ALTERATIONS OF ACCRUED DIVIDENDS: I

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WHEN[1] a preferred stock has cumulative dividends and the dividend period passes without payment, the dividend is said to "accrue." The meaning of the term "accrued" has been the subject of much inquiry. Since a stockholder cannot sue for an accrued dividend for the same reasons that he cannot sue for any other undeclared dividend, the term clearly does not mean what it does in the law of debt, i.e., that a cause of action has arisen.[2] It means only that no dividend can be paid on the common stock until that dividend has been paid on the preferred stock. Thus, if a preferred stock provides that a 7% cumulative dividend shall accrue on January 2 of each year, and if three years pass without payment, on the dividend date in the fourth year every share of preferred is entitled to $28 instead of $7 before any payment can be made to the common stock. Hence, accrued dividends are a measure of the preferred stock's priority over the common stock, and nothing more.[3] A preferred stock with dividends accu-

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1 For general discussion of the power to affect accrued dividends by charter amendment, see: Curran, "Minority Stockholders and the Amendment of Corporate Charters," 32 MICH. L. REV. 743 at 775 (1934); Kohler, "Elimination or Adjustment of Accrued Dividends on Cumulative Preferred Stock Issued by a Tennessee Corporation," 18 TENN. L. REV. 254 (1944); Schmidt, "Constitutional Limitations upon Legislative Power to Alter Incidents of the Shareholder's Status in Private Corporations," 21 ST. LOUIS L. REV. 12 at 21 (1935); notes: 52 HARV. L. REV. 1331 (1939); 4 UNIV. NEWARK L. REV. 323 (1939); and 46 YALE L.J. 985 (1937); comments: 1 MD. L. REV. 254 (1937); 16 ST. JOHN'S L. REV. 230 (1942).

The periodical literature on accrued dividends is very large. Other articles are cited in the succeeding notes, in connection with specific points. I have previously written an article on the subject: "The Power To Remove Accrued Dividends By Charter Amendment," 40 COL. L. REV. 633 (1940). Many new cases, as well as much non-judicial material, have appeared in the meantime, but the stream of cases from the last depression seems to be drawing to its end, and it is a good time to review all the subject matter in light of the whole experience.

The following material has come to my attention since this article was written, and has accordingly not been taken into account: Burstein, "The Elimination of Accumulated Dividends," 28 BOST. UNIV. L. REV. 173 (1948); Lattin, "A Primer on Fundamental Corporate Changes," 1 WEST. RES. L. REV. 3 (1949); Walter, "Fairness in State Court Recapitalization Plans—A Disappearing Doctrine," 29 BOST. UNIV. L. REV. 453 (1949); comments: 45 MICH. L. REV. 183 (1946); 47 MICH. L. REV. 81 (1948); and 48 MICH. L. REV. 657 (1950).

2 But see New England Trust Co. v. Penobscot Chemical Fibre Co., (Me. 1946) 50 A. (2d) 188, holding that preferred stockholders could maintain an action to recover accrued dividends. It seems doubtful that other courts will follow this construction of the contract. Moreover, a corporation usually lets dividends accrue because there are no earnings to pay them. No action would lie in such circumstances.

3 In the periodical articles, I have found only one writer who asserts that there is a qualitative difference between accrued dividends and the dividend rate. Meck, in "Accrued

mulated, is only a stock that has an extraordinarily high rate of preferred dividend due it before payments can be made to the common stock. As a matter of legal analysis, then, it seems that an accrued dividend is not different from a dividend rate, and that an amendment changing or removing it is not different in kind from one reducing a dividend rate. If this be true, the problems presented by accrued dividends are not different legally from those, say, presented by amendment of the dividend rate.

These reflections, though they may be persuasive, have not prevailed with the courts. On the contrary, judges have, from the first, regarded accrued dividends as sui generis, unlike the other property interests of the stockholder.[4] The early decisions show, in consequence, extreme judicial reluctance to permit any tampering with them; and the subsequent cases reveal a continuous search by corporations for means to avoid the earlier ones—a search so successful that it may be said that accrued dividends are no safer, now, than dividend rates are, although the old conception of their unique legal status still persists. Of this result it may be said that since the two are alike in nature it is proper for the law to treat them alike. However, the peculiar conception of the nature of accrued dividends has made it necessary to achieve equality of treatment by devious methods, and from this fruitful soil, tilled by many workers, has grown the amazing structure of case and statute law which now surrounds them.

1. Construction of Statutes and Charter Provisions

It is seldom that a corporation has contended that there was express authority in the charter or statutes to alter or remove accrued dividends. The attack on them has more often taken the route of issuing a prior

Dividends on Cumulative Preferred Stocks: The Legal Doctrine," 55 HARV. L. REV. 71 (1941), states at p. 77, that the present right to accrued dividends is one of substance, immediately enforceable against the common stock, and therefore is different from the right to future dividends. But it seems that this assumes there is power to reduce or remove the dividend rate of the preferred stock in the future. Such an assumption is doubtful, unless we take into account the fact that the majority can force a dissolution, and so end the right to dividends for all classes. But the amendment presupposes that a dissolution is not intended; moreover, if we allow dissolution to control, there is nothing that the majority could not do as a bargain for its not dissolving. The periodical writers generally, both before and after Professor Meck, seem to take the view that accrued dividends are not different in kind from others. See note, 46 YALE L.J. 985 (1937), at pp. 987 and 989; Latty, "Fairness—The Focal Point in Preferred Stock Arrearage Elimination," 29 VA. L. REV. 1 at 3-4 (1942).

Concerning the nature of accrued dividends for accounting purposes, see note, 16 TEMPLE L.Q. 416 (1942).

[4] Thus, in an early case, Branch v. Jesup, 106 U.S. 468 at 475, 1 S.Ct. 495 (1882), the Supreme Court stated in dictum, concerning a "guaranteed" stock: "Their stock is a preferred stock, it is true, entitling them to interest on its face before any dividends can be

made to the common stockholders. But this is not inconsistent with its being stock. It is a very common thing in this country to issue stock of this kind. The interest accruing thereon is in the nature of a preferred dividend, and is sometimes so called. Though after it has accrued it may become a debt, so also does a dividend become a debt after it has been declared and has become payable. It has no priority over other debts, if, indeed, it has an equality with them."

In Roberts v. Roberts-Wicks Co., 184 N.Y. 257 at 263-4, 77 N.E. 13 (1906), the court of appeals said, in speaking of dividends accrued on an issue of preferred stock: "Now this was as much an agreement of the common stockholders, as it was the agreement of the corporation and the right of the preferred stockholder was inviolable. It assured to him, in effect, that if the corporate earnings failed to show surplus profits sufficient to pay a dividend due on the preferred stock, to the extent of the default in payment and of the accruing interest thereon, there would be a specific charge upon all subsequent surplus profits gained by the company. In other words, the dividends agreed to be paid upon such shares of stock were a charge upon the profits of the company for all time and all arrears of such dividends, with accrued interest, were to be paid out of any moneys applicable to such payment before any payment should be made to the common stockholders." A little later the court said at pp. 264-5: "The preferred stockholders, as the result of the reduction of capital stock, would hold a less number of shares; but they would still be creditors for the arrears of dividends due by the company on the shares of preferred stock, which they had previously held. They may not have been creditors of the corporation, in a technical sense; but, as between themselves and other stockholders, they were as creditors, with demands to be fully paid certain arrears of dividends before any of the surplus profits should be appropriated to a dividend upon the common stock. The common stockholders held their shares of stock subject to that prior charge upon the net earnings. No acts of theirs could destroy that right and it, of course, in no wise, depended upon any declaration of the board of directors." For discussion of the decision in this case, see infra p. 381.

On the other hand, judicial opinion to the contrary is not wanting. Judge L. Hand, dissenting in part, in Harr v. Pioneer Mechanical Corp., (2d Cir. 1933) 65 F. (2d) 332 at 336 said: "Personally I should not have thought that the cumulative dividends conferred any 'vested' rights, whatever that much abused word may mean. They seem to me to be no more than a right to an increased dividend when any is declared, or at least when there are earnings. But like my brothers I yield on that to the Delaware courts, which have considered them as creating present rights." For discussion of the decision in this case see infra p. 383.

The Delaware court has consistently held that accrued dividends are different from the other rights of the stockholders. For example, in Penington v. Commonwealth Hotel Construction Corp., 17 Del. Ch. 394, 155 A. 514 (Sup. 1931), reversing on this point 17 Del. Ch. 188, 151 A. 228 (Ch. 1930), the charter provided that the preferred stock should receive par and "all unpaid dividends accrued thereon," on liquidation, before there could be any distribution to the common stock. The court held that the preferred stock was entitled to par and accrued dividends upon liquidation, even though it had a capital deficit and had not earned any dividends. The decision rests in part on the following definition of the term "accrued": "The learned Chancellor in his attempt to find the meaning of the word 'dividend' correctly seeks also to find the reason for the inclusion of the word 'accrued' he correctly considers that 'accrued' must mean something beyond 'unpaid.' 'Accrued' is not synonymous with 'unpaid' and does not cover the same field for a dividend may have accrued and not be unpaid. The word 'accrued' itself is derived from the Latin—*add* and *cresco*—to grow to—and in such a context as that under consideration and construed with the word 'thereon,' it means these claims for dividends that have grown to the par value of the stock and matured and become due by the passage of time by virtue of the provisions of the certificate of incorporation creating the cumulative and preferred rights." 17 Del. Ch. 394 at 403, 155 A. 514 (1931).

But recent decisions have shown an increasing dislike for the traditional conception of the accrued dividend. See the attack on the vested rights terminology in Davison v. Parke, Austin & Lipscomb, Inc., 285 N.Y. 500, 35 N.E. (2d) 618 (1941), in McNulty v. W. & J. Sloane, 184 Misc. 835, 54 N.Y.S. (2d) 253 (1945), and in Western Foundry Co. v. Wicker, 403 Ill. 260, 85 N.E. (2d) 722 (1949).

stock, and, perhaps, of altering other characteristics of the old stock so that its holders would be willing to exchange it; in such cases there is no need to assert power over the accrued dividends directly. In the few cases which have considered the question, the courts have held, almost unanimously that the language appealed to did not authorize direct action against accrued dividends. Thus, the Delaware court, in *Keller v. Wilson & Co.*,[5] after holding that accrued dividends were a vested right, not removable under the state's reserved power, went on to hold that as a matter of construction, the statute, authorizing the amendment of the "preferences, or relative, participating, option or other special rights of the shares," did not permit the destruction of accrued dividends:

> ". . . It authorizes nothing more than it purports to authorize, the amendment of charters. The cancellation of cumulative dividends already accrued through passage of time is not an amendment of a charter. It is the destruction of a right in the nature of a debt, a matter not within the purview of the section. . . . there is nothing in the language of the section, as amended, which compels a retrospective operation."[6]

The court reiterated its position in *Consolidated Film Industries v. Johnson.*[7] Meanwhile the Second Circuit Court of Appeals had held, with one judge dissenting, that the same section authorized amendments affecting accrued dividends:

> ". . . Whatever rights may be possessed under Delaware law by these plaintiffs in respect to dividends already called past due, they must be included within the language of the amended and applicable statute, for they cannot help but come within the scope of 'relative, participating, optional, or other special rights of the shares.' They may now therefore be altered as were the preferences considered in the Morris Case, and accordingly the injunction was properly denied. Those who see fit to become or to remain stockholders in a Delaware corporation can but weigh whatever seems to be the advantage against that which appears to them otherwise and strike the balance."[8]

A federal court has also held that the Maryland statutes authorize removal of accrued dividends.[9] The Delaware court in the *Keller* case,

[5] 21 Del. Ch. 391, 190 A. 115 (Sup. 1936).
[6] Id. at 413.
[7] 22 Del. Ch. 407, 197 A. 489 (Sup. 1937).
[8] Harr v. Pioneer Mechanical Corp., (2d Cir. 1933) 65 F. (2d) 332 at 335.
[9] McQuillen v. National Cash Register Co., (4th Cir. 1940) 112 F. (2d) 877, affirming (D.C. Md. 1939) 27 F. Supp. 639.

indicating its disapproval of the construction of its statute in the *Harr* case, said:

> "By inference it may be said that the Legislature intended the amendment to operate retrospectively, but with deference to the views of the learned Judges who are of contrary opinion, we think that if rights in the nature of a debt are to be destroyed by corporate action under subsequent legislation, the purpose and intent of the Legislature to give its enactment a retroactive operation and thus to destroy those rights, should be expressed in language so clear and precise as to admit of no reasonable doubt. It is one thing to confer a general power to accomplish a purpose in the future. It is quite another thing to say that the power may be exercised to destroy a right accrued and recognized as a vested right of property."[10]

On grounds hardly distinguishable from these opinions of the Delaware court, the North Carolina court has also held that language not mentioning accrued dividends by name did not authorize their removal.[11] The New York Court of Appeals in *Davison v. Parke, Austin & Lipscomb, Inc.*,[12] reached the same result, holding that its elaborate reclassification act did not authorize interference with accrued dividends, expressing in the process its dislike for the "vested rights" analysis. Referring first to the *Roberts* case,[13] one of its own early decisions which compared accrued dividends to debts, the court said:

> ". . . So it seems that only confusion results from saying that 'vested rights' are not within the contemplation of the statute. All preferential rights of stockholders are in a sense vested. They are all property rights founded upon contract. . . .
>
> "With regard to the preferential rights here in question the intention of the Legislature is manifest in its failure expressly to provide that these rights may be taken away without the consent of each stockholder. An earlier statute which did not clearly specify which preferential rights of preferred stockholders could be altered was held, in *Roberts v. Roberts-Wicks Co.* . . . not to cover an amendment which would deprive preferred stockholders of accrued dividends. When the Legislature enacted the present statute, it must have known of the holding in that case. Its fail-

[10] 21 Del. Ch. 391 at 414, 190 A. 115 (1936).

[11] Patterson v. Durham Hosiery Mills, 214 N.C. 806, 200 S.E. 906 (1939); Patterson v. Henrietta Mills, 216 N.C. 728, 6 S.E. (2d) 531 (1940).

[12] 285 N.Y. 500, 35 N.E. (2d) 618 (1941). See comments: 19 N.Y. UNIV. L.Q. REV. 196 (1942); 16 TEMPLE L.Q. 93 (1941); note: 26 MINN. L. REV. 387 (1942).

[13] Roberts v. Roberts-Wicks Co., 184 N.Y. 257, 77 N.E. 13 (1906), discussed supra note 4.

> ure to provide specifically that corporations issuing shares entitled to cumulative dividends could alter without the consent of each such stockholder the preferential right of preferred stockholders to be paid accrued dividends seems conclusive that no such power was intended to be conferred."[14]

This decision produced an amendment of the New York act, so that it provided for:

> ". . . The creation, alteration, or abolition, in whole or in part, of designations, preferences, privileges or voting powers of any shares previously authorized, . . . (including the creation, alteration or abolition of any provisions or rights in respect of . . . (b) any cumulative or non-cumulative dividends, whether or not accrued, which shall not have been declared. . . .)"[15]

In *McNulty v. W. & J. Sloane*,[16] the court held that this language authorized the removal of accrued dividends, even when they had accrued before the statute was passed.

The state court decisions considered thus far have unanimously held that the only language authorizing removal of accrued dividends

[14] 285 N.Y. 500 at 509-10, 35 N.E. (2d) 618 (1941). Compare Harbine v. Dayton Malleable Iron Co., 61 Ohio App. 1, 22 N.E. (2d) 281 (1939), in which the court, holding that the statute did not authorize interference with accrued dividends, said at pp. 12-13: "We have difficulty in following the designation 'has a vested interest.' However, by whatever name known, it is an existing, substantial right, and has a prospective value."

[15] The statute is quoted in full in a footnote to the opinion in the McNulty case, 184 Misc. 835 at 837, footnote 1, 54 N.Y.S. (2d) 253 (1945).

[16] 184 Misc. 835, 54 N.Y.S. (2d) 253 (1945).

A recent decision of the Chancery Division in New Jersey has given the same construction to a similar statute of New Jersey. In Franzblau v. Capital Securities Co., 2 N.J. Super. 517, 64 A. (2d) 644 (Ch. Div. 1949), the plaintiff held shares of a $30 par value, 7% cumulative preferred, on which $36.22½ had accumulated. This stock, with its accrued dividends, was compulsorily converted share for share, for a $50 par value, 5% preferred, and $2.50 in cash. A statute in force when the corporation was chartered, authorized ". . . funding or satisfying rights, in respect to dividends in arrears by the issuance of stock therefor or otherwise." (p. 524) The court held that this statute empowered the majority to make the change, distinguishing several prior decisions because the statute was subsequent to the charters in those cases. The effect of the amendment was to raise the annual dividend from $2.10 per year to $2.50 per year, but the par value and the cash received in the exchange totalled $13.72½ less than the old stock and its accrued dividends. The court held that this was more than offset by the advantages of holding a stock unencumbered by accrued dividends, especially since 86% of the corporation's gross assets were invested in an office building, which could bring in substantial income only if the demand for real estate continued. It also relied upon the large proportion of stockholders who voted for the amendment. The plaintiff's claim that the amendment disturbed his rights in the corporation's surplus was dismissed on the ground that the surplus resulted from an amendment of 1932 which reduced the par value of the common stock from $10 per share to $1 per share, and was not represented by cash or liquid securities. The court finally declared that consideration of the fairness of the plan was unnecessary, in view of the statute, and that it had considered the question only in order to clear the directors of the charge of unfairness.

is that which expressly describes them by that name, while the only cases reaching the other result — the *Harr* and *McQuillen cases* — were decisions of federal courts, and of these two, the *Harr* case has since been repudiated by the highest court of the state. The only exception to this generalization appears in the recent Illinois case of *Western Foundry Co. v. Wicker*,[17] in which the court held that accrued dividends could be removed under a charter provision which authorized changes in the "rights and preferences," with a proviso that "preferences" could not be changed without consent of the holders of two-thirds of the shares. Since the necessary majority had voted for the amendment in this case, the court permitted the removal of the accrued dividends, on the ground that they were included in the term "preferences."[18] It thus appears that the great majority of decisions protects accrued dividends from direct attack, except when explicitly described —a result that could be expected from the early cases elevating accrued dividends above the other interests of the stockholder.

2. *Constitutionality of Statutes Authorizing Interference With Accrued Dividends*

Like the alteration of a dividend rate, the removal or reduction of accrued dividends will shift existing surplus and prospective earnings from one class to another unless some other provision of the amendment prevents it.[19] Interference by the state with private property can be justified only under eminent domain, of which there is no question in these cases, or on the ground that the public interest warrants it. What happens, then, when dividends accrue on the preferred stock of a private corporation, that justifies the state in authorizing a majority to remove them? Can the state have any legitimate interest in changing the division of profits so that one class loses the priority which it has over the other? It seems on first thought that this is exactly the type of situa-

[17] 403 Ill. 260, 85 N.E. (2d) 722 (1949).

[18] The opinion contains a review of the American cases, and relies heavily on English authorities.

The decision, resting as it does upon the provisions of a single charter, yet has implications for Illinois corporations generally. The present Illinois Corporation Act, which dates from 1933, provides that "preferences . . . and the special or relative rights" of the shares may be changed by amendments. The decision of course means that it is highly probable that the word "preferences" in this statute will be held to have the same meaning that it had in the charter in the Wicker case, and that accordingly, Illinois corporations chartered since 1933 can remove accrued dividends directly. See comment, 63 HARV. L. REV. 529 (1950).

[19] The new stock or stocks which the preferred stockholders get in return for their old shares might conceivably provide for retention of all their old property interests in changed form. It is often difficult to tell whether an amendment has this effect.

tion in which, under usual (democratic-capitalist) assumptions, the state has no interest, and over which it has no power.[20] But, the unwillingness of stockholders to suffer alteration of their private rights may hamper the corporation in obtaining needed financing and the state, consequently, may suffer from a general decline in its corporate enterprise. This suggestion is obvious, but it is equally obvious that it is not proved by assertion. Since the initiative in changing property interests is coming from the majority, as authorized by the state, the state, or the majority for the state, ought to offer evidence to prove that the public interest in these matters actually does warrant the interference.

This crucial question has not been illuminated by the courts. Instead they have created a twilight zone, not so much of law as of fact, in which they can declare that the public has or has not an interest, depending on the result which they have reached. For example, the California Appellate Court, in *Blumenthal v. Di Giorgio Fruit Corp.*[21] sustained an amendment under the Delaware act, which permitted assenting stockholders to exchange their old shares for a new prior stock on condition of a release of accrued dividends. Dissenters, of course, became subject to the new issue in dividends and assets. There was no attempt to sell the new stock in order to raise money for the company. The court said:

> ". . . When the recapitalization plan was proposed in February, 1934, the company was in serious financial difficulties. The accrued and unpaid dividends on the 7 per cent stock then amounted to more than four and one-half million dollars. The actual surplus was then approximately $463,000. Neither the available assets nor the outstanding liabilities were found by the trial court, but it is conceded that the company, as owner of large tracts of agricultural properties and engaged in the production and sale of agricultural products, was caught in the whirlpool of the prevailing depression. Facing probable bankruptcy and dissolution, the directors proposed the recapitalization plan as the best method appearing to them at the time of saving the company and of saving the interests of the holders of this 7% stock. Whether some other plan might have been better is a question that is not before us. That the proposed plan has been successful to some extent is shown by the con-

[20] Here and throughout this discussion, the reader will consider the corporate reorganization cases, in which, now by statute, material changes in the claims of creditors have been permitted. The comparison of these with the amendment cases has been deferred until the conclusion.

[21] 30 Cal. App. (2d) 11, 85 P. (2d) 580 (1938).

tinued operations of the company and the payment of substantial dividends to those who accepted the plan and took the $3 preferred stock, and it is obvious from the record that the acceptance of the plan by more than 90 per cent of the holders of the seven per cent stock and by more than 97 per cent of the holders of the common stock was the one thing which made the company able to operate as it has done and able to pay any dividends."[22]

How a readjustment of the interests of the stockholders relieved the company of the risks of bankruptcy does not appear in the opinion, nor does it seem possible to deduce it from the facts. Hence, this passage is characteristic of a good many which abound in assertion but which do not, upon analysis, show why the assertion should be accepted as true. It may *be* true, but it remains unexplained, nevertheless. Again, in *Hottenstein v. York Ice Machinery Corp.*,[23] the court said:

"... As a practical matter we know that it is difficult to refinance corporate indebtedness when there are heavy arrearages of accumulated dividends outstanding. A corporation so situated reasonably may expect litigation and its concomitant miseries. Bankers are loath to float security issues under such circumstances. We are of the opinion that it is not unjust under all the circumstances of the case at bar to treat the equity of the common stockholders as being worth approximately 17% of the stock of the surviving corporation. It follows that the reclassification is fair."[24]

Here the inconvenience of accrued dividends is attributed to their tendency to stir up litigation, but it may be said, in fairness to the dividends, that the litigation generally results from attempts to interfere with them. Left alone, they are not likely to cause law suits, and the bankers' unwillingness to lend can be more reasonably attributed to the poor earnings record than to the risk of litigation. A different approach to the same end appears in the following extract from *Zobel v. American Locomotive Co.*:[25]

"... The existence of a large amount of unpaid cumulative dividends well may be, and in many instances is, detrimental to

[22] Id. at 18. The court sustained the amendment entirely under the provisions of the charter, and so no constitutional question was presented, although the court did discuss due process briefly. See Part II of this article to be published in the Feb. 1951 issue, at note 110.

[23] (3d Cir. 1943) 136 F. (2d) 944.

[24] Id. at 952-3. Again, no constitutional question was presented in this case, as the court relied upon a statute in force when the corporation was chartered.

[25] 182 Misc. 323, 44 N.Y.S. (2d) 33 (1943).

the best interests of a company, and no showing is here made which enables the court to say that that is not true in this case."[26]

Here the burden of proof is put on the stockholder to establish that the accrued dividends are not a burden on the corporation in its financing. Another court has elevated this allocation of the burden of proof to a general principle, saying that in the reorganization cases the burden is on the proponents of the plan, but that in mergers, though they affect accrued dividends, the burden is on the dissenters to show that the plan is unfair.[27] A more sceptical frame of mind is revealed in the following extract from *Davison v. Parke, Austin & Lipscomb*,[28] in which the court held that the statute did not authorize elimination of accrued dividends by compulsory exchange of the old preferred for common stock:

"The issue thus presented is today one of great importance. It is common knowledge that during the past few years many corporations have been unable to pay dividends either upon common stock or preferred stock and that large amounts of unpaid cumulative dividends, constituting as they do a first charge upon future profits, have a tendency to discourage new investment. Balanced against the desire to encourage investment, however, is the sanctity of the rights of contract. The individual preferred stock investor has bargained for certainty in his return, and may not be deprived of his bargain without express statutory authority. Solution of the problem is further complicated by the fact that any device the use of which is desirable in proper cases for the elimination of burdensome preferential rights of preferred stockholders may be used in other cases, without regard to corporate needs and for the sole benefit of common stockholders. No question has been raised here of the worthiness of the motives of the majority of the stockholders in authorizing the amendment to this certificate of incorporation."[29]

If a court wishes to enjoin an amendment, it is possible to take another view of the question of fact. Thus, in *Lonsdale Securities Corp. v. International Mercantile Marine Co.*, [30] the court held invalid a plan

[26] Id. at 325. Again, the court relied upon a statute in force when the corporation was chartered, and so no constitutional question was presented.

[27] See Hottenstein v. York Ice Machinery Corporation, (D.C. Del. 1942) 45 F. Supp. 436 at 438. The case was affirmed (3d Cir. 1943) 136 F. (2d) 944.

[28] 285 N.Y. 500, 35 N.E. (2d) 618 (1941).

[29] Id. at 506-7.

[30] 101 N.J. Eq. 554, 139 A. 50 (Ch. 1927).

which would eliminate accrued dividends on the preferred stock, saying:

"It certainly requires no argument or explanation to show that any such change as is contemplated would result in impairing the investment value of the present preferred shares, and, consequently, would materially reduce the property rights of their respective holders. It has been urged that a proper spirit would cause these complainants to relinquish their strict legal rights in the common interest of the corporation and the other stockholders. Such an argument might well be addressed to the complainants by their fellow-stockholders, but cannot be adopted by the court. It is trite to say that one may be generous with his own property, but it is scarcely generosity to deal lavishly with that of another."[31]

The same court may take one view at one time and the other at another. Thus, in *Johnson v. Lamprecht,* [32] the Ohio court, sustaining an amendment which provided for a voluntary exchange of old preferred for a new prior stock, but which did not directly attack the accrued dividends, said:

"It is claimed that the cancellation of an accumulated and unpaid dividend of a preferred holder impairs a vested right. If there is a surplus, the action usually has been enjoined. If, on the other hand, there is a need for additional capital, the corporate necessity for continued existence overshadows the claims of the minority holders to dividends. In determining the questions courts have considered both the equities and the business situation, attempted to weigh and balance them, and then decided the controversy."[33]

But eight years later, in *Wheatley v. A. I. Root Co.,* [34] the court held invalid a plan that cancelled accrued dividends under a statute subsequent to the charter, saying:

"There could be no basis for the contention in this case that the statutory provisions involved herein were enacted for or in

[31] Id. at 559.

[32] 133 Ohio St. 567, 15 N.E. (2d) 127 (1938).

[33] Id. at 573-4. There may have been grounds for sustaining the amendment on the facts, which, however, do not appear in the opinion. The court said at 575: "There were reasonable grounds for the directors and stockholders to feel that, in view of the business depression and the shrinking of the surplus, the stability of the company would be improved by a waiver of the past dividends. . . ." A little later the court said at 578: ". . . To compel the payment of all accumulated dividends before the new prior preferred stock is to be issued would cause a serious impairment of the company's reserves."

[34] 147 Ohio St. 127, 69 N.E. (2d) 187 (1946).

fact served any public purpose. The provisions of the proposed plan, insofar as they undertake a retroactive application of these statutory provisions and thus impair the contract of the preferred shareholders and thereby deprive them of the rights stipulated therein, are invalid."[35]

From these extracts it seems that the courts have two answers to the question of fact, which they can use as their views of the amendment in question dictate. It seems not out of place, then, to propose that proof, rather than supposition, should be the basis of the finding of a public interest in these cases.

Considering the number of cases involving accrued dividends, it is surprising how seldom constitutional questions concerning them have been raised. When a subsequent statute authorizes interference with them, the stockholder can claim that it impairs the obligation of his contract, and also that it takes his property in the corporation without due process of law. The argument seems to have been made in relatively few of the cases in which it could have been. The courts are divided in their answers to it. The Delaware court, in *Keller v. Wilson & Co.*,[36] the first case in which the point was fairly raised and answered, held that the reserved power did not authorize legislation interfering with accrued dividends. The amendment cancelled the old preferred stock, itself a subordinate class, and its accrued dividends, and converted it to common stock. The court first commented adversely on *Davis v. Louisville Gas and Electric Co.*,[37] a decision of the Delaware Court of Chancery, which adopted a broad construction of the reserved power and held that the state had power to authorize the reduction of dividend rates by statute subsequent to the charter. It then said:

"It may be conceded, as a general proposition, that the State, as a matter of public policy, is concerned in the welfare of its corporate creatures to the end that they may have reasonable powers wherewith to advance their interests by permitting adequate finan-

[35] Id. at 145.

[36] 21 Del. Ch. 391, 190 A. 115 (Sup. 1936). For discussion of the lower court's decision in this case, see comments: 36 COL. L. REV. 674 (1936); 30 ILL. L. REV. 388 (1935); 34 MICH. L. REV. 859 (1936); 10 TEMPLE L.Q. 86 (1935); 3 UNIV. CHI. L. REV. 327 (1936); on the decision of the Supreme Court, see comments: 17 BOST. UNIV. L. REV. 733 (1937); 31 Ill. L. REV. 661 (1937); 35 MICH. L. REV. 620 (1937); 85 UNIV. PA. L. REV. 537 (1937); notes: 3 UNIV. PITT. L. REV. 342 (1937) and 23 VA. L. REV. 579 (1937). The decision is also discussed in comments: 16 CHI.-KENT L. REV. 286 (1938); 22 CORN. L.Q. 257 (1937); 36 MICH. L. REV. 662 (1938); and note, 44 W.Va. L.Q. 125 (1938).

[37] 16 Del. Ch. 157, 142 A. 654 (Ch. 1928). The Davis case and its implications are discussed in another article of this series: Becht, "Corporate Charter Amendments: Issues of Prior Stock and the Alteration of Dividend Rates," 50 COL. L. REV. 900 (1950).

cing. It may also be conceded that there has been an increasing departure from the conception which formerly prevailed when the right of individual veto in matters of corporate government operated as a dangerous obstruction to proper functioning. But in determining whether the rights of the complainants herein are such as ought to be regarded as property rights, all aspects of the question must be considered to ascertain what is conducive to the best interests of society. The State is concerned also with the welfare of those who invest their money, the very essence of generation, in corporate enterprises. Some measure of protection should be accorded them. While many interrelations of the State, the corporation, and the shareholders may be changed, there is a limit beyond which the State may not go. Property rights may not be detroyed; and when the nature and character of the right of a holder of cumulative preferred stock to unpaid dividends, which have accrued thereon through passage of time, is examined in a case where that right was accorded protection when the corporation was formed and the stock was issued, a just public policy, which seeks the equal and impartial protection of the interests of all, demands that the right be regarded as a vested right of property secured against destruction by the Federal and State Constitutions."[38]

It will be noted that the court based its result equally on the contracts and the due process clauses. Similar results, though without such elaborate reasoning, have been reached in North Carolina,[39] the unconstitutionality being said to flow equally from both clauses.

The situation in Ohio requires special attention. The court in *Johnson v. Lamprecht*,[40] sustained an amendment providing for exchange of shares with substitution of common stock for accrued dividends, expressly on the ground that the amendment was not "compulsory," i.e., dissenters had the option of retaining their old stock. It distinguished the *Keller* case on this ground. The court also relied, in part on the ground that the plaintiffs could have had their stock appraised if they did not wish to be bound by the amendment. In *Vulcan Corporation v. Westheimer*,[41] the amendment again sought to avoid the payment of accrued dividends by exchange for new classes of stock, and the Ohio Appellate court granted the corporation a declaratory judgment that the plaintiff, having failed to apply in time for a statu-

[38] 21 Del. Ch. 391 at 412, 190 A. 115 (1936).

[39] Patterson v. Durham Hosiery Mills, 214 N.C. 806, 200 S.E. 906 (1939); Patterson v. Henrietta Mills, 216 N.C. 728, 6 S.E. (2d) 531 (1940).

[40] 133 Ohio St. 567, 15 N.E. (2d) 127 (1938).

[41] (Ohio App. 1938) 34 N.E. (2d) 278, appeal dismissed for lack of a debatable constitutional question, 135 Ohio St. 136, 19 N.E. (2d) 901 (1939).

tory appraisal, had no rights against the corporation in consequence of the amendment. On the other hand, in *Wheatley v. A. I. Root Co.*[42] in which the amendment compulsorily cancelled the accrued dividends, the court held that the state could not, under the reserved power, confer on the majority power to make the amendment, and that the plaintiff, therefore, was not bound to accept an appraisal as the measure of his rights. But the court in the *Vulcan* case seems to have construed the amendment as compulsory. It is difficult, if not impossible, to reconcile this with the *Wheatley* case. The Ohio law, therefore, subject to the doubts raised by the *Vulcan* case, seems to be that a compulsory cancellation of accrued dividends violates the contracts clause, but that a voluntary amendment, which leaves the stockholder in possession of his stock or its appraised value if he prefers, does not. This seems later to have become the law in Delaware also.[43]

The Illinois court, in *Kreicker v. Naylor Pipe Co.*,[44] seems to have indicated that a compulsory exchange with deprivation of accrued dividends might be unconstitutional, but that an optional exchange was not. It is not clear to what extent the decision rests upon the ground that the amendment could be justified under statutes in force at the time the charter was granted. Only in a lower court of New York is there a decisive opinion holding constitutional a subsequent statute authorizing removal of accrued dividends. In *McNulty v. W. & J. Sloane*,[45] the amendment appears to have been involuntary and the court sustained it. After noting that the early New York cases construed the state's reserved power broadly, the court continued:

[42] 147 Ohio St. 127, 69 N.E. (2d) 187 (1946).

[43] Shanik v. White Sewing Machine Corp., (Del. Ch. 1940), 15 A. (2d) 169, affd. 25 Del. Ch. 371, 19 A. (2d) 831 (Sup. 1941). The Delaware law had meanwhile undergone far more drastic reinterpretation. See the discussion of the Havender case in Part II of this article to be published in the Feb. 1951 issue, at note 131.

[44] 374 Ill. 364, 29 N.E. (2d) 502 (1940). See comment, 8 UNIV. CHI. L. REV. 134 (1940).

[45] 184 Misc. 835, 54 N.Y.S. (2d) 253 (1945). See comment, 20 N.Y. UNIV. L.Q. REV. 509 (1945). This case has been cited once with approval by the New York Court of Appeals, but in a case that did not involve the same issues: Anderson v. International Minerals & Chemical Corp., 295 N.Y. 343 at 351, 67 N.E. (2d) 573 (1946).

The McNulty case was followed in Arstein v. Robert Reis & Co., 77 N.Y.S. (2d) 303 (1948), sustaining a reclassification which eliminated accrued dividends. The court simply referred to the opinion in the McNulty case, in deciding the question of constitutionality. The complaining stockholder attempted to distinguish the McNulty case, on the ground that the language of the charter of his corporation made the obligation to pay accrued dividends more like the obligation to pay interest on bonds. But the court held that even if such a contract could be enforced, the language of the charter stipulating for the declaration of dividends showed that the plaintiff's rights were not different from those of conventional preferred stockholders. This decision was affirmed without opinion, 273 App. Div. 963, 79 N.Y.S. (2d) 314 (1948), leave to appeal den. 298 N.Y. 931, 81 N.E. (2d) 335 (1948), cert. den. 335 U.S. 860 (1948).

"It is obvious that the right to accumulated dividends accrued by lapse of time but not declared, is not in the nature of a debt. There is no debt until the dividend has been declared. The only effect of a provision for accumulated dividends in a certificate of incorporation is to restrict the corporation from declaring dividends on other classes of stock until the cumulative dividends have been declared and paid. This is a preferential right and a valuable one. It does not, however, give rise to a chose in action which could be alienated or devised. It is not a property right in the sense that it exists separate and apart from the certificate. . . . No preferred stockholder has a right to demand that dividends be paid him merely because a period of time has elapsed. The directors, before declaring any dividends, must take into consideration not only the earnings, but also the business needs, of the corporation.

"The contract between stockholders *inter sese* is not an unconditional contract. It is a contract subject to a condition that it may be changed or altered in the manner prescribed or authorized by the Legislature. Of course, if a right to a specific sum of money has accrued, this right would be preserved against impairment by the constitutional provision protecting property, but that is because this property right then exists separate and apart from and in addition to the contract. The very essence of the reserved power of the Legislature is to enable it to change preferential rights of the different classes of stock in a corporation. . . ."[46]

A little later the court added:

"The importance of this problem from a legal, a financial and an economic standpoint is reflected in the many scholarly articles in law reviews in recent years concerning it. The courts have realized that the problem was a knotty one and that it involved important questions of public policy. On the one hand, there was the interest of the State, in the welfare of corporations organized under its sanction, in permitting them a certain flexibility in their capital structure to meet business and financial needs; on the other hand there was the concern to protect the rights of small investors, chargeable with an unrealistic, constructive knowledge of the 'reserved power' of the Legislature.

"There was the possibility of improper domination by large stockholders to be weighed against the power of a small stockholder to force the majority to buy his stock at exorbitant prices and to threaten to use his voting rights in such a way as to injure the business of the corporation and thus impair the rights of others. There was the necessity for allowing financial rejuvenation and at

[46] 184 Misc. 835 at 842-3, 54 N.Y.S. (2d) 253 (1945).

the same time there was the realization that there might result the possible enrichment of a junior class of stockholders at the expense of a senior class. In short, the problem was one of balancing intertwining and conflicting interests and of determining what was conducive to the good of society. Such a problem, involving as it does, questions of sound public policy, is primarily for the Legislature and not for the courts.

"With the wisdom of legislation permitting the abolition of accrued cumulative but undeclared dividends the court can have no concern. That is the province of the law maker and we cannot say that there is no reasonable basis for the law that was passed.

"Differences of opinion there may reasonably exist as to whether the legislation, in the form in which it was enacted, is adequate for the purpose sought to be accomplished or whether there are sufficient safeguards surrounding a measure so fraught with danger and so susceptible to abuse. Some may say that supervision should have been given to an administrative agency; others that prior judicial approval should have been required; but these likewise are matters of legislative rather than judicial concern. The Legislature sought to guard against possible evil consequences by requiring a sufficient notice to stockholders, and a vote by the holders of record of two thirds of the outstanding shares of each class of stock and by giving dissenting stockholders the right to an appraisal of their holdings and payment for them in cash. . . . There also exists the inherent power of a court of equity, a power limited generally to the test of good faith rather than a test objective in character, a power the exercise of which may be circumscribed, because too often what is an accomplished fact is presented to the court; but it is a significant, restraining influence nevertheless. . . ."[47]

The court also held that the statute should be construed as authorizing interference with dividends which had accrued before it was passed:

"In construing a statute, moreover, great weight is given to the purpose that it is intended to accomplish. The amendment was designed to relieve the plight in which many corporations found themselves through the accumulation, in the course of many years, of substantial amounts of accrued but undeclared dividends. A cumulative dividend which has accrued is, as a matter of definition, something which has developed in the past. To construe the statute in the sense contended for by the plaintiff would render it in large measure ineffective. Here, likewise, we are confronted not with any question of legislative power, but with a

[47] Id. at 843-5.

question of the intention of the Legislature. It is no more unconstitutional to permit the Legislature, under the reserved power, to authorize a corporation to abolish dividends which have accrued in the past, than it is to authorize a corporation to abolish dividends which may accrue in the future. There is a difference in degree, but not one of kind. In both cases there is interference with a contractual relationship between stockholders and the corporation or between the stockholders *inter sese.* But this the Legislature is permitted to do, certainly under the reserved power in the Constitution and in the General Corporation Law, to alter or amend the charters of corporations, if not under the inherent power of the State for the preservation of the general welfare."[48]

Thus the cases assert freely that the state has or has not an interest, but none of them offer any concrete evidence to justify the assertion. To prove a public interest one has to find some way in which the accrued dividends interfere with the corporation's discharge of its functions. Obviously it can go on rendering service and collecting the price without being affected by the accruals. It is only when the corporation needs more money for its purposes that a public interest becomes even faintly discernible. It is true that accrued dividends make the sale of common stock at a reasonable figure impossible, and that a corporation might be barred by them from this simplest and least dangerous form of financing.[49] It has also been suggested that common stockholders are the most likely source of new risk capital, but will not venture it in the face of arrearages on the preferred stock.[50] But the corporations in the cases do not show as a matter of fact that they propose to raise money by issuing common stock or by selling more to the present common stockholders, and investigation has shown that they have not in fact raised money in this way after the accruals are gone.[51] It has been argued that accrued dividends make management over-eager to pay dividends to the common stock and tempt it to engage in too risky enterprises, and answered that the fact that accruals can be removed will make the management more willing to engage in risky enterprises from the first.[52] If the corporation wishes to borrow money it seems that accrued dividends should not stand in the way, because they

48 Id. at 845.

49 See Dodd, "Fair and Equitable Recapitalizations," 55 HARV. L. REV. 780 at 783 (1942).

50 See note, 4 UNIV. CHI. L. REV. 645 at 655 (1937).

51 See Dodd, "Fair and Equitable Recapitalizations," 55 HARV. L. REV. 780 at 782-3 (1942).

52 See note, 4 UNIV. CHI. L. REV. 645 at 653-4 (1937).

are subject to creditors' claims anyway.[53] The accruals show that the corporation has not been making profits, but that could be ascertained in other ways and would be by any careful lender. It is hard to see how this can prevent the corporation from borrowing money if it would be a good risk, and if it is not the absence of accruals does not help it.[54] There is also the possibility of issuing stock for cash, prior to all the old classes, which is subject to the perhaps valid criticism that it further complicates the capital structure of the corporation,[55] and opens the road to future further accruals on the new class. But these doubtful claims of the majority and the corporation are offered in the face of the certain fact that the common stock is getting present dividends at the expense of the preferred stock. Finally, even if it were true that the preferred accruals hamper financing, there is no vestige of a reason why the sacrifice necessary to get money should come out of the senior class. The preferred stockholders presumably pay more for a smaller return, bargaining for security. Such amendments keep the money and give the security to the class that neither paid nor bargained for it. On the whole, a less satisfactory line of argument for shifting property interests would be hard to find in the law.[56]

3. *Techniques in Removing Accrued Dividends*

In this section I propose to review the various methods that have been used in attacking accrued dividends. Any arrangement of this material presents difficulties; this discussion begins with compulsory amendments which usually fail, and progresses through the various "voluntary" methods, ending with a discussion of mergers, consolidations, and sales of all assets as alternative devices.

[53] See Latty, "Fairness—The Focal Point in Preferred Stock Arrearage Elimination," 29 VA. L. REV. 1 at 12 (1942).

[54] Id. at 12ff. Latty has a convincing collection of instances in which corporations with accrued dividends were successful in borrowing money.

[55] See note, 4 UNIV. CHI. L. REV. 645 at 655 (1937).

[56] More convincing than anything else is the fact that the periodical writers who are dissatisfied with general statements and attempt to get into the questions of fact, are almost unanimously persuaded, for one reason or another, that the arguments advanced for the amendment are almost always merely covers for the fact that the common stockholders want dividends. See in addition to those cited in notes 49 to 55 supra, the following: notes: 55 HARV. L. REV. 1196 at 1206-7 (1942); 54 YALE L.J. 840 at 843 (1945); and see the argument in note, 77 UNIV. PA. L. REV. 256 at 266 (1928).

In view of the importance assigned to questions of fact throughout this discussion, it is perhaps necessary to note that facts alone will not, of course, solve the problem. Whether the law *ought* to permit a particular amendment necessarily involves judgment, the application of a standard of values, to the case. Such a standard cannot be framed from facts alone. The emphasis on facts is due to the meagre attention they have received thus far, not to the hope that they alone will answer the question if and when they are ascertained.

(a) *Direct Removal of Accrued Dividends.* The most celebrated of the early cases dealing with direct removal of accrued dividends is *Roberts v. Roberts-Wicks Co.*,[57] in which the plaintiff owned 250 shares of preferred stock carrying a 6% cumulative dividend. Dividends accumulated from 1901 to 1904, when the corporation reduced its capital, in consequence of an impairment. The plaintiff voted against the reduction, but when it was carried out she surrendered her old certificates and took new ones for only 166 shares, her proportion of the reduced capital. Later in 1904 the directors declared dividends in full on the reduced preferred stock, and a one per cent dividend on the reduced common. The plaintiff brought the action to recover the dividends that had accrued on the full amount of her stock before the reduction, and the court of appeals held her entitled to relief, on the ground that there was no power to disturb dividends which had already accrued when the amendment was made, because such dividends were vested rights, like debts.[58] The decision could have been put, more simply, on the lack of power to make any amendment affecting the dividend rate and the speculation concerning the nature of accrued dividends added nothing to the decision, but the case, nevertheless, has become one of the more celebrated authorities for the vested rights theory of accrued dividends.

The Pennsylvania Supreme Court had reached the same result in the less well known case of *West Chester & Philadelphia R. Co. v. Jackson*,[59] in which the plaintiff held a stock entitled to 8% cumulative "interest." She refused to surrender it under an amendment by which the corporation exchanged a new stock for nearly all the old common and preferred. When dividends were paid on the new preferred stock, the plaintiff was paid the same percentage as the others, and then brought an action of assumpsit to recover the dividends that had accrued on her stock. The court held that she was entitled to maintain the action, since she had retained her stock while the others surrendered theirs, and since the dividends already declared by the corporation proved that it had funds to pay the judgment.[60]

[57] 184 N.Y. 257, 77 N.E. 13 (1906), reversing 102 App. Div. 118, 92 N.Y.S. 387 (1905).

[58] For extensive quotation from this case see note 4 supra.

[59] 77 Pa. 321 (1875).

[60] See also Sterling v. Watson Co., 241 Pa. 105, 88 A. 297 (1913). The plaintiff held cumulative preferred stock retirable at the option of the corporation at par and accrued dividends. The preferred did not sell well, and the corporation turned some of it into common, which was distributed to the preferred and common alike as a 25% stock dividend. Later the directors decided to redeem the preferred at par and accrued dividends, minus the stock dividend already paid. The plaintiff brought suit to restrain the corporation from

In a similar case, *Hildreth v. Western Realty Co.*,[61] the corporation applied its surplus funds to the retirement of part of the preferred stock by paying off the shares without the dividends which had accumulated on them. The plaintiff, a holder of preferred stock, complained that this way of using the funds reduced the voting power of the preferred stock improperly, since if the accrued dividends had been paid on the retired shares, not so many could have been taken up. The court held that under the terms of the charter it was proper to reduce the preferred stock without reducing the common, but that this could not be done without discharging the dividend obligations on the preferred shares.[62]

Direct removal through reclassification has had no better success. In *Affeldt v. Dudley Paper Co.*,[63] the plaintiff held shares of 7% preferred stock with a provision that compelled the corporation to retire them at par. An amendment provided for a new 5% stock to replace the old issue, but the plaintiff did not exchange. The new stock was evidently not prior to the old in any way. The court held that the plaintiff could compel redemption of his stock at the charter price, and that

attempting to redeem at the proposed figure, from stopping dividends on the preferred, from refusing transfers of the preferred, and from paying dividends on the common until the dividends on the preferred were paid in full. The court gave relief on the ground that the preferred was entitled, in the absence of any provision to the contrary, to share equally with the common after the latter had received dividends in any year equal to the dividends on the preferred. Hence, the 25% stock dividend could not legally be counted on the accrued dividends due the preferred.

[61] 62 N.D. 233, 242 N.W. 679 (1932).

[62] In Hay v. Big Bend Land Co., 32 Wash. (2d) 887, 204 P. (2d) 488 (1949), the Washington Supreme Court reached the same result. The corporation had 6% cumulative preferred stock which was redeemable at $101.50 and accrued dividends, and had a preference on dissolution of par and accrued dividends. The requisite majorities approved an amendment which reduced the par value of the common stock from $100 to $10, and authorized the directors to call the preferred stock for redemption as they chose. The directors then elected to redeem seven and one half shares or as much thereof as he might have, from every stockholder. The plaintiff, who held a little preferred stock and a substantial amount of common, brought the action to enjoin redemption of the preferred stock and to secure a declaration that the reduction of the common stock was illegal. The court held that the reduction of the par value of the common stock was proper, but it enjoined the redemption of the preferred stock, on the ground that the accrued dividends were not being paid on the redeemed shares. A declaration that the redemption was without prejudice to the right to accrued dividends, the court held, did not remove the objection to the action, since the effect was to reduce the voting rights of the preferred stock without paying the sum called for by the charter. The court also relied upon the fact that a provision for periodic payment of the redemption price violated the charter rights of the preferred stockholders.

In a somewhat similar case under the Delaware law, Kennedy v. Carolina Public Service Co., (D.C. Ga. 1920) 262 F. 803, the majority voted to reduce the preferred stock by two-fifths and the common by one-fifth. The court held that the amendment was invalid on the ground that the preferred could only be reduced by paying its retirement price, $105 and accrued dividends. It seems to have been conceded, however, that the amendment could not take away the right to dividends already accrued on the retired stock.

[63] 306 Mich. 39, 10 N.W. (2d) 299 (1943).

he could also recover the accrued dividends since the corporation, by paying dividends on the new stock, had shown that it had funds for that purpose. In the fact that the new stock was not prior to the old, and hence that no pressure was put on the old stockholders to exchange for the new, the case resembles *Wiedersum v. Atlantic Cement Products, Inc.*,[64] in which the plaintiff held a preferred stock on which dividends of $56.29 had accrued. The amendment created new classes of preferred and common, but it did not appear that the new preferred was prior to the old. Four shares of new were issued for one of the old preferred, and the accrued dividends were cancelled. The plaintiff sued to have the elimination of accrued dividends declared invalid and to enjoin the payment of dividends on any stock until his arrears had been paid. He was given relief on the ground that the statute permitting reclassification of stock did not authorize removal of accrued dividends. Hence these attempts to replace the old stock with new, under reclassification provisions, failed.

There remain three cases in which the attack was successful. In the first of these, *Harr v. Pioneer Mechanical Corp.*,[65] $7 of dividends had accrued on the old preferred. The amendment provided for the issue of new preferred prior to the old in dividends and liquidation rights. Old preferred stockholders could, on payment of $2.50 per share, exchange the old shares for the new and thus maintain their prior position, or they could exchange share for share for a new preferred subordinate to the prior preferred. The amendment expressly provided that the common stock could receive ordinary and liquidating dividends before the accrued dividends were paid on the old preferred. A majority of the Second Circuit Court of Appeals held that the plan was legal under the Delaware statute, which, when the corporation was chartered, provided that the "relative, participating, optional, or other special rights of the shares" could be changed upon approval of a certain percentage of the class.[66] It should be noted that the Delaware Supreme Court later disapproved of this interpretation of its statute.[67]

[64] 261 App. Div. 305, 25 N.Y.S. (2d) 496 (1941).

[65] (2d Cir. 1933) 65 F. (2d) 332, modifying (D.C. N.Y. 1932) 2 F. Supp. 517, cert. den. 290 U.S. 673 (1933). See comment, 28 ILL. L. REV. 422 (1933).

[66] Judge L. Hand dissented in part, on the ground that under the Delaware law dividends could not be paid on the common stock before accrued dividends were discharged on the dissenting preferred stock.

[67] See the discussion supra, pp. 366-367. The Delaware Court of Chancery had already held that accrued dividends could not be taken directly under an earlier statute allowing alteration of "preferences." Morris v. American Public Utilities Co., 14 Del. Ch. 136, 122 A. 696 (Ch. 1923), discussed infra p. 389 ff.

In another case, *McQuillen v. National Cash Register Co.*,[68] the the plaintiff held class *A* stock, with a $3 cumulative dividend, heavily in arrears. The subordinate class was called *B*, with a $3 non-cumulative dividend. The amendment reduced the capital, issued 238,000 shares of new *A* stock to the old *A* stockholders, in addition to the shares they already held, and issued a new *C* stock, having the same rights as the *A* stock, and exchangeable at the rate of one share for two of the old *B* stock. The amendment expressly cancelled the accrued dividends of the old class *A* stock. The amendment, then, raised all the stockholders to the same level, but by issuing more stock to the old preferred and less to the old class *B*, gave some consideration both for the alteration of status and for the cancellation of the accrued dividends. The decision of the court upholding the amendment, however, did not rest on this ground. The court took the view that the applicable statutes of Maryland, authorizing anything to be put in a charter by amendment that could be put into an original charter, and also authorizing changes in the terms of stock by classification, reclassification, or otherwise, contemplated the direct removal of accrued dividends. It appears that an amendment merely removing the dividends would have been approved.

Until recently these were the only cases in which direct removal of accrued dividends was permitted. Both were federal cases and one of them had been repudiated by the supreme court of the state. In 1949, however, the Illinois Supreme Court supplied another authority in favor of direct removal. In *Western Foundry Co. v. Wicker*,[69] that court sustained an amendment which directly cancelled accrued dividends, on the ground that a charter provision inferentially permitting the alteration of "preferences" by a two-thirds vote, authorized the amendment. The decision, although it rests on the charter, and disclaims any intention to interpret the Illinois Business Corporations Act of 1933, necessarily suggests that direct removal of accrued dividends would also be possible for corporations chartered under that act, which provides for amendment of the "preferences . . . and the special or

[68] (4th Cir. 1940) 112 F. (2d) 877, affirming (D.C. Md. 1939) 27 F. Supp. 639. See comments on the decision of the lower court, in 25 CORN. L.Q. 431 (1940) and 88 UNIV. PA. L. REV. 114 (1939). The case is thoroughly examined in the light of the Maryland statutes and the cases of other jurisdictions in Ober, "The Problem of Funding Accrued Dividends in Maryland," 5 MD. L. REV. 345 (1941). Compare Vulcan Corp. v. Westheimer, (Ohio App. 1938) 34 N.E. (2d) 278, appeal dismissed for lack of a debatable constitutional question, 135 Ohio St. 136, 19 N.E. (2d) 901 (1939), holding that failure to apply for appraisal made a compulsory plan binding on the stockholder. Doubt as to the Ohio law on this point is expressed supra p. 376 ff.

[69] 403 Ill. 260, 85 N.E. (2d) 722 (1949).

relative rights . . . " of the shares.[70] Allowing for these exceptions, however, it seems correct to say that the direct removal of accrued dividends, whether or not accompanied by exchange of shares, has been for the most part a failure.

(b) *Compulsory Exchange of Shares by Destruction of the Old Class.* When the amendment destroys the old class of stock and requires it to be exchanged for the new class, it amounts to a compulsory conversion of the old shares, with or without their accrued dividends, into new. As such amendments do not differ in fact from an outright destruction of the accrued dividends the courts treat them in the same way, that is, if there is no power to remove accrued dividends, the compulsory conversion is not permitted to have that effect.

Thus, in *Keller v. Wilson & Co.*,[71] in which the amendment cancelled the plaintiff's class A stock with its $21.25 of accrued dividends, and compelled its exchange for five shares of common stock, the court, as previously shown, held that there was no power to remove the accrued dividends,[72] and that the amendment, accordingly, could not be sustained. A little later the same court, in *Consolidated Film Industries v. Johnson*,[73] held that a compulsory reclassification of preferred stock with accrued dividends into one and one-fourth shares of new preferred and one-fourth of a share of new common, was also illegal, for lack of power to alter the accrued dividends.[74] The New York Court of Appeals also has held that an amendment reclassifying preferred stock into common, without paying the dividends accrued on it, was illegal in the absence of power to remove the accrued dividends.[75] In *McNulty v. W. & J. Sloane*,[76] holding constitutional a subsequent

[70] See comment, 63 HARV. L. REV. 529 (1950).

[71] 21 Del. Ch. 391, 190 A. 115 (Sup. 1936), reversing 21 Del. Ch. 13, 180 A. 584 (Ch. 1935).

[72] See the discussion supra pp. 374-375 ff.

[73] 22 Del. Ch. 407, 197 A. 489 (Sup. 1937), affirming 22 Del. Ch. 262, 194 A. 844 (Ch. 1937). For comment on the lower court's decision in this case see 32 ILL. L. REV. 478 (1937). But see United Milk Products Corp. v. Lovell, (6th Cir. 1935) 75 F. (2d) 923, cert. den. 295 U.S. 751 (1935), in which the court sustained a transfer of all assets to a new company which was to issue eight-tenths of a share of participating preferred and $3 cash for each share of old preferred. The case perhaps is distinguishable from the amendment cases. See discussion in Part II of this article, to be published in the Feb. 1951 issue, at note 138.

[74] See the discussion of the construction problem supra p. 366.

[75] Davison v. Parke, Austin & Lipscomb, Inc., 285 N.Y. 500, 35 N.E. (2d) 618 (1941), discussed supra p. 372 ff.

[76] 184 Misc. 835, 54 N.Y.S. (2d) 253 (1945), discussed supra, p. 376 ff.

Another lower court of New York has followed the McNulty case in sustaining a compulsory reclassification with removal of accrued dividends, but without adding to the statute authorizing removal of accrued dividends, a compulsory reclassification of stock was, of course, sustained. The Ohio courts in three cases have held that compulsory conversions of preferred stock were illegal so far as they affected accrued dividends, since there was no power to remove the latter.[77] The New Jersey Court of Chancery has restrained a plan that proposed to convert preferred stock into one share of new preferred and five shares of common without payment of accrued dividends,[78] and the Court of Errors and Appeals has enjoined a plan that gave second preferred stock the first position, by converting a prior preferred to common and converting each ten shares of the old second preferred into four shares of new, without paying its accrued dividends.[79] It has also enjoined another plan which would have con-

reasoning of the McNulty case. Arstein v. Robert Reis & Co., 77 N.Y.S. (2d) 303 (1948), affd. without opinion, 273 App. Div. 963, 79 N.Y.S. (2d) 314 (1948), leave to appeal den. 298 N.Y. 931, 81 N.E. (2d) 335 (1948), cert. den. 335 U.S. 860 (1948). For further discussion see note 45 supra.

77 Harbine v. Dayton Malleable Iron Co., 61 Ohio App. 1, 22 N.E. (2d) 281 (1939), commented on in 25 CORN. L.Q. 431 (1940), and in note, 6 OHIO ST. UNIV. L.J. 313 (1940); Wheatley v. A. I. Root Co., 147 Ohio St. 127, 69 N.E. (2d) 187 (1946), modifying 79 Ohio App. 93, 72 N.E. (2d) 482 (1945). But see Vulcan Corp. v. Westheimer, (Ohio App. 1938) 34 N.E. (2d) 278, appeal dismissed for lack of a debatable constitutional question, 135 Ohio St. 136, 19 N.E. (2d) 901 (1939). It seems difficult or impossible to reconcile this with the Wheatley case. See discussion supra pp. 375-376.

In its most recent decision the court again refused to sustain a compulsory destruction of accrued dividends. In Schaffner v. Standard Boiler and Plate Iron Co., 150 Ohio St. 454, 83 N.E. (2d) 192 (1948), the plaintiff held a first preferred stock with a 7% cumulative dividend. The corporation also had second preferred and common stock. The amendment authorized 4,000 shares of no par common stock, of which Class A had a preference of $100,000 on liquidation and a $7,000 annual preference in dividends. It was to be exchanged for first preferred. Class B of the new common stock, which had a liquidation preference of $50,000 and an annual preference in dividends of $3,500, was to be exchanged for the second preferred. The plaintiff did not make the exchange. After the amendment, the corporation paid dividends on the common stock and the plaintiff brought an action to recover accrued dividends and to enjoin dividends on the common stock until he was paid. The court gave the relief. It held that there was no power to remove accrued dividends under the statutes in force when the corporation was chartered, and that the amendment had been adopted before the effective date of a statute which purported to authorize their removal. It indicated that the statute could not have justified the amendment even if it had been in force when the amendment was adopted, as that would have impaired the plaintiff's constitutional rights. But relief was limited to dividends which had accrued before the plan became effective, i.e., the reclassification of the plaintiff's stock was apparently effective. The court also allowed recovery of dividends which had accrued before the plan, to the extent that there had been a distribution from surplus to the common stock. The decision seems perfectly consistent with the Harbine and Wheatley cases.

78 Lonsdale Securities Corp. v. International Mercantile Marine Co., 101 N.J.Eq. 554, 139 A. 50 (Ch. 1927). See comment in 28 COL. L. REV. 662 (1928); the case is also discussed in a comment in 26 MICH. L. REV. 684 (1928).

79 Kamena v. Janssen Dairy Corp., 134 N.J.Eq. 359, 35 A. (2d) 894 (Ct. Err. & App. 1944), affirming on the opinion below 133 N.J.Eq. 214, 31 A. (2d) 200 (Ch. 1943). The federal court sustained this same amendment in an earlier decision. Sander v. Janssen Dairy Corp., (D.C. N.J. 1940) 36 F. Supp. 512.

verted each share of preferred with its accrued dividends into $40 of debentures and 14 shares of another class, while it converted each share of the old common into two-fifths of a share of new.[80] In a recent case, *Franzblau v. Capital Securities Co.*,[81] the new Jersey Chancery Division sustained an amendment which converted each share of the plaintiff's $30 par 7% preferred stock, with its $36.22½ of accrued dividends, into a share of $50 par 5% preferred and $2.50 in cash. The court relied upon a statute in force when the corporation was chartered, authorizing the satisfaction of rights to accrued dividends by the issue of stock or otherwise. It distinguished earlier cases on the ground that the statute had been enacted after the corporations in those cases had been chartered, and was therefore inapplicable to them.

One question results from these decisions that can only be treated completely in connection with so-called "voluntary" plans, but it should be mentioned here. The question is, what relief should be given to the dissenter? Enjoining the entire amendment and restoring the status quo would most effectively prevent any interference with his rights. However, if the amendment is executed, it binds those who consented to it, and also those dissenters who are unable, through laches, acquiescence, or other causes, to assert their objections. Moreover, in many cases the amendment is illegal only so far as it affects accrued dividends. The old stock is no longer listed on the exchanges, and the new has been perhaps sold to purchasers for value. The Ohio court has held that dividends on the common stock will be enjoined until the accrued dividends have been paid.[82] The *Keller* case[83] was evidently settled out of court so that the form of decree which the court would have issued is not known. However, the problem was discussed in other litigation arising out of the same amendment. In *Dunn v. Wilson & Co.*,[84] the federal court held that the change in the future rights of the stock was valid, and that the plaintiff would have to exchange the old preferred for common in consequence. To the little authority on this point must be added the fact that the New Jersey

[80] Wessel v. Guantanamo Sugar Co., 135 N.J.Eq. 506, 39 A. (2d) 431 (Ct. Err. & App. 1944), affirming 134 N.J.Eq. 271, 35 A. (2d) 215 (Ch. 1944).

[81] 2 N.J. Super. 517, 64 A. (2d) 644 (Ch. Div. 1949). The reasoning in this case is considered at some length in note 16 supra.

[82] Harbine v. Dayton Malleable Iron Co., 61 Ohio App. 1, 22 N.E. (2d) 281 (1939). And see the Schaffner case, discussed in note 77 supra, in which the court allowed recovery of accrued dividends to the extent that the payment of dividends to common stockholders had invaded the surplus, while enjoining such payment in the future, until the accrued dividends were paid.

[83] 21 Del. Ch. 391, 190 A. 115 (Sup. 1936).

[84] (D.C. Del. 1943) 53 F. Supp. 205.

courts, in three decisions against the plans, have simply enjoined the plan altogether.[85] Since this goes beyond the relief which the same court has given against "voluntary" plans, which is limited to an injunction against dividends on the new prior stock until the accrued dividends have been paid,[86] it may indicate greater hostility toward the compulsory plans. But it appears that in all three of the cases the action was brought and decided before the plan was executed. This leaves questionable what the New Jersey courts would do if the action were brought after the plan was executed.

Hence, it appears that the courts have given relief against compulsory plans, just as they have against direct removal of accrued dividends, but that in only one state, New Jersey, does the court enjoin the entire plan. In the others, dividends on the common stock are enjoined until the accrued dividends have been paid, but the plans are otherwise left operative.

(c) *Exchange of Old Shares for Prior Stock.* Assuming that the corporation does not have, or does not care to use, a power to remove accrued dividends directly, it may proceed to that end by other routes. The simplest and least violent of these is to issue a new prior stock and exchange it for the shares of the assenting old stockholders, on condition that they release their accrued dividends, leaving the old shares and their accrued dividends untouched. The assenting stockholders thus move ahead of the dissenters, both in dividends and in assets, making the old stock a less desirable investment. If the old shares were listed on an exchange they will be removed in favor of the new ones, and thereby lose their liquidity. Such amendments, while they do nothing to the old stock itself, change the capital structure around it, so that the old shares necessarily become far less desirable. Sustaining these amendments, then, is condoning the use of them to induce the surrender of accrued dividends. But it is possible to argue that no other result can be reached, that the preferred stockholders have contracted only for priority over the common, that the majority has the power to issue prior stock, and that judicial interference with that power because of its incidental effect on accrued dividends would upset corporate financing. If an answer were wanted to this argument, it is not entirely lacking. Issues of prior stock were originally sustained on the ground that they were a convenient source of new money.[87] Stock which is

[85] See notes 78 to 80 supra.

[86] See discussion infra pp. 393-394.

[87] See, for example, Everhart v. The West Chester & P.R.R., 28 Pa. (4 Casey) 339 (1857); Rutland & B.R.R. Co. v. Thrall, 35 Vt. 536 (1863); City of Covington v. Covington and Cincinnati Bridge Co., 73 Ky. (10 Bush) 69 (1873); Hinckley v. Schwarzschild

simply issued for old stock is not going to raise any new money. This would distinguish the old cases, unless it were argued that once the power is found to exist, the courts have no authority to inquire into its use. However, in other amendment cases they do inquire,[88] and will enjoin an amendment which there is power to make when they believe that it is inequitable; a decision that the court will not enjoin the use of prior stock to secure waivers of accrued dividends is simply a decision that such use is not inequitable.

Less drastic relief could be given by enjoining any payment on the prior stock until accrued and current dividends have been paid on the dissenting old stock, thus leaving the dissenters in possession of a prior stock. This might not handicap the corporation, would secure the dissenters their rights and would accomplish in large part the purpose of the amendment. But to enjoin the payment of dividends on the new stock only until the accrued dividends had been paid on the old would put dissenters at a disadvantage, because they would thereafter be subject to the majority of their old class, although the latter had not paid any new money for their prior stock.

These are the possible remedies which might be applied, if the courts wished to use them. The cases conflict, but most courts have given the dissenter only an injunction against dividends on the common stock until the accrued dividends have been paid. In Delaware, for example, dividends may be paid on the new prior stock before payment of the accrued dividends on the old stock; that is, the dissenters, accrued dividends and all, are subject to the new issue. This was settled in *Morris v. American Public Utilities Co.*,[89] in which the plaintiff held

& Sulzberger Co., 107 App. Div. 470, 95 N.Y.S. 357 (1905), affirming 45 Misc. 176, 91 N.Y.S. 893 (1904), appeal dismissed 193 N.Y. 599, 86 N.E. 1125 (1908). I have developed the point at some length in another article of this series: "Corporate Charter Amendments: Issues of Prior Stock and the Alteration of Dividend Rates," 50 COL. L. REV. 900 (1950).

88 Thus, in numerous cases, the courts have not hesitated to impose limitations upon the power to reduce capital, although the language conferring the power expressed no such limitations. Kennedy v. Carolina Public Service Co., (D.C. Ga. 1920) 262 F. 803; Page v. American and British Mfg. Co., 129 App. Div. 346, 113 N.Y.S. 734 (1908); Page v. Whittenton Mfg. Co., 211 Mass. 424, 97 N.E. 1006 (1912). I have written another article examining this question at length, under the title: "Changes in the Interests of Classes of Stockholders by Corporate Charter Amendments Reducing Capital, and Altering Redemption, Liquidation and Sinking Fund Provisions," 36 CORN. L.Q. 1 (1950).

The courts also have imposed a requirement that the terms of mergers be fair to the stockholders, even though the statutes authorizing the mergers made no such requirements. Jones v. Missouri-Edison E. Co., (8th Cir. 1906) 144 F. 765, reversing (C.C.Mo. 1905) 135 F. 153; Outwater v. Public Service Corp., 103 N.J.Eq. 461, 143 A. 729 (Ch. 1928), affd. on the opinion below, 104 N.J.Eq. 490, 146 A. 916 (Ct. Err. & App. 1929).

89 14 Del. Ch. 136, 122 A. 696 (Ch. 1923), commented on in 8 MINN. L. REV. 617 (1924). [This comment purports to treat Harden v. Eastern States P. S. Co., (Del. Ch.

a 6% cumulative preferred stock, on which 4½% of dividend scrip had been issued while, in addition, 24% dividends had accrued on each share. The amendment created prior preferred, participating preferred, and preferred stock, with priorities in that order. The old preferred was designated by the amendment as the last of these, but could be surrendered with cash or dividend scrip of $7.50, for eight-tenths of a share of the participating preferred stock. It seems that the prior preferred stock was to be sold for money, but the dissenters were nevertheless subject to the assenting stockholders, who took participating preferred. Apparently the amendment also destroyed the accrued dividends. The court held that there was no power to do this. But it also refused to enjoin payment of dividends on the two prior stocks before payment of the accrued dividends:

> ". . . The corporation has neither declared nor set apart from earnings any sum for a dividend on the common stock, nor is it threatening to do so. The payment of dividends to the two preferred classes created by the amendment which come in ahead of the class which the complainants hold is not in violation of the rights secured to them by their contract with the corporation and the injunction should, therefore, not issue as prayed."[90]

Hence the plaintiff was left with a stock subject to two other classes as to dividends and assets; the effect of this decision on his accrued dividends was obviously serious, but the use of prior stock in this way did not impress the court as improper.

It will be remembered that the Delaware Supreme Court later held that accrued dividends could not constitutionally be taken under a statute subsequent to the charter and that the statute would not be construed as authorizing such action retrospectively.[91] The court, nevertheless, adhered even after these decisions to the principle of the *Morris*

1923) 122 A. 705, but from the discussion it must be concerned with the Morris case, which immediately precedes the Harden case in 122 A.]. It should be noted that the Delaware court since has held that dividends "accrue" on a cumulative preferred stock even though there are no earnings, so that on liquidation the preferred stock is entitled to accrued dividends as against the common stock although none were ever earned. Penington v. Commonwealth Hotel Constr. Corp., 17 Del. Ch. 394, 155 A. 514 (Sup. 1931), reversing on this point, 17 Del. Ch. 188, 151 A. 228 (Ch. 1930); Garrett v. Edge Moor Iron Co., 22 Del. Ch. 142, 194 A. 15 (Ch. 1937), affd. sub nom. Pennsylvania Co. v. Cox., 23 Del. Ch. 193, 199 A. 671 (Sup. 1938).

The Morris case might also be classified as one in which pressure was exerted by making changes which cause the old stock to be less desirable. See discussion in Part II of this article, to be published in the Feb. 1951 issue, in note 105.

90 14 Del. Ch. 136 at 154, 122 A. 696 (1923).

91 See discussion supra pp. 374-375.

case. In *Shanik v. White Sewing Machine Corp.*,[92] the corporation had preferred stock with $31 accrued dividends per share, and common stock. The amendment created a prior preferred stock, a plain preferred and a common stock. The old preferred could be exchanged for one share of prior preferred and three shares of new common, or the holder could keep it as second preferred. Each share of old common was converted into two-fifths of a share of new common. The Supreme Court of Delaware refused to enjoin the amendment, saying:

> ". . . Here the transfer, if made, is purely voluntary, and any dissentient to the plan may keep his original preference stock with all accumulated and unpaid dividends thereon, and his relative position with reference to the common stock (the only preference to which he was ever entitled) remains precisely the same as if no change had been made. His accumulated dividends in arrear are not, in any sense, wiped out, but remain awaiting a legal fund for their payment, and they must be paid before dividends are paid upon the common stock. We think there was no conflict between the *Morris* case and the *Keller* case, and the present case being substantially similar to the *Morris* case, we think there is no conflict between the *Keller* case and the present."[93]

Hence, the Delaware law seems to be settled: the issue of prior stock to induce the release of accrued dividends is not, of itself, an unfair use of the amending power.

Substantially the same result seems to have been reached in New York. The law there provides that the stockholder may have an appraisal of his stock when the amendment changes his preferential rights. The court of appeals has held that the issue of a prior stock does not entitle the shareholder to an appraisal.[94] But when the prior stock is part of a plan to induce the release of accrued dividends, it

[92] 25 Del. Ch. 371, 19 A. (2d) 831 (Sup. 1941), affirming (Del. Ch. 1940) 15 A. (2d) 169. The decision of the lower court is considered in note, 7 UNIV. PITT. L. REV. 326 (1941).

[93] 25 Del. Ch. 371 at 380-1, 19 A. (2d) 831 (1941). Since the Harr case, discussed supra p. 383, was decided under the Delaware statutes and involved prior preferred stock, it might have been considered at this point. But that amendment provided for payment of dividends on the common stock before the accrued dividends on the old preferred, and I therefore consider it rather as a case of outright destruction of the accrued dividends. No Delaware case has gone as far as this. Both the Morris and the Shanik cases point out that the accrued dividends remain prior to the common stock. The Delaware court has criticized the Harr case. See supra pp. 366-367.

[94] Matter of Dresser, 247 N.Y. 553, 161 N.E. 179 (1928), affirming 221 App. Div. 786, 223 N.Y.S. 864 (1927). The reports of the case are without opinion except for a dissent in the court of appeals, but the facts are stated in a discussion of the case in Matter of Silberkraus, 224 App. Div. 268 at 273, 229 N.Y.S. 735 (1928).

seems that the preferential rights of the dissenters are being changed. However, the courts there have held that there is no right to an appraisal, when the exchange is voluntary, that is, when the stockholder can continue to hold his old stock if he wishes to.[95] The result seems questionable. It is hard to believe that remaining in one's old position while other members of his class pass ahead in dividend and liquidation preferences is no alteration of a preferential right. The appraisal provisions of the New York law, if they were intended to relieve against these consequences of amendments to dissenters, have not been interpreted to reach that result in these cases.[96] The Ohio Supreme Court, in *Johnson v. Lamprecht*,[97] in sustaining a plan which left the preferred stockholder the option of retaining his old stock with its accrued dividends, or of exchanging for a new prior class and releasing his accrued dividends for three-quarters of a share of common stock, joined the Delaware and New York courts, but it differed from the latter in indicating that the dissenter could have an appraisal if he wanted one, and this seems more consonant with the probable legislative intent in adapting the appraisal remedy to charter amendments. The situation in Kentucky is doubtful. The only case raising the question is *Francke v. Axton-Fisher Tobacco Co.*,[98] in which the corporation had preferred stock, class *A* and class *B*, entitled to priority in that order. Dividends had accrued on the preferred and the class *A*. The court held valid a plan which proposed to pay the accrued dividends on both preferred and class *A*, if the owners would exchange for a new prior stock, and that the plan would be binding on dissenters if the necessary majorities voted for it. In the course of its opinion it indicated that so long as the plan did not compel the surrender of accrued dividends, it would be proper to issue a preferred stock prior to the accrued dividends on the

[95] Application of Woodruff, 175 Misc. 819, 26 N.Y.S. (2d) 679 (1941), affd. without opinion, 262 App. Div. 814, 28 N.Y.S. (2d) 756 (1941); Longson v. Beaux-Arts Apts., 265 App. Div. 951, 38 N.Y.S. (2d) 605 (1942), affd. without opinion, 290 N.Y. 845, 50 N.E. (2d) 240 (1943). See also, Matter of Kinney, 279 N.Y. 423, 18 N.E. (2d) 645 (1939), reversing 254 App. Div. 660, 4 N.Y.S. (2d) 377 (1938), in which the court of appeals refused to award an appraisal merely for the issue of prior stock to induce surrender of accrued dividends, but allowed it because of a reduction of capital.

[96] Not exchanging for a prior issue is dangerous. In Matter of Duer, 270 N.Y. 343, 1 N.E. (2d) 457 (1936), commented on in 85 UNIV. PA. L. REV. 324 (1937), the plaintiff, holding preferred stock, did not vote for an amendment which created a prior class, and did not demand an appraisal. Other stockholders exchanged their old shares for the new stock. The corporation then began to liquidate, and the court refused to compel it to issue the new stock to the plaintiff for his old shares. It held that the stockholders who exchanged had a contract right to priority over the plaintiff.

[97] 133 Ohio St. 567, 15 N.E. (2d) 127 (1938), affirming (Ohio App. 1937) 30 N.E. (2d) 1019. See notes: 33 ILL. L. REV. 212 (1938); 5 OHIO ST. L.J. 389 (1939); and 12 UNIV. CIN. L. REV. 576 (1938).

[98] 289 Ky. 687, 160 S.W. (2d) 23 (1942).

old stock, but the statement would of course be merely dictum in a case in which the plan did not provide for the payment of accrued dividends along with the exchange. The federal courts have sustained under the Pennsylvania statute, an amendment which offered a $10 three per cent debenture, one share of prior preferred stock, and two and one-half shares of common for each share of old preferred, relying on the fact that the amendment did not destroy the accrued dividends or terminate the class of the old preferred stock.[99]

The New Jersey courts have limited the powers of the majority to affect the interests of dissenters by the issue of prior stock, but the extent of the limitations is extremely doubtful. In *General Investment Co. v. American Hide & Leather Co.*,[100] the corporation had 7% cumulative preferred stock and common stock. About 140% dividends had accrued on the preferred stock, but there was enough surplus to pay about 40% of them. The amendment proposed the issuance of an 8% cumulative preferred prior to the old preferred. It also proposed to retire about 30,000 shares of preferred stock with the surplus. It seems that it was intended to issue the new preferred for the old, with a surrender of accrued dividends. The court held the issue of the preferred stock legal, but the majority indicated that the corporation could not use so much of the surplus as was applicable to the plaintiff's stock in the retirement of other shares. Two judges concurring specially stated that in their opinion the corporation could not pay dividends on the new preferred stock until it had first paid the accrued dividends on the old preferred stock. This goes beyond any of the cases thus far considered in limiting the power of the majority, but it is not at all clear that the majority of the court agreed on this point with the concurring judges. The only subsequent case, *Buckley v. Cuban American Sugar Co.*,[101] was decided by a lower court. The corporation had preferred stock with accrued dividends of $54.50 per share, and common stock. It had current assets and surplus sufficient to redeem all the preferred stock with accrued dividends. The amendment proposed a new prior preferred with a lower dividend rate, 1.4 shares of which, with $14.50 cash, were to be issued for every share of old preferred. It was expressly provided that the accrued dividends on the old preferred could not be paid until dividends were paid on the new preferred and on the old pre-

[99] Johnson v. Fuller, (3d Cir. 1941) 121 F. (2d) 618, affirming (D.C. Pa. 1940) 36 F. Supp. 744, cert. den. 314 U.S. 681 (1941) commented on in 8 UNIV. PITT. L. REV. 76 (1941). See comment on the lower court decision, 27 VA. L. REV. 954 (1941).

[100] 97 N.J.Eq. 214, 127 A. 529 (Ch. 1925), and 97 N.J.Eq. 230, 127 A. 659 (Ch. 1925), affd. but modified, 98 N.J.Eq. 326, 129 A. 244 (Ct. Err. & App. 1925).

[101] 129 N.J.Eq. 322, 19 A (2d) 820 (Ch. 1940).

ferred accruing after the date of the amendment. The court granted a temporary injunction, indicating that in its view of the *General Investment Company* case the accrued dividends on the old stock would have to be paid before dividends on the new stock. The extremely liquid position of this corporation shows how little financial necessity could have had to do with the amendment. Hence, it seems that under the New Jersey cases, it is extremely doubtful that the power to issue prior stock carries with it the power to prefer that stock to the accrued dividends on old stock.

It is clear that the North Carolina cases prohibit payment of dividends on the new prior stock before the payment of accrued dividends on the old stock. In *Patterson v. Durham Hosiery Mills,*[102] the amendment provided for the purchase of one third of the preferred stock from each holder and for the issue of a new preferred for the rest of the shares, giving two shares of common stock for the accrued dividends on each share. The court held that payment of dividends on the new stock should be enjoined until the accrued dividends on the old stock had been paid.[103] A later decision, however, established that the corporation could pay dividends on the new stock before paying current dividends on the old preferred, as long as the accrued dividends of the latter were discharged.[104]

Thus, it appears that the courts could (1) enjoin the issue of a prior stock absolutely if it is to be exchanged for old stock, (2) enjoin the payment of dividends on a new stock until the accrued dividends and current dividends have been paid on the old, (3) enjoin the payment of current dividends on the new stock until accrued dividends have been paid on the old, or (4) permit payment of dividends on the new stock even before payment of accrued dividends on the old stock. The great majority of courts have taken the last course, leaving the majority as free as possible to put pressure on the dissenters to exchange their shares. Two courts, one of which is doubtful, have taken the third course, requiring payment of the accrued dividends, but permitting payment of current dividends on the new stock before current dividends on the old. No court seems to have taken either of the first two courses, which would give the fullest possible measure of protection to the old preferred stock, and its accrued dividends.

102 214 N.C. 806, 200 S.E. 906 (1939).

103 *Accord:* Patterson v. Henrietta Mills, 216 N.C. 728, 6 S.E. (2d) 531 (1940).

104 Clark v. Henrietta Mills, 219 N.C. 1, 12 S.E. (2d) 682 (1941); Patterson v. Henrietta Mills, 219 N.C. 7, 12 S.E. (2d) 686 (1941).

[To be concluded]