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## Corporations - Amendment of Articles of Incorporation - Power of Majority to Require Holders of Redeemable Preferred Stock to Accept Bonds Instead of Money in Redemption

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CORPORATIONS—AMENDMENT OF ARTICLES OF INCORPORATION—POWER OF MAJORITY TO REQUIRE HOLDERS OF REDEEMABLE PREFERRED STOCK TO AC-

CEPT BONDS INSTEAD OF MONEY IN REDEMPTION—Plaintiffs owned 6 percent cumulative convertible prior preferred stock in defendant corporation. The stock had a stated value of \$100 per share, and was redeemable at the option of the corporation at \$115 per share plus accumulated dividends. By vote of more than two-thirds of the outstanding shares of each class of stock issued, defendant's articles of incorporation were amended to authorize its board of directors to redeem the prior stock at \$120 per share, payable in the company's 5 percent 30-year debentures. Interest on the debentures was to be cumulative, paid out of earnings, and subordinated to the other indebtedness of the company. Redemption was to be compulsory. Plaintiffs sought a declaratory judgment that the amendment was invalid. On appeal from a judgment for defendant, *held*, reversed. The amendment in question was beyond the powers of amendment given by the statute to the corporation. *Bowman v. Armour & Co.*, (Ill. 1959) 160 N.E. (2d) 753.

As a result of the adoption of the "contract view" of corporate charters in the *Dartmouth College* case,<sup>1</sup> states have invariably reserved broad powers to alter, amend, or repeal corporate charters which they grant.<sup>2</sup> When a state chooses to delegate by permissive legislation at least a part of its reserved power of amendment to a corporation or a certain percentage in interest of its stockholders, two types of limitations are imposed on the scope and exercise of this delegated power. First, no amendment will be sustained which impairs "vested rights" existing under the charter,<sup>3</sup> or which substantially changes the original scope and objects of the corporation.<sup>4</sup> The second type of limitation arises out of the common restriction placed on all delegated powers: they may be exercised only within the terms upon which they have been granted by the legislature. Therefore, when a dissenting stockholder contests a charter amendment, a question of statutory construction regarding the scope of the delegated power to amend must first be decided before considerations such as vested rights can ever be relevant. This initial stage of statutory interpretation is the one at which the court purports to resolve the principal case.<sup>5</sup> Aside from the fact that the precise issue seems to be one of first impression,<sup>6</sup> the decision is also

<sup>1</sup> *Dartmouth College v. Woodward*, 4 Wheat. (17 U.S.) 518 (1819).

<sup>2</sup> E.g., Ill. Rev. Stat. (1959) c. 32, §157.162.

<sup>3</sup> See Gibson, "How Fixed Are Class Shareholder Rights?" 23 LAW AND CONTEMP. PROB. 282 (1958); Meck, "Accrued Dividends on Cumulative Preferred Stock: The Legal Doctrine," 55 HARV. L. REV. 71 (1941); comment, 39 MICH. L. REV. 1201 (1941); 8 A.L.R. (2d) 893 (1949); 27 A.L.R. (2d) 1097 (1953).

<sup>4</sup> Dodd, "Dissenting Stockholders and Amendments to Corporate Charters," 75 UNIV. PA. L. REV. 585, 723 (1927). See also comment, 69 HARV. L. REV. 538 (1956); 105 A.L.R. 1452 (1936); 117 A.L.R. 1290 (1938).

<sup>5</sup> Principal case at 755.

<sup>6</sup> No other case has been found dealing with compulsory redemption of all of the stockholder's ownership interest with bonds. As mentioned in the principal case at page 758, such decisions as *Berger v. United States Steel Corp.*, 63 N.J. Eq. 809, 53 A. 68 (1902), revg. 63 N.J. Eq. 506, 53 A. 14 (1902), are distinguishable since redemption in these cases was not compulsory. Cf. *Goldman v. Postal Telegraph, Inc.*, (D.C. Del. 1943) 52 F. Supp. 763 (allowing charter amendment changing liquidation preferences of preferred stock from cash to bonds); *In re Thomas de La Rue & Co., Limited and Reduced*, [1911] 2 Ch.

significant because of the extremely strict construction it imposes on broad statutory language defining permissible charter amendments. The Illinois Business Corporations Act allows amendment of corporate charters in very broad and general terms. The corporation may amend its articles "in any and as many respects as may be desired, provided that its articles of incorporation as amended contain only such provisions as might be lawfully contained in original articles of incorporation."<sup>7</sup> Stock may be created "with such designations, preferences, qualifications, limitations, restrictions, and such special or relative rights as shall be stated in the articles of incorporation."<sup>8</sup> In addition to this language, which by itself would appear to authorize redemption provisions,<sup>9</sup> the act proceeds to specify: "*Without limiting the authority herein contained*, a corporation, when so provided in its articles of incorporation, may issue shares of preferred or special classes: (a) Subject to the right of the corporation to redeem any of such shares at not exceeding the *price* fixed by the articles of incorporation for the redemption thereof. . . ."<sup>10</sup> The court in the principal case, confronted with this sweeping language, invokes the canon of construction that this, like any other statutory grant of power, is to be strictly construed.<sup>11</sup> It finds that because of the above statutory language, the only redemption provisions which may appear in the corporation's original articles of incorporation are those calling for redemption for a "price"; that "price" means money and nothing else; and that therefore an amendment allowing redemption with bonds is *ultra vires*.<sup>12</sup> In thus holding that the Illinois Business Corporation Act allows redemption only in cash, the court adopts a construction which seems clearly inconsistent with the liberal intent manifest in the legislature's sweeping language in the statute. Other jurisdictions have allowed stock to be redeemed for products,<sup>13</sup> services,<sup>14</sup> or promissory notes.<sup>15</sup> In a series of New Jersey decisions<sup>16</sup> redemption for bonds has been explicitly

Div. 361 (allowing reduction of outstanding preferred stock by issuance of debentures therefor); and *Dratz v. Occidental Hotel Co.*, 325 Mich. 699, 39 N.W. (2d) 341 (1949) (through merger with wholly owned subsidiary, one-half of preferred stock outstanding before merger converted into 3% bonds).

<sup>7</sup> Ill. Rev. Stat. (1959) c. 32, §157.52.

<sup>8</sup> Ill. Rev. Stat. (1959) c. 32, §157.14.

<sup>9</sup> Redemption provisions have been referred to as "restrictions" or "qualifications" in *Lewis v. H. P. Hood & Sons, Inc.*, 331 Mass. 670, 121 N.E. (2d) 850 (1954); as part of a contractual "preference" in *Crimmins & Peirce Co. v. Kidder Peabody Acceptance Corp.*, 282 Mass. 367, 185 N.E. 383 (1933); and as "rights" in *Gunther Grocery Co. v. Hazel*, 179 Ky. 775, 201 S.W. 336 (1918) and *Butler v. Beach*, 82 Conn. 417, 74 A. 748 (1909).

<sup>10</sup> Ill. Rev. Stat. (1959) c. 32, §157.14. Emphasis added.

<sup>11</sup> Principal case at 756.

<sup>12</sup> Principal case at 758-759.

<sup>13</sup> *National Sewer Pipe Co. v. Smith-Jaycox Lumber Co.*, 183 Iowa 17, 166 N.W. 708 (1918).

<sup>14</sup> *Oklahoma Hotel Building Co. v. Houghton*, 202 Okla. 591, 216 P. (2d) 288 (1949).

<sup>15</sup> *Sanford v. First Nat. Bank*, (8th Cir. 1916) 238 F. 298.

<sup>16</sup> *Berger v. United States Steel Corp.*, note 6 supra; *Allen v. Francisco Sugar Co.*, (3d Cir. 1912) 193 F. 825; *Alabama Consolidated Coal & Iron Co. v. Baltimore Trust Co.*, (D.C. Md. 1912) 197 F. 347; *C. H. Venner Co. v. United States Steel Corp.*, (C.C. N.Y. 1902) 116 F. 1012.

allowed. Contrary to the court's claim in the principal case,<sup>17</sup> the redemption with bonds in these decisions was not "based upon a specific and peculiar statutory provision,"<sup>18</sup> but rather upon a section of the New Jersey General Corporation Act of 1896 worded much like the Illinois statute in question.<sup>19</sup> The court disposes of cases in other jurisdictions cited by counsel by stating the "general rule to be that preferred shares convertible by the *holders* into bonds or credit obligations, call, in effect, for a purchase by the corporation of its own shares, and like provisions for compulsory redemption should be expressly prohibited."<sup>20</sup> Here the court overlooks the basic distinction that this "general rule" refers only to redemption options in the hands of the *shareholders*, and is not applicable when the option is in the *corporation*. The rationale of the rule is that exercise of the option by the shareholders may force such a sudden and extreme diminution of the corporation's assets that its creditors may be prejudiced.<sup>21</sup> Even if this danger is admitted to be present when the option to redeem is in the stockholders, it manifestly does not exist when the corporation itself decides whether and when to redeem. Nevertheless, it is now apparently impossible for an Illinois corporation to provide either in its original articles or by amendment for redemption of preferred stock out of bonds. While it is true that the facts in the principal case involved only a charter amendment, the court's holding is necessarily broader in scope since by denying the amendment the court had to conclude under the statutory language that the provision could not have been "lawfully contained in the original articles of incorporation."<sup>22</sup> It is clear that the court considered the amendment objectionable mainly because of its compulsory operation upon non-assenting shareholders.<sup>23</sup> But this reason surely is not sufficient to deny the use of a compulsory redemption provision in the original charter since all shareholders in the corporation will have assented to it merely by purchasing their stock. Since the change from preferred stock to earnings bonds is not

<sup>17</sup> Principal case at 758.

<sup>18</sup> The court refers to 2 N.J. Comp. Stat. (1910) §29a, a 1902 amendment to the New Jersey General Corporation Act of 1896. This amendment, which merely imposed regulations on the pre-existing right to use bonds to redeem preferred stock, is found in its present form in 14 N.J. Stat. Ann. (1939) §14:8-5.

<sup>19</sup> 2 N.J. Comp. Stat. (1910) §27: ". . . such preferred stock may, if desired, be made subject to redemption at any time after three years from the issue thereof, at a *price* not less than par. . . ." (Emphasis supplied.) See *Berger v. United States Steel Corp.*, note 6 *supra*, at 823, and *Allen v. Francisco Sugar Co.*, note 16 *supra*, at 836.

<sup>20</sup> Principal case at page 758. Emphasis added.

<sup>21</sup> See *Hills*, "Model Corporation Act," 48 *HARV. L. REV.* 1334 at 1352, n. 21, and 1353, n. 23 (1935), and cases cited.

<sup>22</sup> Ill. Rev. Stat. (1959) c. 32, §157.52, quoted in text accompanying note 7 *supra*.

<sup>23</sup> Principal case at 758: "It seems to us to be evident that the effect of the amendment here sought to be sustained was, in fact, a purchase with bonds by the Armour company of its own outstanding preferred stock without the consent of the owners of said stock. While the Business Corporation Act does, under certain circumstances, permit a corporation to purchase its own stock, it can do so only when the shareholder is willing to sell, and no amendment passed with the approval of a two-thirds vote of the shareholders can force him to sell."

at all a drastic one,<sup>24</sup> it would seem that in its efforts to protect non-assenting shareholders the court has traded too much freedom in corporate recapitalization for too little meaningful protection of stockholder interests. It is certainly possible that the legislature intended the word "price" to encompass more than cash; it is likewise at least arguable that the statutory phrase permitting redemption for a "price" was not intended to be exclusive. Even if these interpretations are rejected, redemption with bonds can be thought of merely as a postponed payment of cash.<sup>25</sup> With these interpretations open to it, it is regrettable that the court would choose an approach so obviously out of harmony with the modern trend in both courts and legislatures to give more and more freedom to corporations in matters of recapitalization and charter amendment.<sup>26</sup>

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<sup>24</sup> Berl, "The Vanishing Distinction Between Creditors and Stockholders," 76 UNIV. PA. L. REV. 814 (1928).

<sup>25</sup> Ill. Rev. Stat. (1959) c. 32, §157.15 provides that there may be variations between different series of stock as to "the price at and the *terms and conditions* on which shares may be redeemed." (Emphasis supplied.) The Illinois Attorney General, in his opinion on the validity of the amendment, relied on this section as showing a legislative intent that the act did not require immediate payment of cash in redemption.

<sup>26</sup> Rutledge, "Significant Trends in Modern Incorporation Statutes," 22 WASH. UNIV. L. REV. 305 at 324 (1937).