Corporations - Charter - Change of Voting Right by Amendment

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CORPORATIONS—CHARTER—CHANGE OF VOTING RIGHT BY AMENDMENT—

Defendant, incorporated in 1938 with an authorized capital stock of 500 shares, amended its articles of incorporation in 1940 to increase the common stock to 2,000 shares, and to authorize the issue of preferred stock. By the amendment, the voting power was vested exclusively in the common stock, with the exception that the holders of preferred stock would acquire temporary voting power upon default of four semi-annual dividends. Default in payment of dividends occurred and the preferred stockholders exercised the right to vote from 1943 on. In 1953, a second amendment was proposed and passed by a majority in interest vote of the common stockholders and a unanimous vote of the preferred stockholders. By this second amendment voting power was given equally, share for share, to the holders of both common stock and preferred stock. The plaintiffs, holders of common stock, brought suit in equity to have the 1953 amendment declared invalid, contending that it abrogated substantial property and contractual rights. The common pleas court held that the exclusive right of common stockholders to vote was not a property or contractual right. On appeal, held, affirmed. The amendment is one which concerns the internal management of the corporation rather than "vested rights." Metzger v. George Washington Memorial Park, 380 Pa. 350, 110 A. (2d) 423 (1955).

It has long been held that the grant of a charter by a state to a private corporation constitutes a contract between the state and the corporation.\(^1\) It has been said also that the charter involves a contract both between the corporation and the shareholders, and between the shareholders \textit{inter se}.\(^2\) This doctrine had the effect of giving corporations a peculiar immunity from the regulatory power of the state by virtue of the constitutional prohibition against impairment of contractual obligations.\(^3\) To overcome this handicap, almost all states enacted legislation or adopted constitutional

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provisions reserving to the state the power to alter, amend or repeal charters granted to private corporations.4 Most courts assume that the reserved power not only authorizes the legislature to impose amendments but also authorizes the legislature to repose the power to amend the charter in a majority in interest of the shareholders.5 In the principal case the applicable statutes authorized the change of preferences or other special rights by an amendment adopted by a majority in interest vote of the shareholders.6 However, certain obligations arising out of the contract have been held to be of such a fundamental nature as to be immune from change except by consent of all the shareholders.7 Some cases have included voting rights within this immunity.8 There is, however, authority sustaining the contrary position of the principal case, based on the reasoning that the right to vote shares is not a property or contractual right.9 A better approach would be to disregard the so-called “vested rights” doctrine altogether, inasmuch as the charter itself incorporates the reserved power and, therefore, the stockholders may be said to have assented to possible changes in the contract. On these grounds, the “vested rights” doctrine has been repudiated, at least in part, in two important corporation states.10 However, some standard is necessary to protect minority stockholders from arbitrary and prejudicial amendments by the majority. With regard to financial interests, a fairness test has been utilized for the

4 See 7 FLETCHER, CYc. CORP., perm. ed., §§3668 to 3671 (1931); PA. CONST., art. 16, §10.
6 "A business corporation, in the manner hereinafter provided in this article, may from time to time amend its articles: . . . (4) To increase or diminish its authorized capital stock, or to reclassify the same by changing the number, par value, designations, preferences, or relative, participating, optional or other special rights of the shares, or the qualifications, limitations, or restrictions of such rights, . . . [and] (5) In any and as many other respects as desired: Provided, That the articles as so amended would be authorized by this act as original articles of incorporation." Pa. Stat. Ann. (Purdon, 1938) tit. 15, §§2852-801 as amended.
7 “. . . Unless the articles require a greater vote, the proposed amendment shall be adopted upon receiving the affirmative vote of the holders of at least a majority of the outstanding shares entitled to vote thereon . . .” Pa. Stat. Ann. (Purdon, 1938) tit. 15, §§2852-805.
9 Lord v. Equitable Life Assurance Society, 194 N.Y. 212, 87 N.E. 443 (1909). In Loewenthal v. Rubber Reclaiming Co., 52 N.J. Eq. 440, 28 A. 454 (1894), it was held that an attempt by the majority to abrogate the right to vote cumulatively was invalid. This result was necessary under the New Jersey rule that, under the reserved power, there may be no delegation to the majority of the right to amend. But as an alternative ground, the court rested its decision on the “vested rights” doctrine.
protection of the rights of the minority, and there is no apparent reason why this same test would not apply equally well to limit unreasonable impairment of voting rights. The difficulty with such a test is that in most cases it involves complicated questions of fact which must be determined in the light of the circumstances of the particular case, thus prolonging litigation. But the “fairness” test, as opposed to a “vested rights” doctrine, has the advantages of allowing a corporation to adapt itself to changing economic circumstances. In addition, it limits the power of a small group of dissenters to block beneficial corporate action or to use their shares for nuisance purposes. These advantages, plus the logical inconsistency in the “vested rights” doctrine, would seem to warrant a shift to a new approach.

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12 Clarke v. Gold Dust Corp., (3d Cir. 1939) 106 F. (2d) 598.