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CORPORATIONS—DIVIDENDS—DATE FROM WHICH CUMULATIVE DIVIDENDS ACCRUE—Defendant corporation issued preferred stock in 1937 under a charter amendment which provided that such stock should "... pay dividends at the rate of six percent ..., but when not so earned and paid, the dividends so provided shall be cumulative. Said dividends shall be paid annually beginning the Fifteenth (15th) day of March, 1938. ..." The plaintiff held 100 shares of defendant's preferred stock issued in 1945, and the above provision appeared on his certificate. During dissolution of the defendant in 1955, the plaintiff claimed cumulative dividends from 1938 as an innocent purchaser for value, basing his contention on the language of the certificate that dividends would be paid beginning March 15, 1938. In the trial court, *held,* judgment for the defendant. The language of the certificate did not bind the corporation to pay dividends for any period prior to issuance of the stock. *Blandin v. United North and South Development Co.,* (Del. Ch. 1956) 121 A. (2d) 686.

The right of a preferred shareholder to cumulative dividends arises from his contract with the corporation and the other shareholders.[1] The terms of this contract are found in the language which appears on the stock certificate,[2] the provisions of the charter or certificate of incorporation,[3] and the circumstances from which the contract arose.[4] It is generally agreed that preferred shareholders' rights to cumulative dividends are not cut off by dissolution.[5] Rather, dissolution can bring about a right to payment of dividends which would have impaired capital if the company were still operating.[6] The question in the principal case was whether the statement in the charter amendment to the effect that "dividends shall be paid annually beginning the Fifteenth (15th) day of March, 1938," referred to all authorized preferred stock of the corporation, or only that issued in or shortly after 1938. Earlier, in *Holland v. Automotive Fibers, Inc.*,[7] a Delaware court faced this problem and arrived at the same conclusion as the principal case. The charter in the *Holland* case provided that dividends would accrue from a stated date, as in the principal case, and also that dividends were to accrue from the date of issue. In resolving this ambiguity, the court emphasized that nothing is presumed in favor of a preference,[8] and invoked the familiar principle that a reasonable construction is preferred to one that does not comport with "custom, prudence or fairness."[9]

1 Collins v. Portland Electric Power Co., (9th Cir. 1926) 12 F. (2d) 671; 48 A.L.R. 73 (1927); Allied Magnet Wire Corp. v. Tuttle, 199 Ind. 166, 154 N.E. 480, 156 N.E. 558 (1926). See Meck, "Accrued Dividends on Cumulative Preferred Stocks: The Legal Doctrine," 55 HARV. L. REV. 71 at 74 (1941); BALLANTINE, CORPORATIONS 501 (1946).

2 Lehigh Structural Steel Co. v. Commissioner of Internal Revenue, (3d Cir. 1942) 127 F. (2d) 67; Warren v. King, 108 U.S. 389 (1883).

3 Under the Delaware statute, a shareholder is ". . . entitled to receive dividends . . . as shall be stated and expressed in the certificate of incorporation, or in any amendment thereto. . . ." Del. Code Ann. (1953) tit. 8, §151 (C). See Allied Magnet Wire Corp. v. Tuttle, note 1 supra; Continental Ins. Co. v. Minneapolis St. P. & S. Ste. M. R. Co., (8th Cir. 1923) 290 F. 87; 31 A.L.R. 1320 (1924). See generally, BALLANTINE, CORPORATIONS 501 (1946).

4 Tennant v. Epstein, 356 Ill. 26, 189 N.E. 864 (1934).

5 Pennington v. Commonwealth Hotel Construction Corp., 17 Del. Ch. 394, 155 A. 514 (1931); Fawkes v. Farm Lands Inv. Co., 112 Cal. App. 374, 297 P. 47 (1931). *Contra:* Michael v. Cayey-Caguas Tobacco Co., 190 App. Div. 618, 180 N.Y.S. 532 (1920); In re W. J. Hall & Co., [1909] 1 Ch. 521. The Hall case has been disapproved in subsequent English decisions. 30 MICH. L. REV. 281 (1931). See generally STEVENS, PRIVATE CORPORATIONS, 2d ed., 470 (1949); BALLANTINE, CORPORATIONS 508 (1946).

6 This is justified by the notion that on dissolution there is only a single fund, capital no longer being a segregated item. Pennington v. Commonwealth Hotel Construction Co., note 5 supra. *Contra,* Michael v. Cayey-Caguas Tobacco Co., note 5 supra. This right is not a necessary incident of the right to cumulative dividends but must be stated in the preferred stock contract. Pennington v. Commonwealth Hotel Construction Co., note 5 supra; Gaskill v. Gladys Belle Oil Co., 16 Del. Ch. 289, 146 A. 337 (1929).

7 22 Del. Ch. 99, 194 A. 124 (1937).

8 Cf. Pennington v. Commonwealth Hotel Construction Co., note 5 supra; Gaskill v. Gladys Belle Oil Co., note 6 supra. See generally STEVENS, PRIVATE CORPORATIONS, 2d ed., 469 (1949). It is generally agreed that whatever preference the preferred shareholder gets must be clearly stated in his contract. Holland v. Automotive Fibers, note 7 supra; Gaskill v. Gladys Belle Oil Co., note 6 supra; Stone v. United States Envelope Co., 119 Me. 394, 111 A. 536 (1920). *Contra,* Englander v. Osborne, 261 Pa. 366, 104 A. 614 (1918).

9 Holland v. Automotive Fibers, Inc., note 7 supra.

This earlier decision, therefore, expresses a desire to prevent an unfair enrichment of the preferred shareholders, as well as a feeling that the shareholder's contention was contrary to normal business practice. In the principal case, the reasonableness of the shareholder's claim presents a substantial hurdle. While the factor of enrichment is present, there is a more fundamental difficulty with the shareholder's interpretation. The dividend preference given a preferred shareholder is that his dividend will be paid before that of the common shareholders.[10] If unissued preferred stock can accrue dividends to be paid after issuance, there would be an unreasonable limitation on the rights of the common stockholders. They could not participate until all dividends had been paid on the preferred, part of which would not have helped to furnish the capital on which earnings were based.[11] It would not seem unreasonable to allow preferred stock sold shortly after the dividend accrual date appearing on the certificate a right to accrue dividends from the stated date, for this stock could reasonably be said to fall within the original issue. On the other hand, a construction which would allow such accrual to preferred stock issued years later seems questionable.[12] In the principal case the interval of seven years served to emphasize the unreasonableness of the stockholder's claim. A further issue was raised in the principal case by the stockholder's assertion that he was an innocent purchaser for value, and thus entitled to rely on representations in the stock certificate.[13] The facts indicated, however, that there was in fact no reliance on the wording in the stock certificate at the time the stock was purchased.[14] Moreover, the time lag between the purchase (1951) and the time when the issue was raised (1955) made it appear that the shareholder merely sought to take advantage of a poorly worded charter in order to enlarge his rights on dissolution. The court's decision is consistent with what authority there is in this area, and substantial justice has been done. The problems encountered here and in the *Holland* case would never have arisen, however, had the draftsmen of the charters taken the care to specify that dividends on subsequent shares were to accrue from the date of issue.

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[10] Day v. United States Cast Iron Pipe and Foundry Co., 96 N.J. Eq. 736 at 740, 126 A. 302 (1924). See generally BALLANTINE, CORPORATIONS 504 (1946).

[11] "Its acceptance means furthermore that the incongruous idea must be adopted that stock may be conceived of as being entitled to dividends before the corporation has ever caused it to be issued." Holland v. National Automotive Fibers, Inc., note 7 supra, at 105.

[12] Holland v. National Automotive Fibers, Inc., note 7 supra.

[13] Delaware-New Jersey Ferry Co. v. Leeds, 21 Del. Ch. 279, 186 A. 913 (1936). The corporation is bound by contract according to the terms as they appear on the stock certificate. In Holbrook v. New Jersey Zinc Co., 57 N.Y. 616 (1874), the court ruled that the right to rely on the representations made in a stock certificate rests on the law of estoppel, which means that the purchaser must have incurred his injury through reliance on defendant's representation. See also Leggett v. Standard Oil Co., 149 U.S. 287 (1893).

[14] It was conceded that the plaintiff made his purchase without notice of the date of issuance of the stock and made no inquiry of defendant as to the amount of unpaid

dividends due on the stock, although financial services (Standard & Poor's) carried the information in 1951 that no dividends had ever been declared on defendant's cumulative preferred stock.