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## CORPORATIONS - RESERVED POWERS - ABROGATION OF PREFERRED DIVIDEND ARREARAGES BY CHARTER AMENDMENT, MERGER, OR CONSOLIDATION

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CORPORATIONS — RESERVED POWERS — ABROGATION OF PREFERRED DIVIDEND ARREARAGES BY CHARTER AMENDMENT, MERGER, OR CONSOLIDATION — The “malignant” decision in the *Dartmouth College* case<sup>1</sup> fathered the passage of reserved-power statutes<sup>2</sup> in vir-

<sup>1</sup> Trustees of Dartmouth College v. Woodward, 4 Wheat. (17 U. S.) 518 (1819); Ohlinger, “Some Comments on the Reserved Power to Alter, Amend, and Repeal Corporate Charters,” 29 MICH. L. REV. 432 (1930). The Dartmouth College case held that the charter granted by a state to a corporation is a contract within the “impairment” clause of the Constitution. 31 ILL. L. REV. 661 (1937).

<sup>2</sup> The states adopted the suggestion of Justice Story in his concurring opinion and made express provisions in all charter grants reserving power to alter, amend, or repeal the grant—ultimately leading to a general declaration of reserved power in the state constitutions or statutes.

tually all the states. These statutes, in turn, when opposed by the retaliatory fundamental-rights safeguards invoked by the courts for the protection of corporate stockholders, procreated problems which have grown more baffling and incorrigible with age. Not the least among these<sup>3</sup> are proposed changes in the liabilities or rights of stockholders, especially the attempted abolition of unpaid accrued dividends upon cumulative preferred stock where there exists a surplus which might lawfully be applied to the payment of such dividends.

Spurred by the overwhelming arrearages which accumulated during the extended period of depressed earnings in the early and middle "thirties,"<sup>4</sup> many corporations recently have launched extensive recapitalization programs<sup>5</sup> embracing in most instances the scaling down or total destruction of accrued dividends.<sup>6</sup> Dissenting preferred interests gallantly accepted the challenge by setting up as their first line of defense the nebulous but time-honored "vested rights"<sup>7</sup> bulwark, with its solicitous protection of dividend accumulations.<sup>8</sup> The familiar device

<sup>3</sup> The reserved power statutes produced problems regarding changes in corporate name and place of business, in the scope of the enterprise, in the number and method of election of directors, in the capital structure of a corporation, and many more. See Curran, "Minority Stockholders and the Amendment of Corporate Charters," 32 MICH. L. REV. 743 (1934).

<sup>4</sup> 25 CORN. L. Q. 431 (1940).

<sup>5</sup> When corporate surplus must be diverted almost in toto to the paying off of preferred arrearages, the value of the common stock as income-producing is negligible. Hence, a logical aftermath of business depression is the concerted demand of common holders for reorganization to eliminate prior preferred claims. See 4 UNIV. CHI. L. REV. 645 (1937).

<sup>6</sup> 38 MICH. L. REV. 214 (1939).

<sup>7</sup> The courts have waged an interesting conflict over the coverage of the elusive "vested right" concept, only to reach opposite conclusions with regard to many interests: amendment to increase the liability of the stockholders to corporate creditors was permitted in *Witt v. People's State Bank*, 166 S. C. 1, 164 S. E. 306 (1932); contra, cases collected in BALLANTINE, CORPORATIONS 812 (1927); making nonassessable stock assessable permitted in *Somerville v. St. Louis M. & M. Co.*, 46 Mont. 268, 127 P. 464 (1912); contra, *Garey v. St. Joe Mining Co.*, 32 Utah 497, 91 P. 369 (1907); superimposition of prior preferred over old issues allowed in *Salt Lake Automobile Co. v. Keith-O'Brien Co.*, 45 Utah 218, 143 P. 1015 (1914), and cases collected in note 28, *infra*, representing the decided weight of authority; contra, *Einstein v. Raritan Woolen Mills*, 74 N. J. Eq. 624, 70 A. 295 (1908); right to redemption of preferred stock at a stipulated price on a named date deemed vested in *Sutton v. Globe Knitting Works*, 276 Mich. 200, 267 N. W. 815 (1936); contra, *Davis v. Louisville Gas & Electric Co.*, 16 Del. Ch. 157, 142 A. 654 (1928); alteration of right to future cumulative preferred dividends permitted in *Morris v. American Public Utilities*, 14 Del. Ch. 136, 122 A. 696 (1923), whereas right to maintenance of a sinking fund for the eventual retirement of preferred stock was declared vested in *Yoakam v. Providence Biltmore Hotel Co.*, (D. C. R. I. 1929) 34 F. (2d) 533.

<sup>8</sup> In protecting preferred accumulations, the courts have described the interest of the stockholders as vested: *Yoakam v. Providence Biltmore Hotel Co.*, (D. C. R. I.

of direct charter amendment was first adopted to cancel or scale down accrued unpaid dividends,<sup>9</sup> but this method, in the main unsuccessful,<sup>10</sup> has quite recently given way to varied attempts to recapitalize and to force dissenting preferred holders to acquiesce through utilization of the procedure of statutory merger or consolidation.<sup>11</sup> Keynoting this trend are two leading Delaware cases. *Keller v. Wilson & Co.*<sup>12</sup> in 1936 emphatically denied the corporation's right to cancel accrued, unpaid, and undeclared dividends by charter amendment. *Federal United Corporation v. Havender*<sup>13</sup> in 1940 repudiated the vested rights concept, in which refuge had theretofore been sought, and allowed repudiation of preferred arrearages by statutory merger. The following discussion, through comparison of these and companion cases in other jurisdictions,<sup>14</sup> will conduct a "post-mortem" on the remains of the vested rights limitation in order to determine the current status of cumulative preferred dividend arrearages.

## I.

Charter amendments under the state reserved-power statutes attack dividend accumulations either directly<sup>15</sup> through frank cancella-

1929) 34 F. (2d) 533; *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 A. 696 (1923); *Lonsdale Securities Corp. v. International Mercantile Marine Co.*, 101 N. J. Eq. 554, 139 A. 50 (1927); *Keller v. Wilson & Co.*, (Del. 1936) 190 A. 115; as a debt or a right in the nature of a debt: *Morris v. American Public Utilities Co.*, supra; *Keller v. Wilson & Co.*, supra; as an existing claim which is a prior charge on net earnings: *Colgate v. United States Leather Co.*, 73 N. J. Eq. 72, 67 A. 657 (1907); or as a present property interest with enjoyment postponed: *Morris v. American Public Utilities Co.*, supra. In truth, the right would seem to be vested only if the courts decide to protect it. See 25 CORN. L. Q. 431 (1940).

<sup>9</sup> 4 UNIV. CHI. L. REV. 645 (1937).

<sup>10</sup> *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 A. 696 (1923); *General Investment Co. v. American Hide & Leather Co.*, 98 N. J. Eq. 326, 129 A. 244 (1925); *Lonsdale Securities Corp. v. International Mercantile Marine Co.*, 101 N. J. Eq. 554, 139 A. 50 (1927); *Yoakam v. Providence Biltmore Hotel Co.*, (D. C. R. I. 1929) 34 F. (2d) 533; *Keller v. Wilson & Co.*, (Del. 1936) 190 A. 115; *Consolidated Film Industries v. Johnson*, (Del. 1937) 197 A. 489. *Contra*, *Thomas v. Laconia Car Co.*, 251 Mass. 529, 146 N. E. 775 (1925).

<sup>11</sup> 38 MICH. L. REV. 214 (1939).

<sup>12</sup> (Del. 1936) 190 A. 115, noted in 31 ILL. L. REV. 661 (1937). See also comments in 46 YALE L. J. 985 (1937); 35 MICH. L. REV. 620 (1937).

<sup>13</sup> (Del. 1940) 11 A. (2d) 331, reversing (Del. Ch. 1939) 6 A. (2d) 618 and (Del. Ch. 1938) 2 A. (2d) 143. The supreme court opinion is noted in 26 VA. L. REV. 822 (1940); 88 UNIV. PA. L. REV. 624 (1940); 24 MINN. L. REV. 992 (1940).

<sup>14</sup> While the *Keller* and *Havender* cases settle only the law of Delaware, they are extremely significant both because of the large number of corporations incorporated in Delaware and because of their influence upon holdings in other jurisdictions.

<sup>15</sup> 4 UNIV. CHI. L. REV. 645 (1937).

tion of arrearages, or indirectly through the creation of new prior preferred issues.<sup>16</sup> The *Keller* case illustrates the former mode of attack and illuminates the countervailing defenses. Despite the prior holding in *Morris v. American Public Utilities Co.*<sup>17</sup> that the majority stockholders have no power to amend the charter of a corporation so as to destroy claims to accumulated dividends, but fortified by a subsequent amendment to the Delaware reserved-power statute,<sup>18</sup> the management proposed in the *Keller* case a plan of recapitalization whereby class *A* stock, a second preferred issue, along with all accrued and unpaid dividends,<sup>19</sup> would be exchanged for a certain number of shares of common. An overwhelming majority of all stockholders approved.<sup>20</sup> Complainant, the owner of five hundred shares of class *A* stock, prayed that the charter amendment be declared void. On appeal the Supreme Court of Delaware reversed the chancellor and held that the right to arrearages was not a "special right"<sup>21</sup> under the Delaware statute, and hence could not be abrogated under the reserved power; that this right should be deemed "a vested right of property secured against destruction by the Federal and State Constitutions" and that

"the cancellation of cumulative dividends already accrued through

<sup>16</sup> *Id.*

<sup>17</sup> 14 Del. Ch. 136, 122 A. 696 (1923).

<sup>18</sup> At the time of the *Morris* case, *supra*, note 17, the Delaware reserved-power statute authorized the majority to alter "preferences" of stocks. Del. Rev. Code (1915), c. 65, § 26. In 1927, an amendment authorized alterations in "preferences . . . and other special rights." Del. Laws (1927), c. 85, § 10, p. 232. See Del. Rev. Code (1935), § 2058. But note that the preferred stock in the *Keller* case was issued prior to the passage of the 1927 amendment. The answer is found in *Consolidated Film Industries v. Johnson*, (Del. 1937) 197 A. 489, discussed in this comment, *infra*, at note 23.

<sup>19</sup> There were accumulated and unpaid dividends on the preferred stock amounting to \$26.25 per share, or a total of \$5,965,260, and unpaid dividends on the class *A* stock of \$21.25, totalling \$6,636,265. *Wilson & Co. and its subsidiaries* had at that time an aggregate earned surplus of \$8,000,000.

<sup>20</sup> An interesting sidelight on this whole problem is the fact that in most of the adjudicated plans in which preferred arrearages are swept away, the preferred holders who must write off the loss approve almost unanimously. This can be attributed to the proxy system. See Fleming, "Are Stockholders People?" 182 *HARPERS MAGAZINE* 422 at 427 (March, 1941), to the effect that "the stockholder's private property is being quietly expropriated," his essential functions have atrophied, and he may be deemed "an obsolete economic institution."

<sup>21</sup> The English courts have held that the statutory phrase "special rights and privileges" authorizes destruction of rights to accrued and unpaid cumulative dividends. *Re Oban & Aultmore-Glenlivet Distilleries*, 5 Sess. Cas. (5th ser.) (Scot.) 1140 (1903); *Last v. Buller & Co.*, 36 T. L. R. 35 (Ch. D. 1919); 31 *ILL. L. REV.* 661 (1937). This view accords with the holding in *Harr v. Pioneer Mechanical Corp.*, (C. C. A. 2d, 1933) 65 F. (2d) 332. Cf. *Yoakam v. Providence Biltmore Hotel Co.*, (D. C. R. I. 1929) 34 F. (2d) 533.

passage of time is not an amendment of a charter. It is the destruction of a right in the nature of a debt. . . ."<sup>22</sup>

A distinction suggested by the *Keller* case based upon whether the date of incorporation was prior or subsequent to the passage of the statute authorizing the charter amendment was rejected unequivocally a short time thereafter in *Consolidated Film Industries v. Johnson*.<sup>23</sup> The protective canopy thus projected over dividend arrearages by the *Keller* case, in so far as direct amendments are concerned, has been pierced rarely by subsequent decisions, and then only when the amendments were implemented by broader and more specific reserved-power statutes.<sup>24</sup>

Cancellation of dividend arrearages by the indirect method<sup>25</sup> of charter amendment embodies the formulation of recapitalization plans offering to the old preferred the alternative of retaining their stock or exchanging it for new prior preferred in full satisfaction of accrued dividend claims.<sup>26</sup> Appraisal statutes are also available in most instances for dissenters who prefer cash realization of the present value of their old shares to continuation in the corporation under either alternative.<sup>27</sup> This procedure, as contrasted with that of direct amendment, has been

<sup>22</sup> *Keller v. Wilson & Co.*, (Del. 1936) 190 A. 115 at 125.

<sup>23</sup> (Del. 1937) 197 A. 489.

<sup>24</sup> In *McQuillen v. National Cash Register Co.*, (D. C. Md. 1939) 27 F. Supp. 639, accrued dividends were abrogated by charter amendment under the Maryland reserved-power statute, expressly authorizing any amendment "which changes the terms of any of the outstanding stock by classification, reclassification, or otherwise." Md. Code Pub. Gen. Laws Ann. (1924), art. 23, § 28; (Supp. 1935), art. 23, § 23. The court defined "terms" as including contract rights of the stockholders and diagnosed preferred arrearages as a contract right. See also the much more explicit Ohio statute, *infra*, part 3.

<sup>25</sup> Like the direct method, the indirect releases immediate dividends to junior interests—but arrearages are subordinated rather than wiped out. A plan of this nature which neglected to incorporate the option feature was flatly enjoined, and the substantiality of preferred accumulations definitely reasserted, in *Harbine v. Dayton Malleable Iron Co.*, 61 Ohio App. 1, 22 N. E. (2d) 281 (1939). The court said, 61 Ohio App. at 12-13: "We have difficulty in following the designation 'has a vested interest.' However, by whatever name known, it is an existing, substantial right, and has a prospective value. Whether it will ever materialize, depends on whether the company makes profits in such an amount as to be available to pay the current and cumulative dividends."

<sup>26</sup> *Johnson v. Lamprecht*, 133 Ohio St. 567, 15 N. E. (2d) 127 (1938). See also 38 MICH. L. REV. 214 (1939).

<sup>27</sup> For a fuller discussion of the adequacy of appraisal and cash payment in these situations, see part 3 of this comment, *infra*. The right to appraisal, in the absence of the option of retaining the shares, will not save a recapitalization plan abolishing vested rights. *Johnson v. Lamprecht*, 133 Ohio St. 567, 15 N. E. (2d) 127 (1938).

generally upheld,<sup>28</sup> since it subordinates the dividend claims of the old preferred to those of the new prior preferred only, and still preserves their stranglehold on surplus with respect to the common and other junior security interests. This alteration solely of preferences leaves vested rights untrammelled, and hence in no wise violates the limitations of the *Keller* case.<sup>29</sup>

## 2.

Thus frustrated, as it were, in its attempts to purge arrearages by the device of charter amendment, corporate management turned to recapitalization along the lines of consolidation and merger. *Federal United Corporation v. Havender*<sup>30</sup> subjected this method to its first real test. Faced with aggregate dividend accumulations of \$510,748, and with no net earnings from ordinary operations,<sup>31</sup> the parent corporation merged with a wholly-owned subsidiary. The plan provided for a new issue of preferred of the parent to replace the old preferred, and for cancellation of accumulated dividend arrears on the old preferred. A minority preferred stockholder demanded an injunction on the ground that a merger could not be used as a subterfuge to wipe out the accumulated dividends when such change could not be accomplished by amendment. In overruling this contention,<sup>32</sup> the Delaware Supreme Court asserted that the catholic quality of the language in the merger statute<sup>33</sup> negatives a technical construction if the purpose of the statute is to be achieved.

<sup>28</sup> *Shanik v. White Sewing Mach. Corporation*, (Del. Ch. 1940) 15 A. (2d) 169; *Johnson v. Lamprecht*, 133 Ohio St. 567, 15 N. E. (2d) 127 (1938); *Harr v. Pioneer Mechanical Corp.*, (C. C. A. 2d, 1933) 65 F. (2d) 332; *Salt Lake Automobile Co. v. Keith-O'Brien Co.*, 45 Utah 218, 143 P. 1015 (1914). This may serve as a convenient alternative to direct scaling-down. See Stempf, "Revamping Capital Structures," 16 NAT. ASSN. COST ACCOUNTANTS BULL. 267 (1934); 4 UNIV. CHI. L. REV. 645 (1937).

<sup>29</sup> *Shanik v. White Sewing Mach. Corp.*, (Del. Ch. 1940) 15 A. (2d) 169, decided subsequent to both the *Keller* and *Havender* cases, held valid the issue of prior preference stock, and at the same time referred to the *Keller* case as still binding.

<sup>30</sup> (Del. 1940) 11 A. (2d) 331.

<sup>31</sup> Subtracting the stated capital from the actual value of the property and securities owned by the corporation at the time of the merger, there existed a corporate surplus of \$744,988.16. This was not all earned surplus, however, but was available for the declaration of dividends.

<sup>32</sup> In the chancellor's opinion, the corporate proceeding complained of, while styled a merger, was no more than an unauthorized attempt at a recapitalization of the defendant corporation, ineffective, as against objection, to extinguish accumulated dividends within the rule announced in the *Keller* case.

<sup>33</sup> Del. Laws (1937), c. 131, § 2, provides for merger or consolidation of a parent corporation with a wholly-owned subsidiary. Del. Rev. Code (1935), § 2091, provides for general consolidation and merger. The agreement is required to set forth the terms and conditions of merger, and the manner of conversion of shares, "with such other details and provisions as are deemed necessary."

"Consequently, in a case where a merger . . . is accomplished in accordance with the law, the holder of cumulative preference stock as to which dividends have accumulated may not insist that his right to the dividends is a fixed contractual right in the nature of a debt, in that sense vested, and therefore secure against attack."<sup>84</sup>

It is to be noted that the court expressly limited this declaration as to vested rights to the merger situation, and that it carefully distinguished the *Keller* case.<sup>85</sup> Notwithstanding, it is conceivable that the cumulative preferred interests received a resounding setback, the reverberations from which may yet echo through subsequent decisions involving the charter amendment situation.

There are, however, factors offering some consolation to the preferred holders. In *Shanik v. White Sewing Machine Corporation*,<sup>86</sup> the Delaware court a few months ago referred to the *Keller* case as still binding, and a federal district court quite recently recognized that the *Keller* case governs elimination of dividend accumulations by charter amendment, while the *Havender* case prevails in the field of merger.<sup>87</sup> Further, the court in the *Havender* case was chary of its position and fortified it by reliance upon the doctrine of laches as a self-complete reason for denying relief to plaintiff.<sup>88</sup>

If the doctrine allowing repudiation of accrued, unpaid dividends were limited to cases wherein two independent corporations underwent merger or consolidation, its ramifications would not be great, for this method would not ordinarily be available to most corporations as an alternative to charter amendment. And in those instances in which merger or consolidation is desired for other reasons, a change in stock rights is usually a necessary concomitant to accomplish the intricate adjustment of interests between stockholders of the constituent cor-

<sup>84</sup> *Federal United Corp. v. Havender*, (Del. 1940) 11 A. (2d) 331 at 339. "In such situation the shareholder is not confronted, as was the complainant in the *Keller* case, with a proposed alteration of rights attached to preference stock not within the contemplation of the law as it stood when the corporation was formed and the stock issued. . . ." *Id.*

<sup>85</sup> See note 34, *supra*.

<sup>86</sup> (Del. Ch. 1940) 15 A. (2d) 169.

<sup>87</sup> *In re Community Power & Light Co.*, (D. C. N. Y. 1940) 33 F. Supp. 901.

<sup>88</sup> *Bovay v. H. M. Byllesby & Co.*, (Del. Ch. 1940) 12 A. (2d) 178; *McQuillen v. National Cash Register Co.*, (D. C. Md. 1939) 27 F. Supp. 639; *Windhurst v. Central Leather Co.*, 101 N. J. Eq. 543, 138 A. 772 (1927); *United Milk Products Co. v. Lovell*, (C. C. A. 6th, 1935) 75 F. (2d) 923; *Venner v. New York Cent. & H. R. R.*, 177 App. Div. 296, 164 N. Y. S. 626 (1917); 19 ANN. CAS. 1266 at 1269 (1911); 70 A. L. R. 53 (1931).



porations.<sup>39</sup> When a parent corporation merges with a wholly-owned subsidiary, however, there is but one group of stockholders, in whose interests no reconditioning of the capital structure of the parent corporation is necessary.<sup>40</sup> Consequently, the courts must scrutinize religiously the cases in which a wholly-owned subsidiary is merged into a parent corporation to determine whether the subsidiary had a valid reason for prior existence, or whether it was set up specifically for immediate absorption with a view to wiping out vested rights of stockholders.<sup>41</sup> Should the door be opened to include the latter type of case, a ready subterfuge would be available to any corporation to avoid charter amendment limitations upon the reserved power.<sup>42</sup>

## 3.

Consideration has thus far been directed to the scaling down and cancellation of arrearages from the point of view of the preferred holder. Many arguments are available, however, to justify the decision in the *Havender* case, especially since the court definitely asserted that the public policy of Delaware does not prohibit the compounding of accumulated dividends.<sup>43</sup>

In the first place, to compel payment of all accumulated dividends before recognition of the claims of junior interests may well cause a serious impairment of the corporation's reserves, and threaten the future stability of the enterprise.<sup>44</sup> Sensing this, and with realization of dividends upon their stock far in the offing, junior interests may prevail upon the management to attempt improvement of the financial condition of the corporation through dangerous speculation.<sup>45</sup> Further,

<sup>39</sup> Berle, "Corporate Devices for Diluting Stock Participations," 31 COL. L. REV. 1239 (1931); 38 MICH. L. REV. 214 (1939); 45 YALE L. J. 105 (1935); 30 MICH. L. REV. 1074 (1932). Where there is a sale of assets, statutory authorization is not required. In order to avoid statutory difficulties, a consolidation is often treated as a sale of assets. See 4 UNIV. CHI. L. REV. 645 (1937); 3 UNIV. CHI. L. REV. 330 (1936); 20 CAL. L. REV. 421 (1932); 81 UNIV. PA. L. REV. 219 (1932).

<sup>40</sup> Unless undue and unnecessary complications in the corporate structure require elimination through a plan of corporate simplification. See *In re Community Power & Light Co.*, (D. C. N. Y. 1940) 33 F. Supp. 901.

<sup>41</sup> In the *Havender* case, it seemed clear that the merged subsidiary was not created purely for merger purposes.

<sup>42</sup> See the opinions of the two chancellors in the *Havender* case. *Havender v. Federal United Corp.*, (Del. Ch. 1939) 6 A. (2d) 618, (Del. Ch. 1938) 2 A. (2d) 143.

<sup>43</sup> Note also the language in *In re Community Power & Light Co.*, (D. C. N. Y. 1940) 33 F. Supp. 901.

<sup>44</sup> That economic reasons favor elimination of accrued cumulative dividends, see 10 TEMP. L. Q. 86 (1935).

<sup>45</sup> 4 UNIV. CHI. L. REV. 645 (1937).

the capital structure of the corporation may be in urgent need of simplification or general overhauling, which might well result in an increase of earned surplus and a consequent augmentation of the amount actually paid to the preferred. If new capital is desired from existing stockholders, no help can be expected from the common unless accumulations are eliminated. And since the amount of outstanding preferred is usually comparatively small, aid from the common may be indispensable.<sup>46</sup>

A further rationale is available. Courts are agreed that states have reserved power to amend corporate charters "for the public interest."<sup>47</sup> Although public interest would not stand the strain of eradication of arrearages by amendment, recent developments may have elasticized the concept to the extent that abolition by merger can be said to be in the public interest. Indeed, it was conceded in the *Havender* case that the terms of the merger were in all respects fair and equitable. And since a fair plan has, in effect, been deemed in the public interest with respect to reorganizations under section 77B and Chapter X of the Bankruptcy Act,<sup>48</sup> an assumption that this idea has permeated into the field of recapitalization by merger of solvent corporations is not unwarranted.

Quite understandably, the preferred holders usually are not so altruistic as to let these factors dampen their desire for accrued dividends. Their forte is that cumulative preferred stock held out to them as prudent investors the promise of protection, upon the strength of which they purchased their stock; that the reserved-power statutes did not then, nor do they now, authorize destruction of dividend rights; that courts have consistently refused to allow elimination of dividend arrearages in dissolution;<sup>49</sup> that a merger approximates dissolution, thus entitling them to specific enforcement of their dissolution rights, including the right to past accumulations;<sup>50</sup> that noncumulative preferred is not highly regarded as an investment, and hence if the guarantees of

<sup>46</sup> In the *Havender* case, certain large holders of common stock, in order to assist the capitalization of the company and to provide a surplus out of which dividends could be paid on the new preferred stock, donated 1418 shares of the preferred stock and a larger amount of common. The preferred alone had an actual value of \$73,161.40.

<sup>47</sup> 31 ILL. L. REV. 661 (1937).

<sup>48</sup> *Northern Pacific Ry. v. Boyd*, 228 U. S. 482, 33 S. Ct. 554 (1913); *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 60 S. Ct. 1 (1939); *Consolidated Rock Products Co. v. DuBois*, (U. S. 1941) 61 S. Ct. 675, noted in 39 MICH. L. REV. 1222 (1941).

<sup>49</sup> *Penington v. Commonwealth Hotel Const. Corp.*, 17 Del. Ch. 394, 155 A. 514 (1931).

<sup>50</sup> *Petry v. Harwood Electric Co.*, 280 Pa. 142, 124 A. 302 (1924); contra, *United Milk Products Co. v. Lovell*, (C. C. A. 6th, 1935) 75 F. (2d) 923 at 928; *Windhurst v. Central Leather Co.*, 101 N. J. Eq. 543, 138 A. 772 (1927).

cumulative preferred are to be rendered hollow and misleading, the desirability of any type of preferred stock as an investment will disappear; <sup>51</sup> that confiscation of unpaid dividends would as to them violate due process.<sup>52</sup>

Nevertheless, the trend signaled by the *Havender* decision is growing. In 1939, the Ohio legislature expanded its reserved power statute to authorize specifically changes in shares which "may include the discharge, adjustment or elimination of rights to accrued undeclared cumulative dividends. . . ." <sup>53</sup> More recently the provision of the Public Utility Holding Company Act <sup>54</sup> subjecting holding companies and subsidiaries to control by the Securities and Exchange Commission and authorizing enforcement of a plan for corporate simplification was held to permit compounding of arrearages in preferred stock dividends.<sup>55</sup>

The funding of arrears <sup>56</sup> is a helpful alternative to the destruction or scaling-down of accrued dividends. Although the corporation is not relieved of liability thereby, there is a tripartite benefit: junior security-holders are moved forward in allocation of dividends; preferred arrears are transformed from contingent claims into concrete securities; and the strain upon current financing of the corporation is lessened. The funding certificates may be made redeemable far enough in the future to allow the corporation a breathing-spell.

The decision in the *Havender* case raises a miscellany of interesting problems. One of the most vital is whether accrued dividends shall henceforth be excluded in the valuation of the stock of dissenting preferred holders who elect to take cash payment under the appraisal statutes. A close examination of the opinion sheds little light, for the court states merely that the corporation on appraisal must pay the value of the stock exclusive of any element of value arising from the expectation or accomplishment of the merger. If arrearages are still to be given substantial consideration in the determination of appraisal rights, a partial loophole appears. Dissenters could by electing ap-

<sup>51</sup> Noncumulative preferred is often termed "the waif of the stock exchanges." See Berle, "Non-Cumulative Preferred Stock," 23 *COL. L. REV.* 358 (1923). See also JAMES, *CASES ON BUSINESS ASSOCIATIONS* 917 (1937) (data derived from a study of noncumulative stock issues).

<sup>52</sup> Dodd, "Dissenting Stockholders and Amendments to Corporate Charters," 75 *UNIV. PA. L. REV.* 585, 723 (1927).

<sup>53</sup> Ohio Gen. Code (Page, Supp. 1939), § 8623-14 (i).

<sup>54</sup> Public Utility Holding Company Act of 1935, §§ 11 (b) (2), 11 (e), 49 Stat. L. 820 (1935), 15 U. S. C. (Supp. 1939), §§ 79k (b) (2), 79k (e).

<sup>55</sup> *In re Community Power & Light Co.*, (D. C. N. Y. 1940) 33 F. Supp. 901.

<sup>56</sup> *Willcox v. Trenton Potteries Co.*, 64 N. J. Eq. 173, 53 A. 474 (1902); 46 *YALE L. J.* 985 (1937).

praisal recover the value of their shares plus accumulations, and then buy back into the corporation. In view of this theory, it would seem that the result in the *Havender* case may black out accrued dividends under appraisal statutes, at least in marked degree.<sup>57</sup>

A possible solution to the entire problem would allow alteration of "special rights," either by charter amendment or by merger or consolidation, where there is an urgent need of new financing. If doubt exists as to such need, or if there is a probability that selfish interests are being served, the minority should be protected in equity.<sup>58</sup> The operative factors are the type of statutes under which the amendment or merger is attempted, the explicitness of the reserved power provisions, and the business necessity of recapitalization. Omnipresent, as well, is the desirability of keeping the corporation going versus the desirability of protecting the small investor, who is an important source of capital.<sup>59</sup>

Despite the apparent preponderance of cases protecting dividend accumulations, many corporations have succeeded in wiping out or scaling down dividend arrearages. This is true because a large number of recapitalization plans, in the absence of effectively organized opposition, never are adjudicated. The informed investor must hence realize today that many of the preferences attached to preferred stock are "mere trimmings," and that the security ostensibly offered thereby may be more a dream than a reality.<sup>60</sup>

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<sup>57</sup> Reaching the opposite conclusion are 24 MINN. L. REV. 992 (1940); 88 UNIV. PA. L. REV. 624 (1940).

<sup>58</sup> *Lonsdale Securities Corp. v. International Mercantile Marine Co.*, 101 N. J. Eq. 554, 139 A. 50 (1927). In this case, although no fraud was present, the court rejected a proposed recapitalization on the ground that the plan was unfair.

<sup>59</sup> 25 CORN. L. Q. 431 (1940).

<sup>60</sup> See 4 UNIV. CHI. L. REV. 645 (1937); 22 MINN. L. REV. 676 (1938).