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CORPORATIONS - RIGHT OF PREFERRED STOCKHOLDERS TO PARTICIPATE IN DIVIDENDS BEYOND SPECIFIED AMOUNT

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CORPORATIONS — RIGHT OF PREFERRED STOCKHOLDERS TO PARTICIPATE IN DIVIDENDS BEYOND SPECIFIED AMOUNT — The holders of a minority of the preferred stock of a foundry company petitioned for receivership and repayment of part of the dividends which had been paid to common stockholders, contending that after payment of the stipulated 6 per cent dividend on the preferred

stock and a like percentage on the common stock, preferred and common stockholders should participate alike in all further dividends declared. There was no provision in the articles or by-laws of the corporation concerning such participation in dividends. *Held*, that in the absence of express provision, preferred stockholders are entitled to receive only their guaranteed dividend and any arrears due under cumulative terms, since that is the ordinary commercial understanding with respect to preferred stock, and since the articles expressly state that upon dissolution, preferred stockholders participate in the assets only to the extent of the par value of their stock and any accrued dividends. *James F. Powers Foundry Co. v. Miller*, 166 Md. 590, 171 Atl. 842 (1934).

The question of the right of holders of preferred stock to participate further in dividends after they have been paid the stipulated amount, in absence of specific provisions, is apparently still an open one. The situation is normally settled by express terms of the statute or articles of incorporation,¹ and of the cases in which the question is raised, a considerable share are concerned with the interpretation of such provisions.² However, in many of these cases, as in the principal one, there is also a discussion of general principles involved which seems to be of considerable weight in reaching a decision, especially where the other considerations are such hazy ones as the relation of participation in assets on dissolution to participation in surplus dividends, and the weight to be given to prolonged acquiescence in the payment of all surplus dividends to the common stockholders.³ Earlier textwriters usually stated that preferred stock is simply common stock with certain additional rights, and hence participates equally with the common stock in all further dividends after the common has been paid a return equal to that guaranteed to the preferred.⁴ The courts of Pennsylvania have adhered

¹ 12 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, sec. 5448 (1932) For good general discussions of the problem from quite different viewpoints, see Thompson, "Respective Rights of Preferred and Common Stockholders in Surplus Profits," 19 MICH. L. REV. 463 (1921), and Christ, "Right of Holders of Preferred Stock to Participate in the Distribution of Profits," 27 MICH. L. REV. 731 (1929).

² *Tennant v. Epstein*, 356 Ill. 26, 189 N. E. 864 (1934). In some instances statutory provisions are also involved. *Star Pub. Co. v. Ball*, 192 Ind. 158, 134 N. E. 285 (1922). The most usual statutory provision on the point, however, merely states that the different classes of stock may have such preferences and participating rights as are provided for in the certificate of incorporation or the amendments thereto. Del. Laws (1929), c. 135, sec. 5, p. 371, amending Del. Rev. Code (1915), sec. 1927; Md. Ann. Code (1924), art. 23, sec. 38.

³ For example, the charter provision involved in the principal case with respect to dividend rights of the preferred stock reads: "The holders thereof are to receive, and the said corporation be bound to pay an annual dividend of not less than six per cent, before any dividend shall be paid to the holders of the common stock of said corporation." 166 Md. 590 at 598, 171 Atl. 842 at 846 (1934). Further discussion of the relation of participation in dividends and of participation in assets upon dissolution may be found in *In re Espuela Land & Cattle Co.*, [1909] 2 Ch. 187.

⁴ Thompson, "Respective Rights of Preferred and Common Stockholders in Surplus Profits," 19 MICH. L. REV. 463 at 470 ff. (1921), citing 1 COOK, CORPORATIONS, 4th ed., sec. 269 (1898), and TAYLOR, PRIVATE CORPORATIONS, 3d ed., sec. 788 (1894).

steadfastly to that rule.⁵ Other courts and textwriters are of the opinion that the preferred shareholders are entitled only to the amount of the stipulated dividend, in the absence of express provision for further participation.⁶ They contend that the guarantee, together with the cumulative feature if that is provided, is given in lieu of the right of the common stockholder to unlimited participation;⁷ and further, that the ordinary stock purchaser expects to get no greater interest than that in dividends, citing the ordinary market prices of preferred and common stock in a profit-making company as evidence of this.⁸ It is inexcusable for lawyers to draft articles of incorporation without spelling out in full the rights and privileges of each class of stockholders. When that has not been done, it would seem that ordinary business practice ought to govern.⁹

J. E. G.

⁵ *Fidelity Trust Co. v. Lehigh Valley R. R.*, 215 Pa. 610, 64 Atl. 629 (1906); *Sternbergh v. Brock*, 225 Pa. 279, 74 Atl. 166 (1909); *Sterling v. H. F. Watson Co.*, 241 Pa. 105, 88 Atl. 297 (1913); *Englander v. Osborne*, 261 Pa. 366, 104 Atl. 614 (1918). In support of this view, see Christ, "Right of Holders of Preferred Stock to Participate in the Distribution of Profits," 27 MICH. L. REV. 731 at 735 (1929).

⁶ *Niles v. Ludlow Valve Mfg. Co.*, 120 C. C. A. 319, 202 Fed. 141 (1913); *Stone v. United States Envelope Co.*, 119 Me. 394, 111 Atl. 536 (1920); *Scott v. Baltimore & O. Ry.*, 93 Md. 475, 49 Atl. 327 (1901). In England, in *Will v. United Lankat Plantations Co.*, the Chancery Division took the Pennsylvania view, 106 L. T. Rep. (N. S.) 531 (1912), but the Court of Appeal, [1912] 2 Ch. 571, 107 L. T. Rep. (N. S.) 360 (1912), unanimously reversed the decision, holding that there should be no participation beyond the stipulated dividend; and the latter decision was affirmed by the House of Lords, 109 L. T. Rep. (N. S.) 754, 83 L. J. Ch. (N. S.) 195 (1913), apparently settling the matter there.

⁷ *Stone v. United States Envelope Co.*, 119 Me. 394, 111 Atl. 536 (1920).

⁸ *Niles v. Ludlow Valve Mfg. Co.*, 120 C. C. A. 319, 202 Fed. 141 (1913); see also Thompson, "Respective Rights of Preferred and Common Stockholders in Surplus Profits," 19 MICH. L. REV. 463 at 476 ff. (1921).

⁹ See cases cited in note 6, *supra*, and Thompson, "Respective Rights of Preferred and Common Stockholders in Surplus Profits," 19 MICH. L. REV. 463 at 484 ff. (1921). That such is the ordinary understanding seems inescapable, when the fact that common stocks of a highly profitable corporation always command a premium over the preferred, as pointed out in the above article, is considered. It should be borne in mind, however, that the conclusions here stated apply only to cash dividends. Stock dividends may bring in the further difficult questions involved in the shifts in control of the corporation. See note in 33 MICH. L. REV. 439 (1935).