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CORPORATIONS-ACCRUED PREFERRED STOCK DIVIDENDS- CHARTER AMENDMENT

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CORPORATIONS—ACCRUED PREFERRED STOCK DIVIDENDS—CHARTER AMENDMENT—In 1943 defendant corporation's charter was amended to cancel 5 per cent cumulative preferred stock, outstanding since 1926 or earlier, and all accrued dividends in exchange for new 5 per cent non-cumulative preferred and non-voting common stock. Dividends had accumulated on the old preferred stock both before and after 1939 in a total amount of \$50 per share. The recapitalization plan rested on a 1939 amendment to the Ohio General Code providing that the terms of outstanding stock can be changed "in such a manner as to discharge (without payment), adjust or eliminate rights to accrued undeclared cumulative dividends"¹ by charter amendment, subject to a dissenting shareholder's right to demand appraisal and payment for his stock.² Preferred stockholders bring this bill to enjoin execution of the plan claiming unlawful impairment of their contract rights. The trial court sustained the broad provisions of the 1939 statute under federal and state constitutions, and

¹ Ohio Gen. Code (Page, Supp. 1946) § 8623-14.

² Ohio Gen. Code (Page, 1938) § 8623-72.

ruled that dissenters were protected adequately by the appraisal remedy. In the court of appeals the statute was held unconstitutional insofar as it authorized destruction of dividends accruing before 1939. Further appeal was taken to the Ohio Supreme Court. *Held*, injunction granted. The statute is an unconstitutional impairment of contracts so far as it permits destruction of dividends accrued before or after 1939 on stock issued before the effective date of the statute. *Wheatley v. A. I. Root Co.*, 147 Ohio St. 127, 69 N.E. (2d) 187 (1946).

If a corporate charter contains a power to destroy preferred stock dividends by charter amendment at the time a preferred class of stock is issued, clearly the corporation has the right to cancel such dividends whenever they accrue.³ The theory is that the preferred shareholders have consented in advance to a defeasance of their rights. Equity will intervene only if the power is exercised so unfairly as to amount to fraud or abuse.⁴ When preferred stock is issued and dividends accrue before the state confers power on the corporation to cancel accruals, are the accrued dividends destructible? Only brief consideration has been given to the argument that the preferred stock contract incorporates the terms of the charter; and, since the state has reserved a power to alter or revoke the charter, the preferred stock contract anticipates any subsequent legislation.⁵ The more common analysis is that once dividends have accrued by the passage of time they are vested contract or property rights entitled to constitutional protection from subsequent delegations of the state's reserved power.⁶ The latter is essentially the position taken by the Ohio Supreme Court. Whether this reasoning applies with equal force to dividends that accrued before and after the effective date of the statute is questionable. On its effective date, the statute became a part of the corporate charter and the power to cancel accrued dividends conferred therein became a part of the preferred stock contract conditioning dividends that accrued thereafter.⁷ Thus, it is submitted that the court of appeals reached a sounder result as to dividends accruing after 1939. Apparently the Ohio legislature intended the 1939 amendment to add flexibility to corporate structures to meet business situations not taken into account at the time a corporation was organized. The instant case limits the extent to which that objective is reached. The same facts were before the Supreme Court of New York County in a recent case⁸ where it was held that the public interest in sim-

³ *Williams v. National Pump Corp.*, 46 Ohio App. 427, 188 N.E. 756 (1933); *Consolidated Film Industries, Inc. v. Johnson*, 21 Del. Ch. 417, 192 A. 603 (1937).

⁴ *Hottenstein v. York Ice Machinery Corp.*, (C.C.A. 3d, 1943) 136 F. (2d) 944; *Dodd*, "Fair and Equitable Recapitalization," 55 HARV. L. REV. 780 (1942).

⁵ *Keller v. Wilson & Co., Inc.*, 21 Del. Ch. 13, 180 A. 584 (1935); *McNulty v. Sloane*, 184 Misc. 835, 54 N.Y.S. (2d) 253 (1945).

⁶ *Harbine v. Dayton Malleable Iron Co.*, 61 Ohio App. 1, 22 N.E. (2d) 281 (1939); *Keller v. Wilson & Co., Inc.*, 21 Del. Ch. 391, 190 A. 115 (1935); *Meck*, "Accrued Dividends on Cumulative Preferred Stocks: The Legal Doctrine," 55 HARV. L. REV. 71 (1941).

⁷ *Harbine v. Dayton Malleable Iron Co.*, 61 Ohio App. 1, 22 N.E. (2d) 281 (1939); 6 OHIO ST. UNIV. L. J. 313 (1940).

⁸ *McNulty v. Sloane*, 184 Misc. 835, 54 N.Y.S. (2d) 253 (1945). Earlier expressions of the New York Court of Appeals make it unlikely that this decision will be reversed.

plified recapitalization overcame the constitutional objection, and that dissenting shareholders were protected adequately by the right to appraisal and the equitable remedy against gross unfairness. A weight of common sense attaches to the New York opinion because accrued dividends could have been cancelled by alternative procedures even if the charter amendment method was foreclosed. There the cooperation could subordinate the right to accrued dividends by the issuance of new classes of prior preferred stock, or cancel them by a merger with a wholly-owned subsidiary.⁹ These same alternatives are available in Ohio.¹⁰

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⁹ Optional plan, *Longson v. Beaux-Arts Apartments, Inc.*, 265 App. Div. 951, 38 N.Y.S. (2d) 605 (1942), *affd.*, 290 N.Y. 845, 50 N.E. (2d) 240 (1942); merger, *Anderson v. International Minerals and Chemical Corp.* (N.Y. 1946) 67 N.E. (2d) 573.

¹⁰ *Johnson v. Lamprecht*, 133 Ohio St. 567, 15 N.E. (2d) 127 (1938); Ohio Gen. Code (Page, Supp. 1946) § 8623-67, -68; *id.* (Page, 1938) § 8623-72. See also *Federal United Corp. v. Havender*, 24 Del. Ch. 318, 11 A. (2d) 331 (1940); 89 UNIV. PA. L. REV. 789 (1941).