract of such shareholders with the corporation, and divested them of vested rights, by placing a mortgage ahead of their preferred shares. These contentions were overruled. (*Venner* v. *U. S. Steel Corp.*, 116 Fed. R. 1012, 17 Am. & Eng. Corp. Cas. N. S. 224; *Berger* v. *U. S. Steel Corp.*, 53 Atl. 68, 17 Am. & Eng. Corp. Cas. N. S. 54, overruling the decision of the Court of Chancery, *Berger* v. *U. S. Steel Corp.*, 53 Atl. 14, 17 Am. & Eng. Corp. Cas. N. S. 36.)

In the foregoing cases the pleadings admitted the act of 1902 had been complied with. Afterwards Mr. Hodge brought suit to enjoin on the ground that this act had not been complied with in that: the dividends had not been continuously paid as required; the contract with the bankers was *void* because 15 out of 24 of the directors were interested in it; and it was not authorized by the votes of the requisite number of disinterested shares in stockholders' meeting.

As to the continuous payment of dividends, the facts showed that quarterly dividends of 1¾ per cent. had been paid four times,—the first for the quarter beginning April, 1901, declared July 2, 1901, and paid August 7, 1901; the last for the quarter ending March 31, 1902, declared April 9, 1902, paid May 15, 1902. The meeting was called for May 19,—this was 44 days less than one year after the first quarterly dividend was *declared*, and 80 days less than a year after it was *paid*. On these facts the lower court held that dividends at the rate of 7 per cent. had not been declared and paid *continuously* for a year, and that, if the dividends were

payable yearly, at least *two* such dividends must be paid; if payable half-yearly, at least *three* would be required; and, if *quarterly*, at least *five*, etc. This was overruled by the Court of Errors and Appeals, holding that "dividends at the rate of 7 per cent. must be paid for a continuous period of one year, so that, where dividends are paid quarterly, a quarterly dividend cannot be passed without losing the benefit of the act." (*Hodge* v. *U. S. Steel Corp.* 54 Atl. 1, February 18, 1903, overruling *Hodge* v. *U. S. Steel Corp.*, 53 Atl. 601, 17 Am. & Eng. Corp. Cas. N. S. 485.)

The other points noted above and of more general interest were not passed on by the Court of Chancery, but the Court of Errors and Appeals held: 1. That directors cannot lawfully enter into any contract, in the benefit of which even one of their number participates, *without the knowledge and consent of the stockholders*. This is the general rule. (3 *Clark & M. Corp.*, §§ 758–760; *Taylor*, 5th ed., §§ 627–629; 3 *Thompson*, §§ 4059–4066; *Stewart* v. *Lehigh Valley R.R.*, 9 Vr. 505; *Traction Co.* v. *Board of Works*, 27 Vr. 431.)

2. That such a contract, however, is not *void*, but only *voidable* at the option of shareholders, when they have notice of the interests of the directors, and, *a fortiori* when the contract is between the directors and stockholders, or when the shareholders expressly authorize the directors to enter into the contract, with notice of their interest, it is unassailable, without actual fraud. This accords with the general rule also. (3 *Clark & M. Corp.*, § 761; *Taylor*, 5th ed., § 630; 3 *Thompson*, § 4061; *Twinlick Oil Co.* v. *Marbury*, 91 U. S. 587, 2 Keener's Cas. Corp. 1510, 2 Wilgus Cas. Corp. 1750; *Munson* v. *Syracuse, etc., R.R. Co.*, 103 N. Y. 58, 2 Keener, 1519, 2 Wilgus, 1753; *Singer* v. *Salt Lake, etc., Co.*, 17 Utah, 143, 70 Am. St. R. 773, 53 Pac. 1024; *New Memphis Gas L. Co. Cases*, 105 Tenn. 268, 80 Am. St. R. 880, 60 S. W. 206; *Graham* v. *Carr*, 130 N. C. 271, 41 S. E. 379.) There are some holdings to the contrary (3 *Thompson*, § 4060).

3. Shareholders are charged with notice of those things which they could ascertain by reasonable inquiry, when their attention has been called to any fact that would ordinarily induce investigation. In this case the notice calling the share-

holders' meeting stated that *some of the directors* were interested in the contract with the syndicate. *Held*, that this was sufficient to put the shareholders upon inquiry as to how many directors were interested and to what extent. This is the general rule. (*Gale* v. *Morris*, 3 Stew. 285; *Haslett* v. *Stephany*, 10 Dick. 68; *Phosphate Lime Co.* v. *Green*, 7 C. P. 43; *Doran* v. *Dacey*, 5 N. Dak. 167, 57 Am. St. R. 550; *Wishard* v. *Hansen*, 99 Ia. 307, 61 Am. St. R. 238.)

4. In this case the plan to retire the stock did not receive a two-thirds vote, without counting the shares of those interested in the syndicate. *Held*, that in the stockholders' meeting the directors were entitled to vote upon the resolution not in their fiduciary capacity, but solely in the right of the shares of stock held by them. They had a right to be influenced by what they conceived to be for their own interest, and they cannot lawfully be denied that right, nor can it be limited or circumscribed by the fact that they occupied the position of directors in the company. The court did not rely particularly upon the express provision of the by-laws that contracts in which the directors were specially interested could be ratified by a majority of shareholders. The rule applied is fully sustained by the authorities. (*Leavenworth* v. *Chicago Ry. Co.*, 134 U. S. 688; *Nye* v. *Storer*, 168 Mass. 53; *Bjorngaard* v. *Goodhue Co. Bank*, 49 Minn. 483, 2 Wilgus Cas. Corp. 1596; *Shaw* v. *Davis*, 78 Md. 308, 28 Atl. 619; *Grant* v. *United Kingdom Ry. Co.*, 40 Ch. D. 135; *Beatty* v. *N. W. Trans. Co.*, L. R. 12 App. Cas. 589, 12 Can. Sup. Ct. 598, 11 Ont. App. 205, 6 Ont. 300; *Windmuller* v. *Stand. Dist., etc., Co.*, 114 Fed. R. 491. Compare *Gamble* v. *Water Co.*, 123 N. Y. 91; *Gage* v. *Fisher*, 5 N. Dak. 297, 31 L. R. A. 557.)

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