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## THE PROBLEM OF FUNDING ACCRUED DIVIDENDS IN MARYLAND

By RICHARD F. OBER\*

An important problem with which the Maryland Court of Appeals may soon have to deal is the extent to which a majority of the stockholders of a business corporation will be permitted to alter or destroy the rights of preferred stockholders to past accrued but unpaid dividends. The importance of this question lies in the fact that, in times of business expansion following a general depression, many corporations find an obstacle to successful re-financing in the existence of a contingent liability for dividend arrearages in their financial structures.<sup>1</sup> The ability of majority stockholders legally to fund this obligation, and so to postpone its payment depends fundamentally upon statutory construction and policy with regard to the powers of those in effective control of a corporation. The seriousness of this problem is enhanced by the relatively large number of corporations organized under the Maryland statutes.

Two general methods of accomplishing such a funding of the arrearages suggest themselves. The charter of incorporation may be amended, either substituting new shares of a similar preferred stock in value<sup>2</sup> equivalent to the value of the old preferred shares with their accrued

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<sup>1</sup> On Oct. 15, 1940, 117 of the 348 cumulative issues (of a total of 396) of domestic preferred stocks listed on the New York Stock Exchange were in arrears in an aggregate amount exceeding one billion dollars. *Wall Street Journal*, Nov. 22, 1940.

<sup>2</sup> The value selected might be par, stated, book, or liquidation value; the rates of return, participation, preemption rights, and other features would also enter into the calculation.

dividends, or creating a new class of prior preferred stock offered in exchange for the old stock with its accrued dividends at a ratio equalizing the value of the new with that of the old plus the latter's dividend arrears.<sup>3</sup> The old corporation may be merged or consolidated into, or all of its assets sold as an entirety to, a second corporation (either pre-existing or created for the purpose) with provisions for compelling preferred stockholders to surrender their old shares with the accrued dividends thereon for an equivalent value in securities of the second corporation.

The problem is whether, regardless of their economic power or rights to require the corporation to buy them out, a dissenting bloc of the preferred stockholders, say ten per cent, could effectually prevent the funding of the accrued dividends on their shares by such methods. In view of the age of many Maryland charters, it is also necessary to consider whether the minority stockholders' rights would be any different if, for example, the corporation had been organized in 1900 instead of sometime during the last two decades.

#### CONSTRUCTIONAL ISSUES

Article 23, Section 22 of the Maryland Code of 1939, after providing that every stockholder in a Maryland corporation shall have one vote per share unless otherwise stipulated by the charter, further provides:

“Notwithstanding any provision of law requiring any action to be taken or authorized by the affirmative vote of the holders of a majority or other designated proportion of the shares or of the shares of each class, . . . , or to be otherwise taken or authorized by vote of the stockholders or members of any corporation, such action shall be effective and valid if taken or authorized by such vote of its stockholders or members as may be required for such action by its charter; but in the case of corporations having capital stock, the requisite number of affirmative votes shall not in any case be less than a majority in number of the ag-

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<sup>3</sup> In either case, of course, the new stock would have no dividend arrearages.

gregate number of votes to which the holders of all the shares (meaning thereby all of the shares of all classes in the aggregate) outstanding and entitled to vote thereon, shall be entitled, except in cases in which the law authorizes such action to be taken or authorized by a less vote . . .”

In the absence of a charter provision specifically referring to the authorization of any of the suggested acts, the corporation must conform to other provisions of the law touching on the particular action contemplated. How general or broadly phrased a charter reservation would be sufficient legal basis for the acts proposed, depends primarily on the general attitude the Court of Appeals would take as to the constitutional scope of such a provision, and discussion thereof will be deferred for consideration along with other matters of policy.

#### (A) *Charter Amendment*

Amending the charter so as to eliminate the dividends which have accrued on preferred stock involves two types of statutory provision. In the first place, statutory authorization must be found for the particular method employed in the amendment whereby the preferred stockholders' dividend arrearages are to be destroyed. Secondly, statutory authorization must be found for destroying the rights of preferred stockholders to dividend arrearages by the device of charter amendment.

As to the first, Section 28 of Article 23 is very broad in the scope of permissible charter amendments, including as legitimate objects of amendment not only increasing, decreasing, classifying or reclassifying all or any part of the capital stock, but also “the making of any other amendment of the charter that may be desired”. Section 29 requires for the validity of an amendment the affirmative vote of the holders of two-thirds of all the shares (or, if two or more classes have been previously issued, two-thirds of each class) outstanding and entitled to vote.<sup>4</sup>

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<sup>4</sup> Of course this required proportion might be reduced by means of a proper charter reservation as contemplated by Section 22.

Thus far an amendment authorized by the vote of the holders of all the voting stock except a small block of preferred, providing for substitution of new preferred shares with an equalizing value and rate of return for old preferred shares, or providing for issue of a new class of preferred stock with an equivalent value and rate of return but having priority over the old preferred stock, would be well within the scope of amendments permissible under Section 28 and the required authorization thereof by a two-thirds majority of each voting class of stock under Section 29.

Each of these amendments would, however, further involve the destruction of the right of the old preferred stockholders to accrued dividends. In the one case this is accomplished by substitution of a certain number of shares of new stock for each share of old preferred stock and its accrued dividends, the old class being abolished. In the other case the old preferred shareholder loses his priority rights unless he accepts the offer to exchange his old shares with their accrued dividends for new prior preferred shares, in which case he has again been parted from his right to accrued dividends, though not quite in such a direct manner.

The fundamental question is whether an amendment which has the effect of destroying the right of preferred stockholders to accrued but unpaid dividends is within the permissible scope of amendments. Even if the amendment seeks to accomplish a legitimate purpose, however, it would be invalid unless authorized by the proportion of shareholders required for this sort of an amendment; this raises a preliminary question. Besides the affirmative vote of two-thirds of each class required by Section 29 for all amendments, there are certain additional limitations imposed on the amending power by the latter part of Section 28, which provides:

“. . . No amendment of the charter of a corporation shall be valid which changes the *terms* of any of the outstanding stock by classification, reclassification, or otherwise, *in the absence of a reservation in the*

*charter of a right to make such amendment, unless such change in the terms thereof shall have been authorized by the holders of all of such stock at the time outstanding, by vote at a meeting or in writing with or without a meeting; . . . The words 'terms' as used in this section in reference to stock is intended to mean only the contract rights of the holders thereof as expressed in the charter and shall be so construed.*" (Italics supplied.)

It seems clear on both principle and authority that an amendment which has the effect of taking away the preferred stockholders' rights to accrued dividends is one changing the "contract rights" of the holders of outstanding stock. How else does the right to accrued dividends arise if not by virtue of the terms of the contract entered into when the preferred shareholder bought his stock? That contract defined the returns to which he was to be entitled on his investment as "cumulative"; his right vests as against junior security-holders by the mere lapse of time, whether or not a surplus was earned out of which the dividends could be paid, this latter contingency conditioning only the assertability of the right as against the corporation.<sup>5</sup> In *McQuillen v. National Cash Register Co.*,<sup>6</sup> the United States District Court for Maryland, speaking through Judge Coleman, expressly stated that this right to accrued dividends was such a preferred contractual right as to come within the terms of Section 28. Hence, dissent by only a single preferred shareholder would render ineffective any amendment seeking to destroy or change this right unless there were a reservation in the charter of power to make such an amendment. There seems little doubt but that a proper reservation in the charter would preclude the necessity for unanimous consent, in view of

<sup>5</sup> See: *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 A. 696 (Ct. of Chancery, 1923); *Penington v. Commonwealth Hotel Construction Corp.*, 17 Del. Ch. 394, 155 A. 514 (Supreme Ct., 1931); *General Investment Co. v. American Hide & Leather Co.*, 98 N. J. Eq. 326, 129 A. 244 (Ct. of Errors & Appeals, 1925).

<sup>6</sup> 27 F. Supp. 639, 646 (D. Md., 1939), noted (1939) 88 U. Pa. L. Rev. 114; procedural questions disposed of in 13 F. Supp. 53 (D. Md., 1935); and 22 F. Supp. 867 (D. Md., 1938); *aff'd* 112 F. (2d) 877 (C. C. A. 4th, 1940); *cert. den.* 311 U. S. —, 85 L. Ed. 280, 61 S. Ct. 316 (1940); discussed fully *infra* circa n. 10.

the terminology of Section 28; indeed a charter provision might even eliminate the necessity for *any* vote on the part of the affected stock other than what it may be entitled to with respect to any ordinary amendment.<sup>7</sup> And Judge Coleman in *McQuillen v. National Cash Register Co.*<sup>8</sup> treated the charter reservation provision of the section as affording the corporation an alternative to unanimous consent to just such an amendment. How specific the charter reservation would have to be raises a distinct question the answer to which will depend primarily on the general broad constructional and constitutional policies of the Court, there being no Maryland cases sufficiently near the point; probably the Court will require that it be reasonably specific.<sup>9</sup>

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<sup>7</sup> See Note (1937) 1 Md. L. Rev. 254, 258.

<sup>8</sup> *Supra*, n. 6.

<sup>9</sup> It seems reasonably certain, at least, that a mere general reservation in the charter of power in a designated proportion of stockholders "to do any corporate act not otherwise inconsistent with charter or statutory provisions" would not be specific enough. Such a reservation would be broad enough to take advantage of Section 22, but that opportunity was created by the legislature in Md. Laws 1922, Ch. 309, Sec. 3, Subs. 17, after the limitation on the amending power contained in Section 28 had been imposed with an express provision for a nullifying charter reservation by Md. Laws 1920, Ch. 545, Sec. 8A, and at the same time that the definition of the words "terms" was added to Section 28 by Md. Laws 1922, Ch. 309, Sec. 3, Subs. 24. This fact would indicate that the legislature did not intend that a general reservation taking advantage of Section 22 would be sufficient to bring into operation the saving clause of Section 28 with respect to amendments changing the terms of outstanding stock.

A reservation in the charter of power in a designated proportion of stockholders to "make any amendment authorized by law, including amendments changing the terms of outstanding stock" would seem specific enough to invoke the saving clause of Section 28: but on the other hand, the Court might feel it so disfranchising to minority stockholders as to require equitable or constitutional limitation.

Some doubt may be expressed as to whether a charter provision reserving the right in a designated proportion of shareholders to alter the "preferences" of outstanding stock by amendment, would be satisfactory. It is submitted that the average layman in the financial community, whose interpretation of charter and stock certificate provisions is entitled to some weight, considers the word "preferences" more as referring to the relative priorities (such as right to share in profits, voting powers, pre-emption rights, conversion privileges and distribution of assets in dissolution) of his security as against other securities in the same corporation than as referring to a matured right to accrued dividends. That is, a "preference" means to a practical business man an existing privilege which may give rise to a *future right*, rather than a presently *existing claim*—existing but not assertable, of course, until earnings are sufficient to warrant payment by the corporation. See: *Powers Foundry Co. v. Miller*, 166 Md. 590, 171 A. 842 (1934). The Delaware Court of Chancery has taken just this stand, with regard to a statute authorizing amendments altering the "preferences" of outstanding stock (29 Del. Laws, Ch. 113, Sec. 26). After ruling in *Peters v. U. S. Mortgage Co.*, 13 Del. Ch. 11.

However, assuming that by means of some proper charter reservation the preliminary requisite of proper authorization by stockholders for such an amendment has been complied with, there is yet to be faced the fundamental problem of whether the Court of Appeals will consider the destruction of accrued dividends within the permissible scope of the amending power. Section 28, after listing a number of relatively specific purposes for which amendments may be made, further authorizes:

“. . . the making of any other amendment of the charter that may be desired, provided that such amendment shall contain only such provisions as it would have been lawful or proper to insert in an original certificate of incorporation made at the time of making such amendment . . .”

Although the Court of Appeals has not yet been presented with the problem, the ground is not completely unbroken in Maryland, for the question has been examined in the light of the relevant Maryland statutes and definitely ruled upon by the United States District Court for Maryland in the *McQuillen* case, above referred to.<sup>10</sup> In that case the defendant corporation, organized in Maryland in 1926, had outstanding on December 15, 1932, a capital stock issue consisting of 1,190,000 shares of Class A \$3 cumulative participating preferred and 400,000 shares of Class B non-cumulative participating preferred, each class being of the no-par variety. At that time there were dividend arrearages on the Class A stock of \$5,801,250, no dividends having been paid since 1931. To relieve the corporation of this obstacle to refinancing and expansion, a recapitalization plan was proposed and the charter amendment providing therefor passed by the two-thirds

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114 A. 598 (Ct. of Chancery, 1921) that the right of a preferred stockholder to *future* priority in payment of dividends was no more than such a "preference" as could be destroyed by amendment, the Chancellor in *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 A. 696 (Ct. of Chancery, 1923) held that accumulated dividend arrearages were a present "*property right*", postponable in enjoyment, but nevertheless assertable upon the happening of the proper contingency and "vested" as against the other stockholders, and that therefore it was more than a mere "preference" and could not be destroyed by amendment.

<sup>10</sup> *Supra*, n. 6.



majority required by Article 7 of the charter for creation of new issues of stock and the making of other amendments.<sup>11</sup> By means of a stock split-up and conversion all accrued dividends were to be eliminated.<sup>12</sup> On this ground, two years after the amendment had taken effect, the plaintiff, who had bought 100 shares of Class A stock in 1928 and 1929, brought a bill praying an injunction against the carrying out of the plan embodied in the amendment. The District Court dismissed the bill, ruling that Section 28 of the Maryland Code was broad enough to permit destruction of the right of preferred stockholders to accrued dividends by a charter amendment passed by the vote of the holder of two-thirds of the aggregate shares of all classes outstanding, where the charter reserved the power in such proportion to do any act requiring authorization by the stockholders. It was held that Articles 7 and 11 of the charter invoked the saving clause of Section 28 by taking advantage of the terms of Section 22.<sup>13</sup> The Court stated that decisions in Delaware, New York and New Jersey favorable to dissenting stockholders in similar circumstances were in no way controlling because the statutes there involved were not so broad as the Maryland amendments statute. Proceeding to analyze the statute, the Court held that an amendment destructive of the rights of preferred stockholders to dividend arrearages was clearly such a provision as might have been inserted in the

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<sup>11</sup> Although the Secretary of the corporation reported that the amendment had been authorized by two-thirds of the stockholders of each class, whereas in fact it had been authorized by two-thirds of the aggregate of stockholders of both classes considered as a single class, this was held neither to be a badge of fraud nor to invalidate the amendment, since Article 7 of the charter, by taking advantage of Section 22, eliminated the necessity for strict compliance with Section 28 requiring two-thirds of each class. *McQuillen v. Nat'l Cash Register Co.*, 112 F. (2d) 877, 883.

<sup>12</sup> The amendment provided for increasing the authorized issue of Class A stock by 238,000 shares which were to be distributed in a split-up to old Class A holders as a stock dividend of 20%. It further called for the creation of a new Class C stock with dividend and voting rights equivalent to those on Class A, authorized in the amount of 200,000 shares without par value, which were to be exchanged for the 400,000 shares of Class B stock. After this exchange was completed, all Class A and Class C stock were to become a new single class of common stock without fixed or cumulative dividends.

<sup>13</sup> See *supra*, n. 9. Section 22 of Article 23 of the present Code of 1939 (Flack) was, at the time of the *McQuillen* decision, Section 23 of the same article in the Code of 1924 (Bagby).

original charter, and that the statute expressly authorized any amendment "which changes the terms of any of the outstanding stock by classification, reclassification, or otherwise". Since the words "terms" was expressly defined to mean "contractual rights", it was ruled that the right to accrued dividends, being unquestionably of such a nature, was therefore subject to being altered by a proper amendment. The unanimous consent required by the statute for such amendment was held to be unnecessary since there was sufficient charter reservation to invoke the saving clause providing an alternative to unanimous consent. The rest of the District Court's opinion dealt with the validity of a stock-purchase option given to a director, a question not pertinent here. The Circuit Court of Appeals for the Fourth Circuit affirmed the District Court on both questions,<sup>14</sup> but it added nothing material to the present discussion, doing little more than to adopt Judge Coleman's views.

As persuasive authority on interpretation of the Maryland law, the *McQuillen* opinion perhaps leaves something to be desired. Although the District Court expressly rested its decision on statutory construction and dismissed the question of the plaintiff's laches as being therefore unnecessary of determination, it is suggested that the facts that the action was not brought until two years after the amendment was passed, and that the recapitalization had been going on for almost six years before the final opinion was handed down, carried no small weight in influencing the Court to refuse to upset the amendment and attempt to undo all that had been done, merely in order to protect the (alleged) rights of a far from alert holder of less than 1% of the outstanding preferred stock.

In such a view of the facts, the decision can only be regarded as eminently fair; but from the purely technical constructional viewpoint, its reasoning is not entirely compelling, for the opinion deals only with the literal terms of the statute and fails to consider the probable intent of

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<sup>14</sup> 112 F. (2d) 877 (C. C. A. 4th, 1940); *cert. den.* 311 U. S. —, 85 L. Ed. 280, 61 S. Ct. 316 (1940).

the Legislature as to the scope thereof. The decision appears to assume that the provision of Section 28 limiting the power of less than a majority to make an amendment altering the contract rights of stockholders, combined with the saving clause, contains affirmative permission to make an amendment destroying the right to accrued dividends. There seems room for doubt whether the Legislature intended "contract rights" to include rights which have been described by other courts as "vested",<sup>15</sup> "property rights",<sup>16</sup> "in the nature of a debt".<sup>17</sup>

It would seem quite possible for the Court of Appeals to consider an amendment destroying rights to accrued dividends as being so fundamental in nature as to require unanimous consent entirely aside from the statute; for the statute permitting charter amendments merely restricts the common law rule and is capable of being held not applicable—the statute clearly does not go so far as to abrogate *completely* the common law rule requiring unanimity of stockholder consent to any amendment. Beyond this, such an amendment might be open to question on the score of the legality or propriety of such a provision in the original charter<sup>18</sup>—it could hardly be argued that permission to alter the contract rights of outstanding stock so far limits the proviso in regard to legality or propriety as to authorize an amendment deemed to be *otherwise* illegal or improper. Finally, it is far from clear that a charter reservation generally worded and primarily if not solely intended to take advantage of Section 22, could or should be held to invoke the saving clause of Section 28 with respect to amendments changing the terms of outstanding stock.<sup>19</sup>

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<sup>15</sup> *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 A. 696 (Ct. of Chancery, 1923); *Keller v. Wilson*, 190 A. 115 (Del. Sup. Ct., 1936); *Patterson v. Durham Hosiery Mills*, 214 N. C. 806, 200 S. E. 908 (1939).

<sup>16</sup> *Ibid.*

<sup>17</sup> *Boardman v. Lake Shore & Michigan Southern Ry. Co.*, 84 N. Y. 157 (1881); *Colgate v. U. S. Leather Co.*, 73 N. J. Eq. 72, 67 A. 657 (Ct. of Chancery, 1907); *Schneider v. Foster-Thornburg Hardware Co.*, 33 F. Supp. 271 (S. D. W. Va., 1940).

<sup>18</sup> Required by the proviso in the first sentence of Section 28.

<sup>19</sup> See *supra*, n. 9.

Since *Erie R. R. v. Tompkins*<sup>20</sup> and its complementary decisions, final authority on matters of local law rests solely with the state courts.<sup>21</sup> Hence the Maryland courts are free to decline the lead offered by the *McQuillen* case and to examine the state of the authorities in other jurisdictions before ruling on the validity of amendments which in one way or another effectually destroy the right of preferred stockholders to accrued unpaid dividends.

Deserving of particular consideration is the judicial opinion prevailing in Delaware, not only because of the generally similar liberality of the Delaware General Corporation Law to the Maryland law, but also because of the frequency with which the Delaware courts have had to deal with this problem.

In the first case on the subject in Delaware, *Morris v. American Public Utilities Co.*,<sup>22</sup> the Chancellor decreed void that part of a charter amendment which provided for cancellation of accrued dividends of 24% on the outstanding preferred stock, on the ground that the dividend arrearages constituted a "vested right" in the nature of a property right, which could not be destroyed by amendment although the applicable statute permitted amendments altering the "preferences" of stock outstanding. In 1927 this statute was amended by the Legislature<sup>23</sup> to permit alteration by self-amendment of "other special rights of the shares" as well. In *Keller v. Wilson*<sup>24</sup> the Chancellor held that this amendment to the statute was intended to abrogate the result of the *Morris* case, and he therefore refused to declare void an amendment substituting 5 shares of common stock for each old share of Class A (cumulative preferred) stock and cancelling accrued dividends thereon of \$21.25. On appeal, however, he was reversed by the Supreme Court,<sup>25</sup> which adopted

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<sup>20</sup> 304 U. S. 64, 82 L. Ed. 1188, 58 S. Ct. 817 (1938).

<sup>21</sup> Destruction of accrued dividends under the Bankruptcy Act, especially Chapter 10, is beyond the scope of this article. See, in this connection, *In re Community Power & Light Co.*, 33 F. Supp. 901 (S. D. N. Y., 1940), involving a Delaware corporation.

<sup>22</sup> 14 Del. Ch. 136, 122 A. 696 (Ct. of Chancery, 1923).

<sup>23</sup> 38 Del. Laws, Ch. 94, Sec. 3.

<sup>24</sup> 180 A. 584 (Del. Ct. of Chancery, 1935).

<sup>25</sup> 190 A. 115 (Del. Sup. Ct., 1936).

the "vested right" theory promulgated in the *Morris* case, and held that the statute as amended was not broad enough to authorize a charter amendment destroying the rights of preferred stockholders to dividend arrearages. In the belief that the Court had been concerned in its opinion more with the scope of the reserved power of the state by amendment of the General Corporation Law to increase the charter rights of majority stockholders in a corporation organized in 1925, the scope and applicability of that 1927 amendment was tested with regard to a corporation organized in 1928 after the 1927 amendment had taken effect. Disregarding this difference in facts, the Supreme Court held in *Consolidated Film Industries v. Johnson*<sup>26</sup> that the Chancellor, in decreeing a charter amendment destructive of dividend arrears<sup>27</sup> to be null and void and permanently enjoining the carrying it into effect, had correctly construed the implications of the decision in *Keller v. Wilson* with respect to the scope of the 1927 amendment.<sup>28</sup>

In view of the definity of the stand of the Delaware courts, it might be well to examine in more detail the "vested rights" theory as first promulgated in the *Morris* case and more particularly as elaborated in *Keller v. Wilson*. The fundamental concept of the theory is the effect of lapse of time upon the terms of the cumulative preferred stock contract. This contract provides in essence that the holder of preferred shares is to receive a fixed yearly dividend, in priority to junior security holders, and if the earnings of the corporation in any year

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<sup>26</sup> 194 A. 844 (Del. Ct. of Chancery, 1937); 197 A. 489 (Del. Sup. Ct., 1937). *Contra*: *Harr v. Pioneer Mechanical Corp.*, 65 F. (2d) 332 (C. C. A. 2d, 1933); *cert. den.* 290 U. S. 673, 78 L. Ed. 581, 54 S. Ct. 92 (1933).

<sup>27</sup> The amendment proposed to convert 4 shares of old \$2 cumulative participating preferred stock with their \$4 per share accrued dividends into 5 shares of new \$1 cumulative participating preferred and 1 share of new common stock.

<sup>28</sup> But see: *Federal United Corp. v. Havender*, 11 Atl. (2d) 331 (Del. Sup. Ct., 1940), where the Court summarily disposed of *Keller v. Wilson* as being purely and simply a decision on the reserved power of the state, and where *Consolidated Film Industries v. Johnson* was considered totally inapplicable because it involved the amendments statute whereas the case at bar involved the merger statute. The logic in distinguishing two very similar cases on entirely different grounds is difficult to perceive.

are not sufficient to justify the payment of any dividends on the preferred, payment thereof may be postponed, but the fixed dividend will nevertheless accrue. Each year dividends are passed, they accumulate, and when earnings increase, no dividend may be paid on junior securities until all the past accumulated dividends on the preferred stock are paid off. The preferred stockholder's right has become "vested" as against the holders of junior securities, who agreed when they bought their interests in, and made their contracts with, the corporation that the preferred stockholders were to have this right. Clearly this is a substantial right of the preferred shareholders, which gives value to his stock and on which he relies in keeping his investment, particularly in years when dividends are passed. If this right were subject to being cut off by the action of a majority of stockholders who felt that its destruction would benefit the corporation financially, it would be merely an illusory right in the hands of the dissident stockholder, for the value of his investment could be violently diminished without his consent. In effect he is being deprived of at least a substantial part of a valuable property right—viz., his part-ownership of the business—for if his investment turns out to be non-productive, he has become an unfortunate speculator against his will, whereas he acquired his interest on the understanding that he would receive a fixed return thereon regardless of all contingencies except ultimate insolvency.<sup>29</sup> Now, however, he finds himself entitled to a fixed return on his investment only if the majority (or whatever other proportion is required) of the stockholders think it wise business policy to give it to him. For the directors can in their discretion let dividend arrearages pile up during the lean years, and then the majority stockholders can ratify this policy and carry it to the length of completely wiping out the accrued rights which induced the preferred shareholder originally to invest and then to retain his interest

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<sup>29</sup> See: Comment, *Preferred Stock as an Investment Security* (1939) 28 Georgetown L. J. 232-258.

in the corporate enterprise.<sup>30</sup> The fact that this might be the best business expedient in the circumstances is an argument which might be used by the majority in attempting to persuade the dissenters to sacrifice their rights, but it does not afford a valid basis for refusal by a court to protect the minority from destruction of their property rights against their will.<sup>31</sup>

While the state undoubtedly has from the public policy viewpoint an interest in the corporate welfare, e. g., in permitting necessary refinancing, nevertheless it must exercise all its powers with regard for the rights of *all* concerned.<sup>32</sup> The state also has an interest in the protection of the investing public, and this involves protection against the destruction of such substantial rights as those of preferred stockholders to dividends which have accrued but are as yet unpaid.

Apparently Delaware has begun to retreat from its original position, one protecting accrued dividends against all form of encroachment, for in two cases decided last year this right was suffered to be effectually destroyed, in one instance by merger<sup>33</sup> and in the other by charter amendment. In the latter case, *Shanik v. White Sewing Machine Corp.*,<sup>34</sup> the complaining preference stockholder was refused an injunction against payment of dividends on prior preference stock issued in accordance with a charter amendment providing for a plan of recapitalization intended to wipe out a deficit of \$3,167,228.26. Under this amendment there were to be a reduction of stated capital, a reverse split of the common stock, 5 shares for 2, and the old preference stock was to be left untouched but could be exchanged for one share of the new prior preference stock and three shares of common. Of course the old

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<sup>30</sup> The increased voting rights which normally accrue to the preferred stockholders on the passing of dividends are usually so circumscribed as to interfere but little with the effective control in the hands of the common shareholders.

<sup>31</sup> *Lonsdale v. International Mercantile Marine Co.*, 101 N. J. Eq. 554, 139 A. 50 (Ct. of Chancery, 1927); discussed *infra*, *circa* n. 44.

<sup>32</sup> *Keller v. Wilson*, 190 A. 115 (Del. Sup. Ct., 1936).

<sup>33</sup> *Federal United Corp. v. Havender*, 11 A. (2d) 331 (Del. Sup. Ct., 1940); discussed *infra*, *circa* n. 85.

<sup>34</sup> 15 A. (2d) 169 (Del. Ct. of Chancery, 1940).

preference stockholder could retain his now junior securities with their \$30 dividends arrearages, but the chance of his ever realizing on the accrued dividends was practically eliminated. Nevertheless, the Vice Chancellor, while paying his lip-service to the doctrine of the *Morris and Keller* and *Consolidated Film Industries* cases, held the recapitalization plan, amendment, and reduction of capital to be legal and proper inasmuch as the preference stockholder could show no interference with his right to accrued dividends, which he still retained.

Similar rulings have been made in Illinois<sup>35</sup> and Ohio. In *Johnson v. Lamprecht*,<sup>36</sup> the Ohio Court sustained an amendment providing for issue of a new class of prior preferred stock, 1½ shares of which, with ¾ share (worth \$6) of common stock, could be acquired in exchange for each share of old preferred stock with its \$20 of accrued dividends. Here again the preferred stockholder was denied equitable relief on the ground that the plan was not compulsory, the Court admitting that its validity would have been questionable had it been compulsory. It is submitted that in each of these cases the Court ignored the obvious economic fact that "the exchange is in law compulsory, if to refrain therefrom would result in an obvious and substantial loss."<sup>37</sup>

It is true that when a prior preferred stock is issued the dissenter could keep his old stock as a junior security, to which position he knew, by the terms of the charter and applicable statutes it might be reduced by the vote of a certain majority, when he bought his stock. It would seem, however, that leaving the dissenting shareholder with a practically worthless right to accrued dividends and expressly destroying that right are similar devices: the distinction is without a difference. Exactly this view has been taken by the Supreme Court of North Carolina. In *Patterson v. Durham Hosiery Mills Co.*<sup>38</sup> an injunction was

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<sup>35</sup> *Kreicker v. Naylor Pipe Co.*, 374 Ill. 364, 29 N. E. (2d) 502 (1940).

<sup>36</sup> 133 Ohio St. 567, 15 N. E. (2d) 127 (1938).

<sup>37</sup> *Yoakam v. Providence Biltmore Hotel Co.*, 34 F. (2d) 533, 537 (D. R. I., 1929).

<sup>38</sup> 214 N. C. 806, 200 S. E. 906 (1939).



upheld against an amendment authorizing issue of prior preferred shares, and so injuring preferred stockholders' rights to accrued dividends, on the ground that a vested right could not be so altered. Subsequently, in *Patterson v. Henrietta Mills*,<sup>39</sup> the doctrine of the former case was held applicable to an amendment providing for substitution of new preferred stock for old, and terminating the right to accrued dividends on the original stock. This seems clearly the more realistic approach and consequently the one more likely to be adopted by the Maryland courts despite the similarity between the Delaware and Maryland statutes.

New Jersey has to some extent recognized the "vested right" theory, and again any supposed distinction between practical destruction of accrued dividends by issue of prior preferred stock and avowed destruction has been ignored. In *Colgate v. U. S. Leather Co.*,<sup>40</sup> it was held that this right fell within the language of the statute permitting consolidation provided that "all debts, liabilities and duties" of the consolidating corporation should attach to the new or consolidated corporation, which was therefore liable for accrued dividends on preferred stock of the consolidating corporation before any property could be distributed to the common stockholders under the consolidation agreement. In *General Investment Co. v. American Hide & Leather Co.*,<sup>41</sup> preferred stockholders sought an injunction against an amendment authorizing purchase and retirement of the outstanding preferred stock, cancellation of unissued preferred stock, and issue of a new series of prior preferred stock, on the ground that it violated the vested rights of the preferred shareholders. The majority of the Court held that (1) the amendment was valid under a statute permitting a corporation to "create one or more classes of preferred stock" at any time, even though such an amendment might to some extent affect the preferred stockholders' vested rights; but that (2) so far as the amendment authorized the purchase and re-

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<sup>39</sup> 216 N. C. 728, 6 S. E. (2d) 531 (1940).

<sup>40</sup> 73 N. J. Eq. 72, 67 A. 657 (Ct. of Chancery, 1907).

<sup>41</sup> 98 N. J. Eq. 326, 129 A. 244 (Ct. of Errors and Appeals, 1925).

tirement of the preferred stock with those accrued dividends unpaid and remaining in the treasury which were allocable to the shares of the dissenting preferred stockholders, it was invalid. It is not clear whether in referring to vested rights, the majority meant that accrued dividends could thus be cut off by amendment or not.

Much clearer is a concurring opinion,<sup>42</sup> cited with approval by the Delaware Court,<sup>43</sup> in which it was suggested that the amendment authorizing the issue of prior preferred stock does not invade any vested rights of holders of outstanding preferred stock as to priorities in future dividends and on dissolution, for their contracts were subject to such alteration by amendment. It was further stated, however, that if the amendment sought to destroy the unpaid accrued dividends of 140% on the preferred stock which were covered to the extent of two-fifths by existing surplus, to this extent the amendment would be invalid as invading a vested contract right on the basis of which the preferred stockholders had invested their money; but that in fact the plan did not accomplish this because as to these accrued dividends the dissenting preferred stockholders *still had preference* over the new prior preferred stock.

In *Lonsdale v. International Mercantile Marine Co.*,<sup>44</sup> a permanent injunction was granted against a proposed amendment whereby each old preferred share with \$70 accrued dividends was to be cancelled in exchange for 5 shares of new common stock. This was done on the theory that the preferred stockholders had by the terms of their contract and the passage of time become vested with rights as against the common stockholders in the corporate surplus of some \$17,000,000. diversion of which rights, as by the proposed amendment, would impair the investment value of the outstanding preferred shares. The consequent reduction of the value of their property rights, it was held, could not legally be accomplished without the consent of the holders.

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<sup>42</sup> White, J., concurring; 98 N. J. Eq. 326, 332, 129 A. 244, 249.

<sup>43</sup> Keller v. Wilson, 190 A. 115, 123-4 (Del. Sup. Ct., 1936).

<sup>44</sup> 101 N. J. Eq. 554, 139 A. 50 (Ct. of Chancery, 1927).

In *Windhurst v. Central Leather Co.*,<sup>45</sup> a merger was allowed whereby each old preferred share with 43% dividend arrearages was to be exchanged for certain stock in the new corporation in addition to \$5 in cash. The Vice Chancellor held that the plan was not unfair or inequitable to the preferred stockholders as it involved only a slight reduction in the return on investment, and distinguished the *Lonsdale* case as involving stockholders' rights in existing surplus, whereas the corporation in the case at bar had a capital deficit of some \$19,000,000. He further held, though not as the controlling element in the case, that the plaintiff stockholders were barred by laches, on which ground he distinguished the *Colgate* case. The Court of Errors and Appeals adopted the Vice Chancellor's opinion in affirming his dismissal of the bill for injunction and specific performance of the stock contract. None of the opinions, however, mentioned the decision in *General Investment Co. v. American Hide & Leather Co.*, presumably because the holding there was not so clear as might be desired. New Jersey now has a statute,<sup>46</sup> however, which specifically allows the elimination of arrearages by charter amendment upon the approval of two-thirds of the class involved. This statute was passed shortly before the *Lonsdale* decision and the first opinion in the *Windhurst* case and evidently was considered inapplicable where the charter of the corporation was in existence previously, for it was cited in neither case; but it would clearly apply when the charter was issued after the passage of the statute.<sup>47</sup>

It might be argued that the authority of some of the foregoing cases is weakened by the fact that the corporation in question had an existing surplus at the time the attempt was made to destroy the rights of preferred stockholders to accrued dividends, and that consequently it was easier for the Court to find that the preferred shareholders

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<sup>45</sup> 101 N. J. Eq. 543, 138 A. 772 (Ct. of Chancery, 1927); 105 N. J. Eq. 621, 149 A. 36 (Ct. Chancery, 1930); *aff'd* 107 N. J. Eq. 528, 153 A. 402 (Ct. of Errors and Appeals, 1931).

<sup>46</sup> N. J. Rev. Stat. (1937) Secs. 14: 11-1 to 11-3.

<sup>47</sup> See *Sander v. Janssen Dairy Corp.*, 36 F. Supp. 512 (D. N. J., 1940).

had a present right therein which was inviolable, than it would be in a case where no surplus existed. It was on this ground that the Federal District Court in Rhode Island in *Yoakam v. Providence Biltmore Hotel Co.*<sup>48</sup> distinguished the *General Investment Co.* case, which was cited to it, and refused to follow the reasoning of the concurring opinion in that case. In the *Yoakam* case, the Court was called upon to determine the legality of an amendment to the charter of a Delaware corporation which had been approved by the holders of 82% of the preferred stock and provided (1) for the creation of new prior preferred Class A and prior preferred Class B stock, (2) that the holders of old preferred were to have the right to receive in exchange for each old share, one share each of new Class A, new Class B, and common stock, this right to be conditioned upon waiver of all rights to accrued and unpaid dividends, (3) that the old preferred stock dividends were to be no longer cumulative, and (4) that the sinking fund for the old preferred stock was to be abolished. Only as to the last provision did the Court hold this amendment invalid under the laws of Delaware. It was held that there was sufficient statutory authorization for the issue of new preferred stock having priority over the old preferred and for the abolition of the cumulative feature of the latter as to future dividends, on the theory that the amendment was thereby merely altering the "preferences" of the outstanding stock, which was specifically permitted by the Delaware amendments statute.

As to accrued dividends the Court interpreted the amendment as having the effect of preserving all rights of dissenting preferred stockholders in respect to earned *surplus then existing* and available for dividend purposes, but that it would be proper for the corporation to pay from *future earnings* dividends on the new prior preferred stock in advance of the payment in full of all accrued dividends on non-assenting preferred stock. This is the only case found which has so definitely drawn a distinction based on the existence *vel non* of a corporate surplus as

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<sup>48</sup> 34 F. (2d) 533 (D. R. I., 1929).

determinative of the question whether a destruction of the rights of preferred stockholders was invalid or not. The opinion fails to give any reason for this holding, merely stating that the court believes this rule to be better than the one suggested by the concurring opinion in the *General Investment Co.* case.

Actually there was a surplus existing in the New Jersey case, so the *Yoakam* opinion may be considered as merely questioning the breadth of the principle expressed in the concurring opinion in that case, which in terms went beyond the facts. The argument that the existence of a corporate surplus weakens the authority of some of the foregoing cases loses force, moreover, in view of the fact that there was no surplus in the *Morris* case, the *Colgate* case, or the *Windhurst* case; and in the *Keller* case the fact that there was a surplus of over \$8,000,000 was not even mentioned in the opinion.

The Supreme Court of Delaware, in *Penington v. Commonwealth Hotel Construction Co.*,<sup>49</sup> in holding that preferred stockholders were entitled to unpaid accrued dividends on dissolution, said that their right thereto matures by lapse of time even though no profits or surplus existed. To similar effect is the New York decision of *Roberts v. Roberts-Wicks Co.*<sup>50</sup> There, after the corporation (with a deficit of some \$90,000) reduced its capital stock, giving to each stockholder a proportionate number of shares in exchange for his former holdings, it succeeded in making a profit. It was held that preferred stockholders had a prior right to a sufficient amount of these profits to pay the arrears of dividends *on shares held by them prior to the reduction of the stock*. The Court in so holding said that statutory authorization of reduction of capital stock did not permit the impairing thereby of any vested right of a shareholder nor of any corporate obligation. As to the obligations of the corporation, the court stated:

“Its agreement to pay dividends on the preferred stock had not been fulfilled, and, so long as the corpor-

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<sup>49</sup> 17 Del. Ch. 394, 155 A. 514 (Sup. Ct., 1931).

<sup>50</sup> 184 N. Y. 257, 77 N. E. 13 (1906).

ation was a going concern, this default created an *indebtedness*, which was payable whenever, in the future, it should accumulate surplus profits from the conduct of the business. The preferred shareholder, 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."<sup>51</sup> (*Italics supplied.*)

In this connection it is interesting to note some language used in the past by the Maryland Court of Appeals regarding the nature of preferred stockholders' rights to accrued dividends, though the cases did not involve the problem here under consideration. In *Heller v. Marine Bank*,<sup>52</sup> the Court was required to determine the rights in insolvency of creditors of a corporation as against those of holders of preferred stock issued pursuant to an act of 1880.<sup>53</sup> This law was the first general law to authorize the issuance of anything in the nature of preferred stock, authorizing corporations, instead of issuing mortgage bonds, to issue preferred stock under a publicly recorded agreement guaranteeing to the holders thereof a perpetual dividend of 6%, and further providing that the holders of such stock should have all the rights of holders of capital stock, and in addition "that the said preferred stock shall be and constitute a lien on the franchises and property of such corporation, and have priority over any subsequently created mortgage, or other encumbrance".

In holding that the holders of this statutory so-called preferred stock had a limited priority in the assets over unsecured creditors, the Court took occasion sharply to

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<sup>51</sup> 184 N. Y. 257, 264-5, 77 N. E. 13, 15 (1931).

<sup>52</sup> 89 Md. 602, 43 A. 800 (1899).

<sup>53</sup> Md. Laws 1880, Ch. 474; Md. Code (1888) Art. 23, Sec. 294; repealed by Md. Laws 1908, Ch. 240, which enacted provisions substantially similar to those now appearing in Md. Code (1939) Art. 23, Sec. 42.

differentiate it from ordinary preferred stock. The latter the Court considered to be merely an entrepreneur's interest in the capital far different in nature from the claims of ordinary creditors, which had to be satisfied before any part of the capital could be withdrawn by the entrepreneur. It said further:

"To be strictly accurate, we ought to say, there is a sense in which a shareholder is a creditor. In that sense every corporation includes its capital stock amongst its liabilities, but it is a liability which is postponed to every other liability. And as to matured and unpaid guaranteed dividends due on preferred stock, the relation of creditor undoubtedly exists."<sup>54</sup>

The last sentence has been interpreted as referring only to dividends already declared and set aside but not yet paid,<sup>55</sup> and this interpretation seems corroborated by a recent decision.<sup>56</sup> It is entirely possible, however, that the Court will reject those dicta as inapplicable or of little help at best in a situation where accrued dividends are sought to be destroyed, and will proceed to analyze the nature of the right to matured but undeclared dividends in full detail.

Besides the weight of persuasive authority in other jurisdictions, the Court of Appeals cannot ignore the economic and commercial effects before adopting a rule of destructibility of the right to accrued dividends by charter amendment. Although such a rule might at first blush tend to encourage promoters to incorporate in Maryland because of the ease with which refinancing could be accomplished, the ultimate effect might very well be the reverse. Potential investors in preferred stock would be more careful in determining which state the corporation in question was organized in, because stock of those organized in Maryland would be subject to destruction by charter amendment of any dividends which accrue in times of financial stress,

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<sup>54</sup> 89 Md. 602, 611, 43 A. 800, 801 (1899); citing *Baltimore & Ohio R. R. Co. v. State*, 36 Md. 519 (1872), *aff'd* 89 U. S. (22 Wall.) 105 (1874).

<sup>55</sup> BRUNE, *MARYLAND CORPORATION LAW* (1933) 47.

<sup>56</sup> *Heyn v. Fidelity Trust Co.*, 174 Md. 639, 649, 197 A. 292, 296 (1938).

whereas the stock of those organized in other states, including those where the law has not been settled, might be better protected. In view of the opinion in some quarters favoring more preferred stock financing in the future,<sup>57</sup> this aspect might well discourage future promotion of Maryland corporations, with the concomitant loss of tax revenue, etc.

Furthermore, such a construction placed upon the Maryland statute tends to make the word "cumulative" in the preferred stock of Maryland corporations misleading to the investing public. If dividends may be passed at any time of financial difficulty and the accrued dividends may then be wiped out by a simple charter amendment, cumulative preferred stock would be no better an investment than non-cumulative, which long since became unpopular. Assuming that a participating feature is attached to the stock, it is no better than common stock, for dividends depend entirely upon business success with no hope of back payments to even out the cycle, which is the most attractive feature of cumulative stock.

For that matter, preferred stock in a Maryland corporation would be worse than common stock, for it usually carries less voting power, even when dividends are passed; and the common stockholders could regulate dividend payments so that the preferred shareholders fare no better than they. At least some consideration should be given to the fact that long usage and construction of a number of statutes have led the average investor to regard the "cumulative" feature as a substantial right giving preferred stock more the nature of an investment than that of a speculation.<sup>58</sup>

### (B) *Merger, Consolidation or Sale of Assets*

Elimination of accrued dividends by the device of merger or consolidation with, or sale of assets to, another corporation under a plan whereby preferred stockholders in the old corporation would be compelled to exchange their

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<sup>57</sup> Comment, *supra*, n. 29, 236 *et seq.*

<sup>58</sup> See Note (1939) 88 U. Pa. L. Rev. 114, noting the McQuillen case.



old shares plus accrued dividends for an approximately equal value in similar shares without dividend arrearages in the second corporation, stands a better chance of being upheld by the Court of Appeals than does simple destruction by charter amendment. Of course dissenting stockholders would be entitled to appraisal and payment of the fair value of their shares, which would no doubt include dividend arrearages, but at least such a maneuver would eliminate most of the arrearage load, provided dissenting stockholders could not block the move entirely.

Until the 1935 amendments to the Maryland Code, no provision was made for merger as such, but consolidation of two corporations to form a new corporation has been authorized since the Code of 1888.<sup>59</sup> It would not require any very broad stretch of the statutory provisions to hold that they permitted what is technically described as a merger, as well as a technical consolidation, for the distinction is really one of form only. The general language of the Court in *Roselle Park Trust Co. v. Ward Baking Corporation*<sup>60</sup> lends support to this view, merger and consolidation being there treated as historically contemporary. Until 1908 consolidation required the assent of the holders of only a majority of the stock entitled to vote; at that time the law was changed<sup>61</sup> so as to require the assent of two-thirds of all the shares outstanding and entitled to vote. In 1935 the consolidation laws were again amended,<sup>62</sup> this time expressly to authorize merger as well as consolidation, the formalities as to the latter undergoing further changes not material to the present discussion. It is not apparent that this amendment was induced by any decisions holding that merger was not authorized under the statutes as formerly phrased; it seems merely to have been an effort to make the statute more explicit. In any case, as will subsequently be pointed out,<sup>63</sup> it is highly probable that the Court of Appeals will hold statu-

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<sup>59</sup> Md. Code (1888) Art. 23, Sec. 39; Md. Code (1939) Art. 23, Secs. 33-37.

<sup>60</sup> 177 Md. 212, 9 A. (2d) 228.

<sup>61</sup> Md. Laws 1908, Ch. 240, Sec. 29.

<sup>62</sup> Md. Laws 1935, Ch. 551.

<sup>63</sup> *Infra*, circa n. 96, *et seq.*

tory amendments subsequent to filing of the original charter of incorporation applicable thereto.

Sale of the assets of the principal corporation as an entirety in exchange for stock or perhaps other securities of a second corporation, followed by dissolution of the former or distribution of its new assets, would accomplish the same result as merger or consolidation if the agreement of sale or plan of distribution of assets called for surrender of accrued dividends on old securities in exchange for new securities without arrearages. Section 32 of Chapter 240 of the Laws of 1908<sup>64</sup> constitutes the first statutory authorization of the sale of assets as an entirety, approval by vote of holders of two-thirds of the outstanding stock entitled to vote being required. Sale is also permitted now pursuant to a charter amendment,<sup>65</sup> but dissenting or non-voting stockholders are entitled to the usual appraisal unless there was a reservation in the charter of a right to amend in such terms as would authorize an amendment conferring power to sell the corporate assets as an entirety; this provision was added to permit sale without compliance with other statutory requirements, by means of proper charter provision. Section 38 further provides that dissent of minority stockholders shall not delay the carrying out of the sale.

Under the merger and consolidation statutes the surviving or new corporation, as the case may be, must assume the "debts and liabilities" and "obligations" of the old corporation.<sup>66</sup> Although this is not required of the vendee corporation in the case of sale of assets, it may well be necessary to acceptance by the required two-thirds majority stockholders of the vendor that the agreement of sale provide for assumption of its debts and liabilities by the vendee corporation. On this ground it might be argued that an attempt to eliminate dividend arrearages by one of these methods would prove abortive, for the responsibility for accrued dividends is merely transferred from the

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<sup>64</sup> Now Md. Code (1939) Art. 23, Sec. 38.

<sup>65</sup> Md. Code (1939) Art. 23, Sec. 39.

<sup>66</sup> Md. Code (1939) Art. 23, Sec. 35.

old corporation to the new or surviving or vendee corporation as a "debt" or "liability" or "obligation" for which the latter is now "responsible", to use the pertinent phraseology of the Maryland statutes. This view has been taken by a number of courts in other jurisdictions in construing local merger and consolidation statutes. The New York Court of Appeals in *Boardman v. Lake Shore & Michigan Southern Ry. Co.*<sup>67</sup> held that dividends accrued on preferred stock of the old corporation, even though never declared, constituted a debt and obligation thereof which the corporation into which it was merged was bound to pay before paying dividends on its own stock. This case has been distinguished,<sup>68</sup> however, on the ground that the dividends there were expressly *guaranteed* in the directors' resolution and the stock certificates when the stock was originally issued, and they therefore came within the provision of the merger agreement whereby the surviving company agreed to assume all just "debts, *guarantees*, liabilities and obligations" of the old company.

In *Colgate v. U. S. Leather Co.*<sup>69</sup> it was held that rights of preferred stockholders to accrued and undeclared dividends on the cumulative preferred stock of one of the merging corporations were unaffected by the consolidation, and the corporation into which it was merged was liable for such dividends under the terms of the statute permitting consolidation provided all "debts, liabilities and duties" of the consolidating corporation attached to the new or consolidated corporation. The consolidation was eventually held invalid,<sup>70</sup> however, on other grounds; so the authority of the Vice Chancellor's opinion may be open to question. In *Geiger v. American Seeding Machine Co.*,<sup>71</sup> the Supreme Court of Ohio, in modifying an injunction against a proposed distribution of assets of an Ohio corporation following a sale of its former assets, decreed that

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<sup>67</sup> 84 N. Y. 157 (1881).

<sup>68</sup> *Federal United Corp. v. Havender*, 11 A. (2d) 331 (Del. Sup. Ct. 1940).

<sup>69</sup> 73 N. J. Eq. 72, 67 A. 657 (Ct. of Chancery, 1907).

<sup>70</sup> *Colgate v. U. S. Leather Co.*, 75 N. J. Eq. 229, 72 A. 126 (Ct. of Errors and Appeals, 1909).

<sup>71</sup> 124 Ohio St. 222, 177 N. E. 594 (1931), noted (1932) 17 *Corn. L. Q.* 269.

the preferred stockholders were entitled to hold in preference to the common stockholders to the extent of the par value of their shares plus accrued dividends, all the common stock of the vendee corporation received by the Ohio corporation in exchange for its former assets. In that case, however, the agreement of sale failed to include provisions as to distribution of the proceeds thereof; hence the preferred stockholders were not precluded by their consent to the sale from later challenging the distribution of the proceeds. The opinion further intimated that had such provisions been included and the proposed sale been approved by the requisite majority, dissenting shareholders would only have been entitled to the remedy of appraisal; so the arrearage load would have been at least greatly diminished, which is the maximum that can be accomplished by any of these devices, assuming that the accrued dividends will be included in appraising the fair value of dissenters' shares.

It is therefore evident that the argument that accrued dividends survive the merger, consolidation or sale of assets, as a liability of the second corporation, finds but unconvincing authority in the most unequivocally worded decisions. Furthermore, although the statutes in those cases may be similar to the Maryland statutes in phraseology and intent, fundamentally the question is not so much one of statutory or contract interpretation as one of the view the particular court takes as to nature of the right to accrued dividends. It is to be noted that under the Maryland merger and consolidation statute the responsibility of the new corporation for the liabilities and obligations of the old corporation is to be the same as if it had originally incurred those liabilities and obligations itself: no greater, no lesser.<sup>72</sup> A recent decision of the Court of Appeals, while not dealing with the merger statute, has specifically held that accrued preferred stock dividends do not constitute a debt. In *Heyn v. Fidelity Trust Co.*<sup>73</sup> the Court was called upon to apportion various dividends

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<sup>72</sup> Md. Code (1939) Art. 23, Sec. 35 (2) (d).

<sup>73</sup> 174 Md. 639, 197 A. 292 (1938).

on stocks held in trust between corpus and income, and it remarked in passing that:<sup>74</sup>

“there is no relation of debtor and creditor between the corporation and preferred stockholders or cumulative preferred stockholders until the declaration of the dividend, when, in consequence of the declaration, the obligation of debtor and creditor does arise.”<sup>75</sup>

It would not seem at all inconsistent for the Court to consider accrued dividends as something in the nature of a vested right, invulnerable to destruction by charter amendment, and yet not go so far as to call them a “debt”, “liability” or “obligation” in the very technical sense evidently intended in the merger and consolidation statute or as would be intended in the ordinary contract of purchase and sale.

The facts that a merger or consolidation or sale of assets approved by the requisite proportion of stockholders would be valid as such, and that accrued dividends on stock of the old corporation would not normally be held to survive against the new corporation, do not dispose of the entire problem, however. There is yet to be considered the possibility that the Court of Appeals would refuse on general equitable principles to sustain the employment of such devices for the primary purpose of eliminating dividend arrearages. Reduced to its simplest terms it is a question of the extent of the powers of a majority in vote of the stockholders to bind the minority. In *American General Corp. v. Camp*,<sup>76</sup> a case involving the fairness of the commissioners' appraisal of dissenting preferred stockholders' shares under the consolidation statute, it was said:

“The power of a dissenting stockholder to prevent the sale of all the assets or the consolidation or merger of its corporate existence with another corporation frequently proved in the past a disadvantage to the other stockholders. To overcome this difficulty and to meet a general demand and at the same time to protect

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<sup>74</sup> 174 Md. 639, 649, 197 A. 292, 296 (1938).

<sup>75</sup> For a clear discussion of this rule see *American Steel Foundries v. Lazard*, 204 F. 204 (C. C. A. 3rd, 1913).

<sup>76</sup> 171 Md. 629, 190 A. 225 (1937); noted (1937) 1 Md. L. Rev. 338.

the dissentient in his property rights to their full extent, the General Assembly of Maryland passed appropriate legislation. So, by compliance with prescribed conditions and procedure, any one or more corporations of this state may be consolidated with another corporation of this or another state to form a new corporation or be merged into another such corporation, provided, *inter alia*, that the consolidation or merger shall be approved by the requisite vote of two-thirds of all the shares entitled to vote."<sup>77</sup>

The Court went on to quote from *Homer v. Crown Cork and Seal Co.*,<sup>78</sup> indicating a similar state of the law with respect to sale of assets. In that case the Court had refused an injunction to restrain the calling of a meeting of stockholders to vote on, and the carrying out of, a sale of all the assets of the defendant corporation, on the ground that there was no sufficient evidence of fraud to warrant judicial interference. In so doing the Court was merely reaffirming the doctrine, built up in Maryland in such cases as *Shaw v. Davis*<sup>79</sup> and *Matthews v. Headley Chocolate Co.*,<sup>80</sup> to the effect that in the absence of fraud, illegality, ultra vires or gross negligence, a court of equity will not substitute its judgment as to the propriety of a proposed corporate act for the judgment of those in control of the corporation.<sup>81</sup> Nothing in the two later opinions, however, indicates any intention of the Court, because of the breadth of the statutes, to relinquish its right to interfere with proposed mergers, consolidations or sales of assets, where such action is warranted by fraud, illegality or the like. Indeed it seems quite generally recognized that the broad terms of such statutes are subject to judicial limitation, the general theory being that in fairness and justice ma-

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<sup>77</sup> 171 Md. 629, 634, 190 A. 225, 227 (1937).

<sup>78</sup> 155 Md. 66, 141 A. 425 (1928).

<sup>79</sup> 78 Md. 308, 28 A. 619 (1894), recognizing the right of majority stockholders to carry out a lease of the road of another railroad organized expressly for the purpose.

<sup>80</sup> 130 Md. 523, 100 A. 645 (1917), recognizing that minority stockholders had a valid cause of action to recover excessive salaries voted by the majority stockholders to themselves as officers of the corporation.

<sup>81</sup> See *McQuillen v. National Cash Register Co.*, 27 F. Supp. 639, 647 (1939). See also *Williams v. Salisbury Ice Co.*, 176 Md. 13, 3 A. (2d) 507; and *Williams v. Messick*, 177 Md. 605, 11 A. (2d) 472 (1940).

jority stockholders cannot be allowed to run roughshod over impotent minorities.<sup>82</sup>

The question is therefore reduced to one of whether destruction of preferred stockholders' rights to accrued dividends presents a case for equitable limitation of the right of a majority to merge, consolidate or sell all the assets of the corporation. Although dividend arrearages were involved in the consolidation in *American General Corp. v. Camp*,<sup>83</sup> the question of the validity of their attempted destruction was not before the Court, for the aggrieved stockholders were merely seeking an appraisal of the value of their shares and had sought no other legal or equitable relief against the consolidation. The decision will therefore afford but little assistance when the Court is faced with the petition of a preferred stockholder who is being forced to sell out his interest in the enterprise on pain of sacrificing his accrued dividends in a merger, consolidation or sale of assets.

Several courts confronted with the problem have ruled adversely to the stockholder. In *Geiger v. American Seeding Machine Co.*,<sup>84</sup> the Ohio Supreme Court stated that the remedy afforded under the appraisal statutes is the *exclusive* remedy of minority stockholders; and that if they fail to act within the prescribed time, the dissenters may be compelled to take the new securities under a fair plan of distribution.

The Delaware Supreme Court, in *Federal United Corp. v. Havender*,<sup>85</sup> approved a merger plan whereby each old share of \$6 preferred stock with its accumulated dividends of \$28.50 was to be exchanged for 1 share of \$3 preferred stock and 6 shares of Class A common stock of the new

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<sup>82</sup> See Levy, *Rights of Dissenting Shareholders to Appraisal and Payment* (1930) 15 Corn. L. Q. 420, 425; Lattin, *Remedies of Dissenting Stockholders under Appraisal Statutes* (1931) 45 Harv. L. Rev. 233; Lattin *Equitable Limitations on Statutory or Charter Powers Given to Majority Stockholders* (1932) 30 Mich. L. Rev. 645; Comment (1937) 35 Mich. L. Rev. 626; Note (1932) 17 Corn. L. Q. 269; Note (1932) 41 Yale L. J. 908.

<sup>83</sup> 171 Md. 629, 190 A. 225 (1937).

<sup>84</sup> 124 Ohio St. 222, 177 N. E. 594 (1931), noted (1932) 17 Corn. L. Q. 269.

<sup>85</sup> 11 A. (2d) 331 (Del. Sup. Ct., 1940); *rev'g* *Havender v. Federal United Corp.*, 2 A. (2d) 143 (Del. Ct. of Chancery, 1938), 6 A. (2d) 618 (Del. Ct. of Chancery, 1939).

corporation. The Chancellor had held the merger void and enjoined the payment of dividends on the new \$3 preferred stock until all the accrued dividends on preferred shares of the old corporation held by the dissenting stockholders had been paid. He reasoned that the merger statutes (including provision for appraisal), even though they required a filed statement as to capital adjustments incident to the proposed merger, did not contemplate or permit a merger proposed solely as a cloak for recapitalization involving destruction of accrued dividends; an act which would be illegal under the rule of *Keller v. Wilson*<sup>86</sup> if attempted by amendment was not made legal by employment of the device of merger instead. On appeal the Supreme Court reversed the Chancellor and ordered the bill of complaint dismissed. It was ruled that since the law with regard to merger and consolidation had been in the statutes, and therefore written into all corporate charters, all along, the stockholder had advance notice that his rights, including those to accrued dividends, were defeasible in that they might be altered at any time by merger in accordance with the law. The Court dismissed the argument that the accrued dividends were a "debt or liability" which must, under the statute, be assumed by the surviving corporation, on the ground that the statute was clearly intended to, and did, deal only with the rights of outsiders as against the merging corporation, and not with the rights of stockholders *inter sese* or between the stockholders and the corporation. *Keller v. Wilson* was distinguished on the ground that the corporate charter there antedated the statutory amendment permitting alteration or destruction of accrued dividends, and the state's reserved power with respect to corporate charters could not be exercised to the detriment of rights vested under the old law. *Consolidated Film Industries v. Johnson*<sup>87</sup> was held inapplicable as involving the charter amendment statutes, whereas only the merger statutes were involved in the case at bar. After distinguishing other decisions and

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<sup>86</sup> 190 A. 115 (Del. Sup. Ct., 1936).

<sup>87</sup> 194 A. 844 (Del. Ct. of Chancery, 1937); 197 A. 489 (Del. Sup. Ct., 1937).



asserting that the existence of the alternative of appraisal which the stockholder might have elected made the alteration of his rights by merger fair, the Court concluded that in any case the complainant was barred from seeking relief by his laches. It seems reasonable to suppose, however, that although the laches was sufficient alone to warrant the ruling, the Court deliberately set forth its views as to the law it would apply in the future.

The same may be said of the decision of the New Jersey Court of Errors and Appeals in *Windhurst v. Central Leather Co.*,<sup>88</sup> upholding both decrees of the Vice-Chancellor, one denying injunctive relief because of laches and the other refusing specific performance of the preferred stock contract as to rights in dissolution. The Court adopted the view expressed by the lower tribunal that the merger plan, calling for the surrender of old preferred stock with its accrued dividends in exchange for cash and stock in the new corporation, was fair and just to all parties involved and was not inequitable to preferred shareholders.

The existence of the statutory right of dissenting stockholders to demand appraisal and payment in cash of the fair value of their interests argues strongly against the imposition of any further limitations on the power of the majority to merge, consolidate or sell all the assets of the corporation. As pointed out in *American General Corp. v. Camp*,<sup>89</sup> the Legislature imposed the statutory condition on the power of the majority for the express purpose of protecting dissenters. This may reasonably be said to indicate a legislative intent that appraisal was to be the *exclusive* remedy of stockholders who do not wish to join the reorganization and accept an investment in a new corporation in lieu of their old interests. One court has already adopted just this view.<sup>90</sup>

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<sup>88</sup> 107 N. J. Eq. 528, 153 A. 402 (Ct. of Errors and Appeals, 1931); *aff'd* 101 N. J. Eq. 543, 138 A. 772 (Ct. of Chancery, 1927), 105 N. J. Eq. 621, 149 A. 36 (Ct. of Chancery, 1930).

<sup>89</sup> 171 Md. 629, 190 A. 225 (1937).

<sup>90</sup> *Geiger v. American Seeding Machine Co.*, 124 Ohio St. 222, 177 N. E. 594 (1931).

On the other hand, it has been held in Maryland that consolidation, at least, accomplishes a *practical* dissolution of the old corporation.<sup>91</sup> This might be considered to give rise to the common-law consequences of dissolution purely aside from the appraisal statutes, in which case the old corporation would be required to make a fair distribution of its assets to dissenting stockholders. The Pennsylvania court has held in regard to merger that such a "practical" dissolution of the old corporation brought into operation the provisions in the preferred stock contract with respect to rights upon dissolution, and that therefore the holders thereof were entitled to accrued dividends in addition to par value.<sup>92</sup> In this connection it is important to note that in *American General Corp. v. Camp* the Court of Appeals in applying the appraisal statute approved an award of the commissioners which included the amount of accrued dividends on the preferred stock of one of the absorbed corporations which had a capital surplus at the date of consolidation, but which included nothing for accrued dividends on the preferred stock of another of the absorbed corporations which had a deficit at that date.

Similar results might well be expected were the Court to adopt the Pennsylvania view that the "practical" dissolution of the corporation gave dissenting stockholders common-law rights as well as their rights under the appraisal statutes. The existence of the latter, however, would seem to eliminate entirely the necessity for according dissenters the additional remedy, as well as to justify refusal to interfere with any merger, consolidation or sale of assets.

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<sup>91</sup> *State, use of Dodson, v. Baltimore & Lehigh R. R.*, 77 Md. 489, 26 A. 865 (1893); *State v. Consolidated Gas, Electric Light & Power Co.*, 104 Md. 364, 65 A. 40 (1906); *Diggs v. Fidelity and Deposit Co.*, 112 Md. 50, 75 A. 517 (1910).

<sup>92</sup> *Petry v. Harwood Electric Co.*, 280 Pa. 142, 158, 124 A. 302, 307 (1924). Even so, there is authority for the proposition that the preferred stockholders need not be paid in cash where the stock acquired as assets by the old corporation already has a well-established market value, rendering it the virtual equivalent of cash. *Geddes v. Anaconda Copper Mining Co.*, 254 U. S. 590, 598, 65 L. Ed. 425, 41 S. Ct. 209 (1921); *American Seating Co. v. Bullard*, 290 F. 896 (C. C. A. 6th, 1923). This, however, would not cover the situation where the new corporation is created solely for the purpose of accomplishing this recapitalization.

Since the Court of Appeals considered the status of the corporation's capital account to be important *after* a consolidation, in *American General Corp. v. Camp*, there is reason to believe that it might also consider this element of importance *before* a consolidation is carried out. While this element was not decisive of either the New Jersey or the Delaware case discussed above,<sup>93</sup> it affords a basis for evaluating the true importance of the right to accrued dividends of whose threatened destruction a dissenting stockholder complains. In a case where a surplus exists, the accrued dividends represent a real interest of the stockholders in the corporate enterprise; and the Court might hesitate long before withholding protection of such an interest, especially if it felt that appraisal was not an entirely adequate remedy but that common-law rights on dissolution could not be invoked.

On the other hand, if there is no surplus, the rights to accrued dividends are indeed hollow, and surely mere empty shells of now valueless rights do not merit the serious consideration of a court faced with the problems of a corporation seeking financial rehabilitation. Nevertheless it may well be that a rule making the existence *vel non* of corporate surplus determinative of the validity of a plan of merger, consolidation or sale of assets, would be too arbitrary, especially in view of the indefiniteness of the nature of *any* corporate surplus or deficit. Rather than to attempt an analysis in each case of the surplus or deficit existing, it would be much simpler and would probably produce more equitable results if the Court were to decide the question in the light of all the facts presented. There is at least one case in Maryland tending to indicate that the Court will attach considerable importance to the business aspects of the situation in dealing with matters of corporate financing. In *Leviness v. Consolidated Gas, Electric Light & Power Co.*<sup>94</sup> the corporation wished to make an advantageous sale of certain of its real property,

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<sup>93</sup> *Federal United Corp. v. Havender*, *supra*, n. 85; *Windhurst v. Central Leather Co.*, *supra*, n. 88.

<sup>94</sup> 114 Md. 559, 80 A. 304 (1911).

but the vendee objected to the title as being imperfect because subject to the statutory lien of preferred stockholders thereon. This stock had been issued pursuant to the same statute involved in *Heller v. Marine Bank*,<sup>95</sup> which provided that the preferred stock should constitute a lien on the franchises and property of the corporation. There was no provision for release of this lien by the preferred stockholders, on which ground the defendant vendee resisted the corporation's suit for specific performance. The Court decreed a release of the lien and ordered the vendee to pay the purchase price, on the ground that the exigencies of the business situation warranted such a judicial release where it was to the advantage of all the parties concerned and precautions were taken to safeguard all interests.

#### CONSTRUCTIONAL AND CONSTITUTIONAL POLICY

Up to this point the discussion has been primarily a more or less technical analysis of the legal aspects of the problem of funding accrued dividends. Of course no examination of this problem would be complete without an attempt to indicate those broad lines of constructional policy which are likely to influence the decision of the Court of Appeals to a considerable degree. Indeed since all the authority on the question is merely persuasive and since strictly legal grounds may be found on which to rest a decision either way, perhaps it will be the general approach of the Court that will ultimately determine the conclusion.

It is highly probable that the Court of Appeals will consider all provisions of the General Corporation Law, including all amendments, applicable to any existing Maryland corporation regardless of the date of its incorporation. Past decisions indicate a general judicial tendency in Maryland to give wide scope to the State's reserved power of amendment of corporate charters, the general theory being that this reservation in the Constitutions of 1851<sup>96</sup> and

<sup>95</sup> 89 Md. 602, 43 A. 800 (1899); *supra*, n. 53.

<sup>96</sup> Art. 3, Sec. 47.

1867<sup>97</sup> constitutes a condition upon which every charter is granted, as if written into the charter itself.<sup>98</sup> It has been generally recognized, however, that this power reserved by the State is not without its constitutional and equitable limitations. In *Sprigg v. Western Telegraph Co.*,<sup>99</sup> the Court of Appeals, in refusing to enjoin a proposed reincorporation under the then new General Corporation Law of a corporation originally chartered by special act, suggested a test as to the legality of any exercise of the state's reserved power. This test has gained wide acceptance as a result of its lucid exposition by the Supreme Court of the United States in *Looker v. Maynard*.<sup>100</sup> As generally applied today, the test involves two aspects: (1) as affecting the contract between the state and the corporation or the contract between the corporation and its stockholders, any exercise by the state of its reserved power which results in a *fundamental and material change* in the objects expressed in the charter is invalid unless assented to unanimously by the stockholders; and (2) as affecting the contract between the stockholders *inter sese*, any exercise of the power is void if it *impairs any right vested under the charter*. The test has found further expression in Maryland in *Jackson v. Walsh*,<sup>101</sup> *Webster v. Cambridge Female Seminary*<sup>102</sup> and *Brown v. Maryland Telephone & Telegraph Co.*<sup>103</sup>

It is clear that any change or alteration which the Legislature might make in a corporation's charter by direct act may be made indirectly by delegating to the corporation or to a majority or other proportion of the stockholders

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<sup>97</sup> Art. 3, Sec. 48; also given expression in Md. Code (1939) Art. 23, Sec. 135.

<sup>98</sup> *State v. Northern Central Ry. Co.*, 44 Md. 131, 165 (1875); *Sprigg v. Western Telegraph Co.*, 46 Md. 67 (1877); *Jackson v. Walsh*, 75 Md. 304, 23 A. 778 (1892); *Webster v. Cambridge Female Seminary*, 78 Md. 193, 28 A. 25 (1893); *Phinney v. Shepard & Enoch Pratt Hospital*, 88 Md. 633, 42 A. 58 (1898); appeal dismissed 177 U. S. 170, 44 L. Ed. 720, 20 S. Ct. 573 (1900); *Brown v. Maryland Telephone & Telegraph Co.*, 101 Md. 574, 61 A. 338 (1905).

<sup>99</sup> 46 Md. 67 (1877).

<sup>100</sup> 179 U. S. 46, 52, 45 L. Ed. 79, 21 S. Ct. 21 (1900).

<sup>101</sup> 75 Md. 304, 23 A. 778 (1892).

<sup>102</sup> 78 Md. 193, 28 A. 25 (1893).

<sup>103</sup> 101 Md. 574, 61 A. 338 (1905).

permissive power to do so.<sup>104</sup> Hence action taken by a majority or other designated proportion of stockholders under authority conferred by statute subsequent to the date of incorporation stands on the same footing as such action would if effected directly by the state. The problem therefore becomes one of whether statutory authorization of action by a majority or other proportion of stockholders resulting in destruction of the preferred stockholders' right to accrued dividends, constitutes such a fundamental and material change in, or so impairs rights vested under, existing charters that it is invalid. There being little if anything of assistance on the precise issue in the Maryland case and statute law, the Court of Appeals will again have to resort to legal writings and persuasive authority from other jurisdictions, weighing the merits of one view as against the other.

Opinion seems to be general among text-writers and commentators, who have written much on the subject,<sup>105</sup> that destruction of accrued dividends is destruction of a vested right, and therefore any legislative enactment which, in the exercise of the state's reserved power, authorizes less than all the stockholders to take such action by charter amendment or otherwise, impairs an obligation of the threefold contract between state, corporation and stockholders. If not unconstitutional on such grounds, at least the legislation tends to interfere with the relations of the stockholders *inter sese*, and it should not be construed so to apply. A number of courts have held outright that statutes subsequent to the date of incorporation would be

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<sup>104</sup> See *Breslav v. New York & Queens Electric Light & Power Co.*, 249 App. Div. 181, 184, 291 N. Y. Supp. 932, 936 (Second Dept. 1936); *aff'd memo.*, 273 N. Y. 593, 7 N. E. (2d) 708 (1937).

<sup>105</sup> BRUNE, *op. cit. supra*, n. 55, 76-87; FLETCHER, *CYCLOPEDIA OF CORPORATIONS* (Perm. Ed.) Sec. 5447; Cades, *Constitutional and Equitable Limitations on the Power of the Majority to Amend Charters so as to Affect Shareholders' Interests in the Corporation* (1928) 77 Univ. Pa. L. Rev. 256; Curran, *Minority Stockholders and Amendment of Corporate Charters* (1934) 32 Mich. L. Rev. 743; Dodd, *Dissenting Stockholders and Amendments to Corporate Charters* (1927) 75 Univ. Pa. L. Rev. 585, 723; Stern, *The Limitations of the Power of the State Under a Reserved Right to Amend or Repeal Charters of Incorporation* (1905) 53 Univ. Pa. L. Rev. 73; Comment (1931) 31 Col. L. Rev. 1163; Comment (1937) 23 Va. L. Rev. 579; Note (1936) 34 Mich. L. Rev. 859.

unconstitutional if interpreted to permit majority stockholders by charter amendment to destroy the rights of preferred stockholders to dividend arrearages.<sup>106</sup> If the Court of Appeals adopts this view, it seems reasonably certain that as to corporations chartered before June 1, 1916, majority stockholders would be held unable to alter or destroy accrued dividends by the device of charter amendment; for the earlier statutes strictly limited the legitimate purposes of charter amendment<sup>107</sup> and contained no provision which could be construed broadly enough to authorize an amendment of that sort, such as the present provision permitting "any other amendment of the charter that may be desired", which became law on the date mentioned above.<sup>108</sup> It might be argued that, even as to dissenting stockholders who acquired their stock prior to that date, rights to dividends which accumulated thereafter did not become "vested" under the old law but arose subject to powers granted to majority stockholders by the new law. Such an argument, however, ignores the fact that the rights "vested" in accordance with, and by virtue of, the terms of a contract entered into under the old law and whose obligations cannot be impaired by subsequent law.

On the other hand courts have gone far as to what rights they have considered alterable by majority stockholders under legislative authority conferred subsequent to the date of incorporation. For example, charter amendments so authorized have been upheld which actually destroyed

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<sup>106</sup> *Keller v. Wilson*, 190 A. 115 (Del. Sup. Ct., 1936); *Patterson v. Durham Hosiery Mills Co.*, 214 N. C. 806, 200 S. E. 906 (1939); *Harbine v. Dayton Malleable Iron Co.*, 61 Ohio App. 1, 22 N. E. (2d) 281 (Ct. App. Montgomery Co., 1939).

<sup>107</sup> Md. Code (1888) Art. 23, Sec. 47, provided merely that ". . . any alteration or amendment . . . made by the authority of the corporation" should be acknowledged and recorded in the same manner as an original certificate, and should then become a part of the charter. Sections 73 to 78 permitted increase or diminution of the capital stock by the vote of the holders of at least two-thirds of all the shares. These provisions underwent no substantial change until 1908, when all the amendment sections were collected into Md. Code (1912) Art. 23, Sec. 24, and added permission was granted to a majority in vote to change the corporate name, principal place of business and a few other matters not material here.

<sup>108</sup> Md. Laws 1916, Ch. 596, Sec. 8. At the same time the proportion of stockholders required for amendment was raised to two-thirds in vote of each class.

accrued dividends (a doubtful precedent, however),<sup>109</sup> or altered relative preferences of different classes of stock,<sup>110</sup> or made non-assessable stock assessable,<sup>111</sup> or authorized (by a two-thirds vote where unanimous approval was previously required) the issuance of a preferred class of stock.<sup>112</sup> Similarly a Federal court<sup>113</sup> construing New Jersey law sustained a merger although the elimination of par value on the complainant's shares accomplished thereby was authorized only by a post-incorporation statute, and this was in a strong case where dissenting preferred stockholders were also deprived of voting and pre-emption rights. The Supreme Court of the United States<sup>114</sup> has held an Ohio corporation bound by a post-incorporation appraisal statute requiring the corporation to pay the value demanded by dissenters for their shares if the corporation fails to make an offer to them.

The Maryland Court's decision in *Public Service Commission v. Consolidated Gas, Electric Light & Power Co.*<sup>115</sup> has been interpreted as upholding a charter amendment reducing par value stock to no-par stock under post-incorporation legislative authority.<sup>116</sup> While the amendment there involved was in fact upheld, the Court did not even consider the question of the state's reserved power, the chief point at issue being whether such a charter amendment had to be approved by the Public Service Commission under the terms of the statute regulating public utilities. The result of the case might, however, taken in conjunction with the Maryland cases previously cited,<sup>117</sup> be said to indicate a general tendency of the Court of Appeals

<sup>109</sup> *Yoakam v. Providence Biltmore Hotel Co.*, 34 F. (2d) 533 (D. R. I., 1929), a Federal decision construing Delaware law before *Keller v. Wilson*.

<sup>110</sup> *Davis v. Louisville Gas & Electric Co.*, 16 Del. Ch. 157, 142 A. 654 (Ct. of Chancery, 1928).

<sup>111</sup> *Somerville v. St. Louis Mining and Mill. Co.*, 46 Mont. 268, 127 Pac. 464 (1912); *contra*, *Garey v. St. Joe. Mining Co.*, 32 Utah 497, 91 Pac. 369 (1907).

<sup>112</sup> *Hinckley v. Schwartzchild & Sulzberger Co.*, 107 App. Div. 470, 95 N. Y. Supp. 357 (First Dept., 1905).

<sup>113</sup> *Clarke v. Gold Dust Corporation*, 106 F. (2d) 598 (C. C. A. 3rd, 1939).

<sup>114</sup> *Voeller v. Neilston Warehouse Co.*, 311 U. S. —, 85 L. Ed. 314, 61 Sup. Ct. 376 (1941).

<sup>115</sup> 148 Md. 90, 129 A. 22 (1925).

<sup>116</sup> *Curran, Minority Stockholders and The Amendment of Corporate Charters* (1934) 32 Mich. L. Rev. 743, 770.

<sup>117</sup> *Supra*, n. 98.



to give relatively wide scope and applicability to the state's reserved power of amendment.

The liberality with which the applicable provisions of the Maryland statutes, as amended, will be construed presents a distinct and rather difficult question. This is due not only to the fact that there are no Maryland cases sufficiently in point, but also to the numerous dynamic factors which enter into every decision, including the varying experience and outlook of the judges, their estimate as to the probable economic effect of holding one way or the other, and the peculiar facts of the particular case, to mention only a few. The only Maryland cases which throw any light on the situation, and that but dim and diffused at most, are two involving railroads whose corporate existence was challenged on purely formal grounds when they sought to condemn land for rights of way. In *Piedmont & Cumberland Ry. Co. v. Speelman* it was said:<sup>118</sup>

"The general railroad law of this state is a remedial statute, and is therefore to be construed liberally. Good faith and reasonable certainty is all that is required. In passing that law, the Legislature distinctly recognized the benefit of railroads to the community, and did away with the old cumbersome and expensive mode of obtaining, by legislative action [i. e., special act of incorporation], the right to build them. It was the manifest object of that law to enlarge and not to restrict the construction of railroads." (Insert supplied.)

This language, which was quoted with approval a quarter-century later in *Hyattsville v. Washington, Westminster & Gettysburg R. R.*,<sup>119</sup> would be just as valid if the word "corporation", meaning ordinary commercial corporation, were substituted for the word "railroad". This is especially true in view of the fact that the general railroad law referred to comprises Sections 197 to 274 of Article 23 of the present Maryland Code, which is the General Corporation Law.

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<sup>118</sup> 67 Md. 260, 272, 10 A. 77, 79 (1887).

<sup>119</sup> 120 Md. 128, 136, 87 A. 828, 831 (1913).

It does not seem unreasonable to argue that there is just as much public policy favoring the development of ordinary commercial corporations in a jurisdiction wherein is located the second most important seaport in the United States, as there was in favor of development of railroads. A commercially-minded Court certainly would not hesitate to give the General Corporation Law such liberal construction as public interest required in the particular case. Where a corporation is in financial straits it is clearly to the general public's benefit that it should be able to rehabilitate itself by a fair recapitalization plan rather than that minority preferred stockholders should be permitted to block any reasonable attempts at refinancing. Care must be taken, however, not to look on every suit by a minority stockholder as a mere "strike" suit unworthy of judicial consideration.<sup>120</sup>

#### CONCLUSION

There is no inconsistency of result if the Court of Appeals declines to follow the lead of the *McQuillen* case, and holds that funding of accrued dividends may not legally be accomplished by charter amendment but may be accomplished by means of a merger, consolidation or sale of assets. Destruction of his right to accrued dividends alters considerably the contract the preferred stockholder originally made. Hence the Court would be justified in protecting him against forcible deprivation of this right by charter amendment which offers him no compensation for the lost right other than an unasked-for larger investment in the enterprise; and it should make no difference whether the amendment expressly eliminates dividend arrearages or is of the so-called "voluntary" or "optional" type creating a prior preferred stock but leaving the old shareholder no real economic choice but to surrender his rights on the terms of exchange proposed. On the other hand, the stockholder needs no judicial protection against loss of this right resulting from a merger, consolidation or sale of

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<sup>120</sup> See Berback, *Stockholders' Suits: A Possible Substitute* (1937) 35 Mich. L. Rev. 597, 604 *et seq.*

assets, for the statutes have provided adequate protection by affording him the opportunity of demanding that he be bought out at a fair value. The existence of this real alternative disposes of any contention that to allow funding of accrued dividends by merger, consolidation or sale of assets is to allow the accomplishment by one device of an end which would be illegal if sought to be gained by another means, charter amendment. It is primarily a question of weighing the exigencies of the business situation against the equities of minority stockholders in attempting to reach a fair result.