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CORPORATIONS-POWER TO REACQUIRE OWN STOCK-CONSTRUCTION OF STATUTE THEREON

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COMMENTS

CORPORATIONS—POWER TO REACQUIRE OWN STOCK—CONSTRUCTION OF STATUTE THEREON—The Supreme Court of Rhode Island recently upheld[1] the purchase by a corporation of its own stock in a transaction which impaired capital, despite the presence of an express statutory provision "that no corporation shall use its funds or property for the

[1] Goldberg v. Peltier, (R.I. 1949) 66 A. (2d) 107.

purchase of its own shares of capital stock when such use would cause any impairment of the capital of the corporation."[2] The court maintained that this statute applies only to an impairment of capital which is detrimental to creditors; and that since the corporation in question had no creditors, there was no violation. This contention was based on the proposition that the statute merely adopted the common law rule "that corporations . . . may buy and sell their own shares provided they do so in good faith without intending to injure, and without in fact injuring, their creditors."[3] Consequently, the court's holding squarely asserts that the statutory limitation upon a corporation's power to acquire its stock is designed solely for the benefit of creditors. Is this true? If so, is it good law?

The earliest American cases[4] in this field held that a corporation may purchase its own shares, although the reasons advanced for this result varied. Finding no express prohibition against the practice in the incorporation statutes or corporate charters, some courts jumped to the conclusion that the power existed.[5] Others were of the opinion that the power was incidental and necessary to obtain the main objects for which the corporation was formed.[6] Still others found the necessary justification in the corporation's power to buy, hold, and sell personal property.[7] Later the rule was modified to the extent that purchases adversely affecting the rights of creditors were prohibited.[8] In many instances the limitation was of legislative design and took the form that only purchases "out of surplus,"[9] or "out of surplus profits,"[10] or "not impairing capital"[11] were permissible. Undoubtedly these statutory conditions were engendered by the "trust fund" theory[12]—the principle that capital may not be returned to shareholders so as to injure cred-

[2] Id. at 108.

[3] Id. at 109.

[4] The first case on the question, Hartridge v. Rockwell, R. M. Charlt. 260 (Ga. 1828), held that a corporation, here a bank, could invest its idle capital in its own stock regardless of the rights of creditors.

[5] Dupee v. Boston Water Power Co., 114 Mass. 37 (1873); Atlanta & Walworth Butter & Cheese Assn. v. Smith, 141 Wis. 377, 123 N.W. 106 (1909).

[6] New England Trust Co. v. Abbott, 162 Mass. 148, 38 N.E. 432 (1894).

[7] Farmers' and Mechanics' Bank v. Champlain Transportation Co., 18 Vt. 131 (1846).

[8] Townsend v. Maplewood Investment and Loan Co., 351 Mo. 738, 173 S.W. (2d) 911 (1943); Myers v. C. W. Toles & Co., 287 Mich. 340, 283 N.W. 603 (1939); McKay v. Luzerne and Carbon County Motor Transit Co., 125 Pa. Super. 217, 189 A. 772 (1937).

[9] Fla. Stat. (1941) §612.08.

[10] 2 N.D. Rev. Code (1943) tit. 10-0323; Okla. Stat. (1941) tit. 18, §58.

[11] 2 Colo. Stat. Ann. (1935) c. 41, §24.

[12] This theory was enunciated by Judge Story in Wood v. Dummer, (C.C. Me. 1824) 3 Mason 308; Sawyer v. Hoag, 84 U.S. (17 Wall.) 610 (1873). The phraseology used is unrealistic but the end result of the theory is universally recognized as sound.

itors. This doctrine is so deeply rooted in American jurisprudence that its limiting effect upon corporate acquisition of treasury stock was felt universally throughout the country. That this doctrine alone has circumscribed to any extent the power of a corporation to repossess its own stock is somewhat startling to the writers of treatises[13] and law review articles.[14] Nevertheless, such is the case, with the result that the Rhode Island court must be held to have been on safe grounds in its decision from the standpoint of the common law as it stands.

There are numerous objections to this holding, both in theory and in practice. In the first place, if a corporation is allowed to buy back some of its stock, it must likewise be permitted, as a matter of logic, to reacquire the entire amount outstanding. But this is absurd. The result would be to leave a surplus without an owner.[15] Secondly, the practice circumvents the precise statutory provisions found in many states[16] relating to the reduction of capital stock, provisions that must be held to be all inclusive if they are to have vitality. The numerous precautions set forth in these statutes are avoided if the corporation may repurchase its own stock, since it is difficult to distinguish, for practical purposes, stock that has been retired as a result of following the statutory method from reacquired stock. Even if the controlling interests of the corporation intend to reissue the stock they have caused the corporation to buy in, this intention is open to objection because of the principle that corporations ought not to "traffic in their own shares."[17] Corporations must perform useful functions. Speculation in their own stock is not one of them.

Turning to practical business matters, another severe objection to allowing a corporation to reacquire its own stock pertains to the resulting effect upon the remaining stockholders. This objection is particularly acute in the case of corporations whose stock is in the hands of a small number of holders.[18] When one makes an investment in such a company, he naturally assumes that his purchase will entitle him to a certain percentage of the concern's voting power. He could not

[13] 1 MORAWETZ, PRIVATE CORPORATIONS, 2d ed., §§112, 113 (1886); 1 MACHEN, MODERN LAW OF CORPORATIONS §626 (1908).

[14] Glen, "Treasury Stock," 15 VA. L. REV. 625 (1929); Nussbaum, "Acquisition by a Corporation of Its Own Stock," 35 COL. L. REV. 971 (1935).

[15] This problem of logic concerned Lord Watson in Trevor v. Whitworth, 12 App. Cas. 409 (1887).

[16] The Rhode Island court ignored its own state statute, R.I. Gen. Laws (1938) c. 116, §53, in reaching its decision in the case under consideration.

[17] This principle is originally found in Trevor v. Whitworth, 12 App. Cas. 409 (1887).

[18] This is so because in a small corporation management's control often rests on the narrowest majority of votes.

reasonably have anticipated that its funds would be diverted from the legitimate objective for which the enterprise was formed to that of reacquiring stock in the hope of perpetuating the current management's control. This, of course, is accomplished by buying a portion of the minority stock outstanding, thus leaving the majority faction with an even greater percentage of the votes. The condition of control under which the investor originally agreed to participate is altered.

The investor has grounds for another complaint. He contributed capital for carrying on the company's business, eyeing the capital already invested as a gauge of its prospects. When the corporation turns around and spends its money on its own stock it may well have reduced its capital below the point at which the stockholder was willing to participate. Although he stands the chance of receiving increased dividends since there are fewer holders, he also is faced with the possibility of severer losses on his investment.

In the face of these objections[19] it is not surprising that courts have on occasion shown tendencies to limit further the power of corporations to acquire treasury stock. Where the purchase of stock was the first step in a deliberate plan to place shares in the hands of those in collusion with the current management of the company for the purpose of perpetuating its control, the transaction has been cancelled by courts of equity.[20] Further, it has been recognized by a few courts that in purchasing its own stock the corporation is effecting a reduction of capital outside of the prescribed statutory method.[21] On this ground these courts have rescinded the contract of sale. The New York Stock Exchange now requires that corporations whose securities are listed report purchases for their own account of treasury stock.[22] The purpose of this requirement is to reduce stock manipulation designed to stimulate artificially the stock's value.

It is submitted that the Supreme Court of Rhode Island overlooked an excellent opportunity to take another step in the desired direction—an advance which could have been accomplished without fundamen-

[19] An analysis of the benefits to be derived by a corporation from being permitted to buy back its own stock is found in Levy, "Purchase by a Corporation of Its Own Stock," 15 MINN. L. REV. 1 (1930). The author demonstrates convincingly that these benefits are largely imaginative, or else can be accomplished by other means.

[20] Elliott v. Baker, 194 Mass. 518, 80 N.E. 69 (1907); Luther v. J. C. Luther Co., 118 Wis. 112, 94 N.W. 69 (1903).

[21] Crandall v. Lincoln, 52 Conn. 73 (1884).

[22] See C.C.H., Stock Exchange Regulation Service, p. 8825, §11615. The reasons are set forth in a report by the Committee on Stock List of the New York Stock Exchange made on Dec. 18, 1933 to the Governing Committee.

tally violating the common law precedents on which it rested its decision. By obeying the words of the statute[23] as they stood, that is, without implying a condition that creditors be injured, the court could have forbidden the reacquisition. This construction of the statute is the more natural and, at the same time, is in line with the better reasoning. The presence of the word "any" in the statute adds reinforcement to the advanced condition. Each word of a statute should be given meaning. Yet, the Rhode Island Court neglected "any," since it allowed a purchase which did in fact deplete capital. How could the court have done this if it had given the word in question its normal force? Without specifically deciding whether under any conditions a corporation should have the power to repossess its own stock, there should be no doubt that a purchase depleting capital is undesirable.

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[23] The statute reads: "Every corporation shall have the power to acquire, hold, sell and transfer shares of its own capital stock: *Provided,* that no corporation shall use its funds or property for the purchase of its own shares of capital stock when such use would cause any impairment of the capital of the corporation." R.I. Gen. Laws (1938) c. 116 §5(g).