

# Michigan Law Review

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Volume 32 | Issue 1

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1933

## CORPORATIONS - PRE-EMPTIVE RIGHTS IN TREASURY SHARES

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### Recommended Citation

*CORPORATIONS - PRE-EMPTIVE RIGHTS IN TREASURY SHARES*, 32 MICH. L. REV. 110 (1933).

Available at: <https://repository.law.umich.edu/mlr/vol32/iss1/17>

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CORPORATIONS — PRE-EMPTIVE RIGHTS IN TREASURY SHARES — Plaintiff, a former shareholder, sued the directors of a corporation for damages arising out of their alleged refusal to allow him pre-emptive rights in stock that had

been issued, re-purchased by the corporation from the shareholders, and re-issued by the defendant-directors to themselves. Upon appeal from an order dismissing the complaint for insufficiency, *held*, that the order be reversed on the law. *Hammer v. Werner*, (App. Div. 1933) 265 N. Y. S. 172.

There is current dogma,<sup>1</sup> rarely challenged,<sup>2</sup> and a decision,<sup>3</sup> that no pre-emptive right to treasury stock exists. As to new issues of stock, the bases upon which the pre-emptive right rests, which have never been formulated with precision, are the dual equitable considerations (1) that each shareholder should be allowed to preserve his proportionate voting rights, and (2) to preserve unimpaired his rights directly involving his pecuniary interest, that is, his rights in the assets and in the surplus.<sup>4</sup> In addition he may be said to have a right to contribute his proportionate share of any additional capital required, thus causing to inure to his benefit a part of the profits derived therefrom. We can justify these propositions only on the ground that there is an implied contract between the corporation and the shareholder that his interest, once fixed by him, shall, if he wishes, be preserved intact during the life of the corporation. Whatever may have been the situation in 1807 when the doctrine of pre-emptive rights was first announced,<sup>5</sup> many complex stock structures of the present day, both in regard to financial interest and voting control, render the interest to be protected impossible of accurate ascertainment.<sup>6</sup> The retention of a doctrine impossible of rational application and grounded upon an implication that may do violence to the realities of the situation is of questionable value. If its retention is desirable, however, it would seem that the issuance of treasury shares should come within its scope, for it cannot be denied that alteration of the corporate voting structure may result therefrom. There is ground more firm, however, for requiring that pre-emptive rights should exist in regard to treasury shares. The acquisition of shares by the corporation itself increases the relative control of the remaining shareholders,<sup>7</sup> since the shares acquired cannot be voted,<sup>8</sup> hence the issuance of those same shares does have the effect of cutting down the shareholders' newly-acquired gains, and it would seem to do no violence whatever to the realities of the situation to imply an agreement between the corporation and the shareholders that the former should do no act decreasing the relative control of the latter. The situation presented in cases involving pre-emptive right in treasury shares is frequently,<sup>9</sup> as in the principal case, that of an alleged breach by the directors of their fiduciary obligations to the shareholders. In such a case it requires no resort to the pre-emptive right to protect the shareholders, and care should be exercised, as in the principal case, to avoid confusing the issues presented.

T. S.

<sup>1</sup> 1 COOK ON CORPORATIONS, 8th ed., sec. 286 (1923).

<sup>2</sup> *Dunn v. Acme Auto and Garage Co.*, 168 Wis. 128, 169 N. W. 297 (1918).

<sup>3</sup> *Borg v. International Silver Co.*, (C. C. A. 2d, 1925) 11 F. (2d) 147.

<sup>4</sup> *Stokes v. Continental Co.*, 186 N. Y. 285, 78 N. E. 1090 (1906).

<sup>5</sup> *Gray v. Portland Bank*, 3 Mass. 364 (1807).

<sup>6</sup> See Frey, "Shareholders' Pre-emptive Rights," 38 YALE L. J. 563 (1929).

<sup>7</sup> *Drinker*, "The Pre-emptive Right of Shareholders," 43 HARV. L. REV. 586 (1930).

<sup>8</sup> *O'Connor v. International Silver Co.*, 68 N. J. Eq. 67, 59 Atl. 321 (1904).

<sup>9</sup> *Hartridge v. Rockwell*, R. M. Charl. (Ga.) 260 (1828); *State v. Smith*, 48 Vt. 266 (1876); *Crosby v. Stratton*, 17 Colo. App. 212, 68 Pac. 130 (1902).