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CORPORATIONS PREFERRED STOCK CUMULATIVE IF NOT OTHERWISE SPECIFIED

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CORPORATIONS — PREFERRED STOCK CUMULATIVE IF NOT OTHERWISE SPECIFIED — Ten thousand shares of preferred capital stock in defendant corporation were left in trust for plaintiff by her father. This stock was issued to discharge a debt due by the corporation to plaintiff's father, who, together with his son and his attorney, owned all the stock of the corporation. In certain of the preliminary papers the word "non-cumulative" was used, but the certificate itself, in regard to dividends, merely spells out that the "preferred capital stock shall receive annual dividends of 6%, and not more to be declared by the board of directors." For several years no dividends had been declared, and plaintiff claims a right to dividends for those years before any can be paid to the common stockholders. The court *held* that defendant corporation could not pay any dividends on its common stock until payment of cumulative dividends at the rate of six per cent per annum was made on the preferred stock. The court observed that the intention of the plaintiff's father at the time the stock was originally issued controlled the case, and that, since his intention was to secure an annual income to his daughter, the stock was cumulative. *Warburton v. John Wanamaker Philadelphia*, 320 Pa. 5, 196 A. 506 (1938).

The preferences which one class of stock has over another class are entirely a matter of contract, and in determining questions of preference the courts are engaged wholly in interpreting this contract between the parties.¹ Where the right of a preferred stockholder to dividends is fixed by contract, the directors are bound thereby, and may not divert to other purposes funds which should be distributed as dividends on the preferred stock.² While the terms of this contract are ordinarily set forth in the stock certificate, the prospective purchaser should not content himself with reliance upon this evidence of his proprietary interest for a full definition of his rights, but should check it with the various other documents which together constitute the contract governing his stock.³ In a situation somewhat analogous to the present one, where there is no specific provision in the contract governing the point, the courts are not agreed as to the

¹ 6 A. L. R. 802 at 808 (1920) (and cases cited therein); Christ, "Right of Holders of Preferred Stock to Participate in the Distribution of Profits," 27 MICH. L. REV. 731 (1929).

² 6 A. L. R. 802 at 806 (1920) (and cases cited therein); 67 A. L. R. 765 at 768 (1930) (and cases cited therein).

³ Thompson, "Respective Rights of Preferred and Common Stockholders in Surplus Profits," 19 MICH. L. REV. 463 at 468 (1921). In a footnote the writer says, "It is agreed that the terms of these contracts are to be gathered from the articles of incorporation or memorandum of association, the by-laws, minutes of corporate meetings, resolutions of the stockholders and directors, propositions or reports to the company, and agreements, conveyances, etc., pertaining to the issue of the stock in question, and classes having a preference over it." To the same effect, see 1 COOK, CORPORATIONS, 8th ed., § 269, p. 899 (1923), and the many cases cited therein.

right of the preferred stockholders to participate, in any degree, with the common, in a further distribution of profits after the payment of the stipulated dividends.⁴ The text writers are agreed that, unless a contrary intention appears, dividends on preferred stock are cumulative, and arrearages in one year are payable in subsequent years, when there are sufficient profits, before dividends can be paid on common stock.⁵ In England this appears to be the established rule.⁶ But the American cases have never had to resort to the rule in its strict sense, though it has been given lip service. The decisions can all be explained as reasonable and fair interpretations of the contract due to the peculiar language in the articles, certificates, or statutes.⁷ It has been held that the word "guaranteed" makes the dividends cumulative.⁸ The authorities, and the cases, are agreed that the preferred stock may be non-cumulative under peculiar provisions of the

⁴ 1 COOK, CORPORATIONS, 8th ed., § 269, p. 895 (1923); Christ, "Right of Holders of Preferred Stock to Participate in the Distribution of Profits," 27 MICH. L. REV. 731 (1929); Thompson, "Respective Rights of Preferred and Common Stockholders in Surplus Profits," 19 MICH. L. REV. 463 at 468 (1921); 33 MICH. L. REV. 968 (1935). The so-called Pennsylvania view permits further participation on the premise that all stock is equal unless preferences are given to one class, *Fidelity Trust Co. v. Lehigh Valley R. R.*, 215 Pa. 610, 64 A. 829 (1906); *Sternbergh v. Brock*, 225 Pa. 279, 74 A. 166 (1909); *Englander v. Osborne*, 261 Pa. 366, 104 A. 614 (1918). Other courts, for various reasons, have held that the preferred stock is entitled to no participation beyond the stated preference. *Stone v. United States Envelope Co.*, 119 Me. 394, 111 A. 536 (1920), in which the court said there was an implied agreement to give up equal participation upon receiving the greater security of the preferential rights. Other courts have reached the same result on the basis of that being the common commercial understanding. *Scott v. Baltimore & Ohio R. R.*, 93 Md. 475, 49 A. 327 (1901); *Niles v. Ludlow Valve Mfg. Co.*, (C. C. A. 2d, 1913) 202 F. 141; *James F. Powers Foundry Co. v. Miller*, 166 Md. 590, 171 A. 842 (1934). And see *Whitney v. Puro Filter Corp.*, (C. C. A. 2d, 1933) 63 F. (2d) 811.

⁵ 1 MORAWETZ, PRIVATE CORPORATIONS, 2d ed., § 458 (1886); 2 CLARK and MARSHALL, PRIVATE CORPORATIONS, § 529 (a) (3), p. 1640 (1901); 1 COOK, CORPORATIONS, 8th ed., § 273, p. 922 (1923), citing many cases; 14 C. J. 410, § 559 (1919). Commenting on the rule, Cook says it is not only equitable, but is the understanding of the business community.

⁶ The statement seems to have been first made in *Henry v. Great Northern R. R.*, 1 De G. & J. 606, 44 Eng. Rep. 858 (1857), where the statutory language apparently dictated the result. Later cases have indorsed the principle literally. See, *Corry v. Londonderry & E. R. R.*, 29 Beav. 263, 54 Eng. Rep. 628 (1860); *Webb v. Earle*, L. R. 20 Eq. 556 (1875).

⁷ *Prouty v. Michigan, S. & N. I. Ry.*, 1 Hun. (N. Y.) 655 (1874); *Lockhart v. Van Alstyne*, 31 Mich. 76 at 84 (1875); *West Chester & Philadelphia R. R. v. Jackson*, 77 Pa. St. 321 (1875); *Boardman v. Lake Shore & M. S. R. R.*, 84 N. Y. 157 (1881); *Jermain v. Lake Shore & M. S. R. R.*, 91 N. Y. 483 (1883); *Fidelity Trust Co. v. Lehigh Valley R. R.*, 215 Pa. 610, 64 A. 829 (1906).

⁸ 14 C. J. 410, § 559 (1919): "The term 'guaranteed stock' is sometimes used as synonymous with preferred stock, but properly speaking it applies to preferred stock on which the payment of the dividend is guaranteed, and a distinction is sometimes drawn to the effect that guaranteed stock is entitled to arrears of dividends, while ordinary preferred stock is not." *Boardman v. Lake Shore & M. S. R. R.*, 84 N. Y. 157 (1881); *Dickinson v. Chesapeake, etc. R. R.*, 7 W. Va. 390 (1874).

contract, as where the dividends upon preferred stock are made to depend upon the profits of a certain year.⁹ The present decision, with its own particular background, would seem to be in accord with the American approach to the question in its search for the controlling intention, and it illustrates well how difficult it may be to interpret that intention when it is not expressly stipulated. Inasmuch as this problem could have been definitely determined by an express provision in the contract,¹⁰ it is apparent that an abundance of precaution on the part of a lawyer can avoid the embarrassment of having the court construe the contract to be otherwise than contemplated by the corporation. Careful and intelligent draftsmanship in the present instance would have stated categorically that the stock was cumulative or non-cumulative, as the purpose might be.

⁹ 2 CLARK and MARSHALL, PRIVATE CORPORATIONS, § 529 (d), p. 1643 (1901), citing cases; 1 COOK, CORPORATIONS, 8th ed., § 273, p. 922 (1923), citing cases; 14 C. J. 421, § 578 (1919); *Dent v. London Tramways Co.*, 16 Ch. D. 344 (1879); *Elkins v. Camden & Atlantic R. R.*, 36 N. J. Eq. 233 (1882); *Murphy v. Richardson Dry Goods Co.*, 326 Mo. 1, 31 S. W. (2d) 72 (1930); 98 A. L. R. 1526 (1935).

¹⁰ See notes 1 and 2, *supra*.