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CORPORATIONS — CHARTER AMENDMENTS — DELAWARE DILEMMA — It may be conceded that a corporate charter¹ is a contract² having a threefold aspect as to the combinations of parties thereto,³ and that this contract, as between the corporation and the state, may be changed by the state without conflict with the Federal Constitution,⁴ providing the state has reserved a power to change.⁵ It still is an ever

¹ This term is here used generically throughout the discussion to denote the older form of charter as well as modern certificates of incorporation.

² *Trustees of Dartmouth College v. Woodward*, 4 Wheat. (17 U. S.) 518, 4 L. Ed. 629 (1819); *Dow v. Northern R. R.*, 67 N. H. 1, 36 A. 510 (1887); *Yoakam v. Providence Biltmore Hotel Co.*, (D. C. R. I. 1929) 34 F. (2d) 533; *Shields v. Ohio*, 95 U. S. 319, 24 L. Ed. 357 (1877). It is not the purpose of this comment to criticize this rule, but it has not been free from criticism. See Dodd, "Dissenting Stockholders and Amendments to Corporate Charters," 75 *UNIV. PA. L. REV.* 585 (1927); Willis, "The Dartmouth College Case—Then and Now," 19 *ST. LOUIS L. REV.* 183 (1934).

³ *Somerville v. St. Louis Min. & Mill Co.*, 46 Mont. 268, 127 P. 464 (1912); *Garey v. St. Joe Mining Co.*, 32 Utah 497, 91 P. 369 (1907); *Salt Lake Auto Co. v. Keith-O'Brien Co.*, 45 Utah 218, 143 P. 1015 (1914). See also Curran, "Minority Stockholders and the Amendment of Corporate Charters," 32 *MICH. L. REV.* 743 (1934); 34 *MICH. L. REV.* 859 (1936).

⁴ Under the terms of the United States Constitution, Art. I, § 10. See 34 *MICH. L. REV.* 859 et seq. (1936). Subject always, of course, to the "due process clause," Amendment XIV, § 1. See 40 *HARV. L. REV.* 891 (1927).

⁵ *Sherman v. Smith*, 1 Black. (66 U. S.) 587, 17 L. Ed. 163 (1862); *Wilmington City Ry. v. Wilmington & B. S. Ry.*, 8 Del. Ch. 468, 46 A. 12 (1900); *Philadelphia, W. & B. R. R. v. Bowers*, 9 Del. 506 (1873). Some writers have advocated a limitation of the amendment power to the contract of the corporation and the state. Stern, "The Limitations of the Power of the State Under a Reserved Right to Amend

present problem, however, as to how far the state may affect the contracts of stockholders, either inter se or with the corporation.⁶ This problem is particularly a live one in Delaware, both because of the recent *Keller* case⁷ and the large number of corporations which are organized under the laws of that state.⁸

It may be admitted, generally, subject to early and minority doubts,⁹ that intracorporate relations may be affected to some extent either directly¹⁰ or indirectly through the medium of permissive amendments adoptable by something less than a unanimous vote.¹¹ The question of *how far* such intracorporate relations may be affected remains elusive and important, especially as connected with the swiftly changing economic conditions of the present century.

In *Peters v. United States Mortgage Co.*,¹² holders of preferred stock sued to enjoin the adoption of an amendment which was designed to cut off their rights in the future to participate in distributable funds after their own and common stock dividends had been paid. Refusing the injunction, the court said that although the change would materially alter the stockholders' contracts with the corporation and inter se, nevertheless, these contracts were subject, when made, to the

or Repeal Charters of Incorporation," 53 UNIV. PA. L. REV. 73 (1905); 40 HARV. L. REV. 891 (1927).

⁶ *Note recent litigation*: *Sutton v. Globe Knitting Works*, 276 Mich. 200, 267 N. W. 815 (1936), noted in 15 MICH. S. B. J. 406 (1936); *Petry v. Harwood Elec. Co.*, 280 Pa. 142, 124 A. 302 (1924); *Windhurst v. Central Leather Co.*, 105 N. J. Eq. 621, 149 A. 36 (1930), affd. 107 N. J. Eq. 528, 153 A. 402 (1931). See also the Delaware cases discussed *infra*, this comment. *Note recent discussion*: Curran, "Minority Stockholders and the Amendment of Corporate Charters," 32 MICH. L. REV. 743 (1934); 34 MICH. L. REV. 859 (1936); 3 UNIV. CHI. L. REV. 327 (1936); 10 TEMPLE L. Q. 86 (1935); 16 VA. L. REV. 282 (1930).

⁷ *Keller v. Wilson & Co.*, (Del. Ch. 1935) 180 A. 584, reversed (Del. 1936) — A. —.

⁸ Berle, "Investors and the Revised Delaware Corporation Act," 29 COL. L. REV. 563 (1929).

⁹ *Zabriskie v. Hackensack & N. Y. R. R.*, 18 N. J. Eq. 178 (1867); *Snook v. Georgia Imp. Co.*, 83 Ga. 61, 9 S. E. 1104 (1889); *Garey v. St. Joe Mining Co.*, 32 Utah 497, 91 P. 369 (1907); *Kenosha, Rockford & Rock Island R. R. v. Marsh*, 17 Wis. 13 (1863); *Yoakam v. Providence Biltmore Hotel Co.*, (D. C. R. I. 1929) 34 F. (2d) 533, noted in 14 MINN. L. REV. 413 (1930). See also, 16 VA. L. REV. 282 (1930).

¹⁰ As by an enactment imposing a change upon the corporation under the reserved power exclusive of questions of control through the state's police power.

¹¹ See cases collected in Curran, "Minority Stockholders and the Amendment of Corporate Charters," 32 MICH. L. REV. 743 at 749 (1934); 10 TEMPLE L. Q. 86 (1935); 28 ILL. L. REV. 422 (1933); 30 ILL. L. REV. 388 (1935).

¹² 13 Del. Ch. 11, 114 A. 598 (1921).

reserved power¹³ under which the later change was valid.¹⁴

Two years later,¹⁵ the Delaware court held that although the reserved power¹⁶ allowed the state to authorize amendments which would affect intracorporate relations, yet the terms of the statute permitting a change¹⁷ did not cover accrued unpaid dividends, and further, because the right of the preferred stockholders to the accruals, as against other members of the corporation, was a *present vested property interest*, it could not be divested without the consent of all owners thereof.¹⁸

After a lapse of five years, the same court again passed on the question.¹⁹ At this point it refused to enjoin the filing of an amendment destroying redemption rights of certain stock, on the basis that this was matter within the purview of the reserved power as aug-

¹³ The original reservation was Del. Rev. Code (1915), Gen. Corp. Law, c. 65, § 82: "This Chapter may be amended or repealed at the pleasure of the Legislature. . . . this Chapter and all amendments thereof shall be a part of the charter of every . . . corporation. . . ." Then, Del. Rev. Code (1915), c. 65, § 26, amended by Del. Laws (1917), c. 113, § 12, provided "Any corporation . . . may . . . amend its charter . . . provided that such amendment . . . shall contain only such provisions as it would be lawful and proper to insert in an original certificate of incorporation. . . ." A later clause requires that if stock rights and preferences were to be affected that the amendment must be approved by a majority of the class affected and all other classes as well.

¹⁴ *Peters v. United States Mortgage Co.*, 13 Del. Ch. 11 at 14, 114 A. 598 (1921), Chancellor Wolcott saying: "Unless there be some provisions in either the law or the corporate certificate reserving the power to do so, there can be no alteration in the terms of the contract under which the shareholder, as such, possesses his rights, without his consent. If, however, the right to change or alter the stockholder's contract be reserved in a proper way, then no shareholder can complain against a proposed change therein, for the very plain reason that one of the terms by which he holds his contract is that the same may be altered." Again, 13 Del. Ch. 11 at 15, "In view of this language in the act, it is clear that the stockholders may amend the certificate in the manner suggested by the proposed amendment. . . ."

¹⁵ *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 A. 696 (1923).

¹⁶ *Supra*, note 13.

¹⁷ Del. Rev. Code (1915), Gen. Corp. Law, c. 65, § 26, as amended by Del. Laws (1917), c. 113, § 12: "provided, however, that if any such proposed amendment would alter or change the *preferences* given to any one or more classes. . . ." (Italics added.) See *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136 at 147, 122 A. 696 (1923), Chancellor Wolcott saying, "in the view which I take of the matter the right of the preferred stockholder to accrued and unpaid dividends, though the same have never been declared, cannot be said to constitute a *preference* within the meaning of the section. . . ." (Italics added.)

¹⁸ *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136 at 152, 122 A. 696 (1923), the Chancellor pointing out the similarity between accrued unpaid dividends on cumulative stock and declared unpaid dividends on common stock.

¹⁹ *Davis v. Louisville Gas & Elec. Co.*, 16 Del. Ch. 157, 142 A. 654 (1928). Cf. *Sutton v. Globe Knitting Works*, 276 Mich. 200, 267 N. W. 815 (1936) (date of redemption changed); *Yoakam v. Providence Biltmore Hotel Co.*, (D. C. R. I. 1929) 34 F. (2d) 533 (cutting off sinking fund).

mented by the statutory amendment of 1927.²⁰ Questions of corporate finance, of which the various stock-rights were said to be an integral part,²¹ were stated to be of public concern, and subject to regulation for the good of the state and the corporation.²²

In 1935, under the amended Delaware statute,²³ the chancellor handed down a decision which seemed to open the door for any and all changes by refusing to enjoin an amendment cutting off accumulated unpaid dividends.²⁴ With this decision, it would seem that Delaware had departed from the usual rule which limits the power of the state over intracorporate relations by refusing to allow amendments to impair "vested rights."²⁵ The decision is strictly logical, both as to the

²⁰ The amending power [Del. Rev. Code (1915), Gen. Corp. Laws, Ch. 65, § 26] was itself amended in 1927 [Del. Laws (1927), c. 85, § 10]: "Any corporation . . . may . . . amend . . . by increasing or decreasing its authorized capital stock or reclassifying the same, by changing the number, par value, designations, preferences, or relative, participating, option, or other special rights of the shares. . . ." (Italics added.) Attention is called to the italicized portion, in view of the Keller case, discussed infra. The original reservation, § 82, quoted supra, note 13, still remains in force.

²¹ *Davis v. Louisville Gas & Elec. Co.*, 16 Del. Ch. 157 at 163, 142 A. 654 (1928).

²² *Davis v. Louisville Gas & Elec. Co.*, 16 Del. Ch. 157 at 163, 142 A. 654 (1928), Chancellor Wolcott saying, "Certain it is that the state in authorizing the creation of corporations is interested as a matter of public policy in seeing to it that its corporate creatures shall possess such powers as are best calculated to promote the corporation's welfare, advance its interests, and facilitate the meeting of its business and financial needs." (Italics added.)

See also, *Fornataro v. Atlantic Coast Bldg. & Loan Assn.*, 10 N. J. Misc. 1248, 163 A. 240 (1932); *Salt Lake Auto Co. v. Keith-O'Brien Co.*, 45 Utah 218, 143 P. 1015 (1914); 28 MICH. L. REV. 1009 (1930). But cf. the result of the *Davis* case with *Yoakam v. Providence Biltmore Hotel Co.*, (D. C. R. I. 1929) 34 F. (2d) 533. *Harr v. Pioneer Mechanical Corp.*, (C. C. A. 2d, 1933) 65 F. (2d) 332, agreed with the construction put on the statute by the *Davis* case regarding an amendment said to cut off preferred stockholders' right to accrued unpaid dividends, although the district court viewed the facts differently to the end that the amendment merely gave new preferred stock priority over old. See *Harr v. Pioneer Mechanical Corp.*, (D. C. N. Y. 1932) 2 F. Supp. 517; *Hinckley v. Schwarzschild & Sulzberger Co.*, 107 App. Div. 470, 95 N. Y. S. 357 (1905); *Cox*, "Extent of the Power of the Majority to Amend Corporate Charters," 3 CONN. B. J. 240 (1929); 31 COL. L. REV. 1163 (1931).

²³ *Supra*, note 20. See also note 13, *supra*, for the original reserved power and amending power granted to corporations at an earlier date.

²⁴ *Keller v. Wilson & Co.*, (Del. Ch. 1935) 180 A. 584 at 585, Chancellor Wolcott saying, "I think there can be no doubt . . . that the legislative amendment of 1927 was purposely adopted in order to obviate the consequences of the *Morris* case. . . ." The case is criticized in 34 MICH. L. REV. 859 (1936); 3 UNIV. CHI. L. REV. 327 (1936). But see 36 COL. L. REV. 674 (1936), approving the logic of the result.

²⁵ *Morris v. American Public Utilities Co.*, 14 Del. Ch. 136, 122 A. 696 (1923); *Looker v. Maynard*, 179 U. S. 46, 21 S. Ct. 21 (1900). Statements also have been made in decisions ultimately going the minority way (mentioned *supra*, note 9) to

meaning of the statute and as to the view taken that any given right or preference could not become "vested" once interpreted to fall within the scope of the reserved power.²⁶ Notwithstanding the logic, the decision opens the way for greater control by "management interests"²⁷ in a field where, but for some degree of equitable control,²⁸ these interests already are practically autonomous.²⁹ Although it may well be argued that such control is a practical necessity, or that the small investor never wants to control anyway,³⁰ or that even where voting power is most vital (*viz.*, in a stock-fight) it is merely a matter of which group is able to obtain the most proxies in a short time, it still would appear to be unwise to give *any* majority too great a sense of security in their control. To do so would only serve to place temptation in their path. Nor does it seem to be any solution to state that the controlling powers would defeat their own ends if they

this effect. See *Zabriskie v. Hackensack & N. Y. R. R.*, 18 N. J. Eq. 178 (1867); *Yoakam v. Providence Biltmore Hotel Co.*, (D. C. R. I. 1929) 34 F. (2d) 533.

²⁶ The decision is also consistent with the view taken of the amending power in the Peters case (*supra* at note 14) and the Davis case (*supra* at note 22), the Chancellor recognizing the rule of the Morris case (*supra* at notes 15 and 18) but now believing that the original reserved power (*supra*, note 13) and the 1927 statute (*supra*, note 20) would have called for a different result in the Morris case, and that the 1927 statute was passed to obviate the result of the Morris case.

²⁷ This term and its equivalents have been used by Mr. Berle and others to denote particularly "bankers' control" where non-voting stock has been issued, as under reorganization plans. However, here it is used merely as a convenient figure to represent the majority and to cover, as well, that class of case involving actual "management interests," as a fixed group, as distinguished from mere majorities which are usually in a relatively constant state of flux. Too great freedom of control could cause combination of groups for greater control where greater control does not appear desirable to the writer, although logically possible and consistent with the theory and development of the corporate structure.

²⁸ BERLE, *STUDIES IN THE LAW OF CORPORATION FINANCE* 173 (1928), reviewed in 42 HARV. L. REV. 714 (1929); Berle, "Investors and the Revised Delaware Corporation Act," 29 COL. L. REV. 563 at 580 (1929). Provision for compensation to dissentients is also unsatisfactory, the fact appearing that this procedure remains a sort of condemnation or "freeze-out." See Del. Rev. Code (1915), Gen. Corp. Law, c. 65, § 61; Cal. Civil Code (1933 Supp.), § 369; Ill. Rev. Stat. (1935), c. 32, par. 73. Such statutes usually cover only a disposal of assets or a merger.

²⁹ BERLE and MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY*, bk. 2, cs. 4, 5, 6 (1932).

³⁰ 42 HARV. L. REV. 714 (1929), a review of BERLE, *STUDIES IN THE LAW OF CORPORATION FINANCE* (1928), by Joseph V. Kline of the New York Bar. It is admittedly a well-recognized fact that most small investors never intend to do more than take their dividends; yet does it not evidence the need for some form of supervision that litigation is frequent, and seldom concerned with "professional obstructionists"? Witness the *Davis v. Louisville Gas & Electric Co.*, 16 Del. Ch. 157, 142 A. 654 (1928), even though the stockholders involved would not normally be classed as "small-man" investors.

yielded to such temptation, for the small man has lost or been made to lose his investment in many ways in the past and still comes back for more.⁸¹

With these elements underlying, perhaps, the Supreme Court of Delaware, on November 10, 1936, reversed⁸² the chancellor's decision in the *Keller* case,⁸³ holding that even in view of the reserved power,⁸⁴ the amendment of 1927,⁸⁵ the *Davis*⁸⁶ and *Harr* cases,⁸⁷ the preferred shareholders' right to accrued unpaid dividends on cumulative stock could not be taken away under a charter amendment approved by less than a unanimous vote. The exact basis for the decision was not made clear, the court speaking not only in terms of "vested rights" from a constitutional viewpoint, but also stating that the chancellor's construction of the 1927 statute⁸⁸ was incorrect and that it did not cover a destruction of previously accrued rights, since these could not be said to constitute rights under any amending power at all, but were something extrinsic thereto. The court also analyzed an applicable public policy, and the need for the protection of minority investors' interests. The result was to overrule the logically sound decision of the chancellor below,⁸⁹ to limit the broad rule of the *Davis* case⁴⁰ to its particular facts, and to place Delaware back in the fold with the majority of the courts, which hold that, notwithstanding the reserved power,

⁸¹ Ripley, "From Main Street to Wall Street," 137 ATLANTIC MONTHLY 94 (1926). Notice also how "penny-stocks" at this writing are almost on a level with where they left off in 1929.

⁸² *Keller v. Wilson & Co.*, (Del 1936) — A. —, as yet unreported.

⁸³ *Keller v. Wilson & Co.*, (Del Ch. 1935) 180 A. 584.

⁸⁴ *Supra*, note 13.

⁸⁵ *Supra*, note 20.

⁸⁶ *Davis v. Louisville Gas & Elec. Co.*, 16 Del. Ch. 157, 142 A. 654 (1928).

⁸⁷ *Harr v. Pioneer Mechanical Corp.*, (C. C. A. 2d, 1933) 65 F. (2d) 332.

⁸⁸ *Keller v. Wilson & Co.*, (Del. 1936) — A. —, Chief Justice Layton, after reviewing earlier cases, stated, "It may be conceded . . . that there has been an increasing departure from the conception, which formerly prevailed when the right of individual veto in matters of corporate government operated as a dangerous obstruction to proper functioning. But in determining whether the rights of the complainants herein are such as ought to be regarded as property rights, all aspects of the question must be considered to ascertain what is *conducive to the best interests of society*. . . . Some measure of protection should be accorded [investors]. While many interrelations of the State, the corporation, and the stockholders may be changed, there is a limit beyond which the state may not go. Property rights may not be destroyed; and when the nature and character of the right of a holder of cumulative preferred stock to unpaid dividends, which have accrued thereon through passage of time . . . a *just public policy*, which seeks the equal and impartial protection of the interests of all, demands that the right be regarded as a *vested right of property* secured against destruction by the Federal and State Constitution." (Italics added.)

⁸⁹ *Keller v. Wilson & Co.*, (Del. Ch. 1935) 180 A. 584.

⁴⁰ *Davis v. Louisville Gas & Elec. Co.*, 16 Del. Ch. 157, 142 A. 654 (1928).

the contract of the stockholders with the corporation and inter se cannot be reached to the extent that "vested rights" may be impaired.⁴¹

Such a limitation on the power of the state to change the rights of the stockholders of the nature involved in the *Keller* case appears to be wise. It would, perhaps, have been more understandable, more logical, and more predictable an approach to reach the result through a realistic analysis. This analysis would admit that the reserved power prevented rights from "vesting" but would deny that the state or the majority with the state's permission had power to destroy contract rights which constituted a weighty portion of the consideration for the purchase of the stock in the first instance. And, since it might be argued that this proves too much, such that even the result of the *Davis* case would be outlawed, it should be remembered that the suggested approach is primarily equitable in character, with the result that the preservation of minority stockholders' investments would give way of necessity in a proper case to the rights of other stockholders as well as to the interests of the public in the maintenance of a valuable business.⁴² In fine, the suggested approach is not definitely severable from a treatment based on the police power of the state to justify or outlaw amendments to corporate charters, and what would be considered thereunder were the courts to employ such a treatment.⁴³

⁴¹ *Supra* at note 25.

⁴² See, for instance, what may happen if the "vested rights" theory is carried to its ultimate conclusion arbitrarily. *Lonsdale Securities Corp. v. International Merchant Marine Co.*, 101 N. J. Eq. 554, 139 A. 50 (1927).

⁴³ See 34 MICH. L. REV. 859 at 861 (1936).