1890

The Rights of Minority Stockholders

John Guy McDowell
Cornell Law School

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by

John Guy McDowell.

Cornell University.

School of Law.

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CONTENTS.
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1. Right to Examine Books .................. 3

2. Right to Certificates of Stock ............ 5

3. Right to Transfer and Record ............. 6

4. Right to Vote and Elections Generally .... 9

5. Right to Restrain Ultra Vires Acts ........ 17

6. Ultra Vires Acts in Reference to Sales,
   Consolidation, etc. ........................ 21

7. Rights to Dividends ........................ 29
Corporations, both at Common Law and under the Statute, act by and through their trustees and agents, and cannot act otherwise. It is a part of the contract of subscription of a share-holder that the affairs of the corporation shall be governed and controlled by its directors, trustees, or other duly authorized agents. It has, for this reason, been held to be an implied condition in the formation of every association of a business character, that the majority of members present at a share-holders' meeting shall have authority to bind the whole association by their vote. Each and every share-holder contracts that the will of the majority shall govern in all matters coming within the limits of the act of incorporation. This rule was laid down by Chief
in Durfee
Justice Rigelow, vs. the Old Colony R. R. Co. 5 Allen, 242
be
as follows: "It may be stated as an indisputable proposition
that every person who becomes a member of a corporation aggregate, by purchasing and holding shares, agrees, by necessary implication, that he will be bound by all acts and proceedings within the scope of the powers and authority conferred by the charter, which shall be sanctioned or adopted by a vote of the corporation duly taken and ascertained according to law. This is the result of the fundamental principle that the majority of the stockholders can regulate and control the lawful exercise of the powers conferred on a corporation by its charter." It is implied that the majority shall have supreme authority to direct the policy of the corporation in attaining its chartered purposes and shall have the
power to appoint the usual managing agents to whom the immediate control and direction of the company's business is delegated. While the general principle is, as has been stated, there are some rights which persons representing the minority of the stock possess, and of these I shall treat.

Right to Examine Books.

It was formerly held in England, that stock-holders, unless in the majority and by an appointed agent, could not examine the books of the corporation at their own pleasure. 1 El. and El. 289. In the United States, however, the prevailing doctrine appears to be that the individual share-holders have the same right to examine the company's books, as the members of an ordinary partnership have to the firm books. The doctrine and reason of
this law is, that the books are the common property of the corporation, though they are necessarily kept by some one person, or perchance in the possession of the majority. 105 Penn. St. 111, 116.

In many states statutes have been passed giving the share-holder the right, with certain limitations and restrictions, to inspect the books in a respectable manner, and even to obtain a sworn statement of their condition from the agents of the corporation. Statutes of New York, Act of 1848, Chap. 40, secs. 25, 27. Amended L. 1854, Chap. 201, and Laws 1862, Chap. 472.

It is clearly a right of a share-holder to obtain a right of production of the company's books in a legal proceeding, whenever he can base this right to inspection either upon statutes or established rules of prac-
tice. His remedy, in case of a refusal, is a mandamus
against the company to allow an inspection. 5 Cowen,
419. 1 Q. B. 282.

Right to Certificates of Stocks.

It is customary to issue to each share-holder of the
corporation, a certificate stating the number of shares
held by him and anything else that is necessary to in-
dicate his standing as a share-holder in the corpora-
tion. These certificates are treated as representing
the shares themselves, and are issued to enable the share
holder to transfer and negotiate his stock in a free and
unincumbered manner. If the charter provides that
these certificates shall be issued, or if it is custo-
mary and usual that they are issued, the agents of the
company are bound to issue a certificate in the customary
form to each holder of shares upon the company's books. They have no right to discriminate against particular share-holders under these circumstances. 54 N. Y. 416.

Right to Transfer and Record.

A transfer of stock at Common Law could not be enforced in a Law Court, but could be in a Court of Equity. The doctrine was in those early times, that there was necessarily novation in an operation of this kind, and that, in order to have novation, there must be consent, express or implied, on the part of all the other members. 3 E. and K. 20; 10 Hare 163.

Corporations and joint stock companies, organized under statutory provisions, are governed by other rules. It is implied in the charter that the share-holders may transfer stock at will by simply giving notice to the
company of the transfer. Of course, reasonable rules regarding the transfer may be made by the managing agents of the corporation, as to the manner in which shares may and shall be transferred. But they cannot prohibit transfers entirely, and any unreasonable restrictions on the right to transfer will not be allowed. Thus a majority of the stock-holders of the corporation cannot, without express provision in the charter, pass a by-law making the right to transfer shares depend upon the approval of the board of directors or any other agent of the company. 48 Iowa, 339; 8 Pick, 90.

The right of a share-holder to transfer his shares is founded upon the implied terms of his contract of membership. It is a legal right based upon contract. The refusal of the agent of the corporation to transfer
the shares does not cancel the shares and put an end to the contract of membership. The right of action still exists and the vendor would have his action against the company.

It has been held by some courts that mandamus is the proper remedy to compel the officers of the corporation to make a transfer. 9 Cal. 112; 45 Ind. 1; 2 South Car. 25; but the weight of authority is the other way. 15 Minn. 177; 46 Mo. 155; 47 Mich. 429; 6 Hill 243; 110 Mass. 95. Mandamus, being a purely legal remedy, ought not to be granted at the suit of one who has a mere equitable interest, as the claim of the vendor will be in almost all cases. 127 Mass. 104; 47 Mich 429.
Right to Vote and Elections Generally.

Since the power to appoint directors would, on general principles of law, even in the absence of special regulations, rest in the members, and as membership consists principally in the ownership of shares, and the right to and the ownership of such shares is evidenced by the certificates of stock prepared and vouched for by the corporate agent, and as such certificates may be held by the original owners or transferred by assignment to others, it is deduced on a fundamental principle that holding stock constitutes membership in a corporation and carries with it the right to vote. This right is incident to the relation which the corporators bear to the corporation, and is one of those absolute rights, to deprive him of which would be a violation of his con-
But it is held in Becket vs. Hous-
ton, 32 Ind. 393, that it is not always necessary or
essential that the owners of stock have a certificate
thereof, to entitle them to vote for directors.

As has been said, the power of electing directors
is lodged in the stock-holders. If the exercise of
this power is regulated by statute, the corporation can-
not by its by-laws, resolutions, or contracts, either take
or give it away. When the statute is silent in this
respect, the election of directors, like the election or
appointment of subordinate officers, would be subject to
the regulation and control of the corporation; but, if
the statute expressly declares who shall be entitled to
vote for directors, its provisions are imperative on the
corporation, forming a part of the law of its being
and the corporation has no power to extend or limit the right as regulated by statute. Brewster vs. Hartley. 37 Cal. 15.

Under certain circumstances it seems that a Court of Equity might enjoin a stock-holder from voting a particular stock. But such injunction can only issue when the complainant can show a plain purpose of parties to vote the stock, and to vote it a particular way; that the effect of the vote will be to control the election; that the mischief will result to the corporation, and that irreparable or permanent mischief will come either to the corporation itself or to the stockholders. The right itself is clear, but the circumstances upon which the relief will be granted must be very clear.

So, also, where a combination or conspiracy can be
shown for the purpose of controlling an election in fraud of the rights of those share-holders who are not in the combination, an injunction will issue. 535 Barb. 344; 5 Blatchf, 525. But such an injunction will not prevent the election from taking place. On the contrary, the election goes on, and is valid even though it happen that what would have been a minority of the votes, had not the injunction issued, becomes by reason thereof a majority and elects. Ryder vs. Alton & R. R. 13 Ills. 516.

The general rule, however, unquestionably is, that one stock-holder has nothing to do with the vote of another stock-holder, and can lawfully do nothing to abridge the right of another to vote or to control or direct the casting of the vote of any other member of
the corporation. Alton R. R. Co. Case, Supra.

There are various ways in which an illegal or fraudulent election of directors or managers of an incorporated company can be investigated, the fraud unearthed and the illegality set aside. In New York, the Supreme Court sitting as a Court of Chancery is empowered to review corporate elections, and to grant relief as the particular circumstances and justice of the case seem to require. Under this power, granted by statute, an election may be declared void by reason of the conspiracy, frauds, or trickery on the part of the corporators. Schoharie Valley R. R. Case, 12 Abb. Prac. (N. S.) 394.

In the application of Syracuse etc. R. R. Co. 91 N. Y. 1. Stockholders owning a majority of the stock have a right to combine and secure the election of a board of direc-
tors, provided it be without fraud in forming the combination; and this is done every day. But the combination must be without fraud; otherwise an injunction will lie in favor of the minority.

At Common Law mandamus would lie in favor of stockholders who desired an election. Under the statutes of New York the right is given them to compel an election. If the directors could keep themselves in office by not having an annual election, the stockholders would be powerless, and the officers once elected might perpetuate themselves in power as long as they chose. Such a course would be in direct opposition to the mandatory provision, requiring that the trustees, annually elected, shall manage the affairs of the corporation. The enactment prevents any such arbitrary use of power and pro-
tects the stock-holders of corporations from the mis-
conduct of their officers in this respect. This is in
entire harmony with the provisions of the Manufacturing
Act, and does not in any way conflict with the right of
the officers to make reasonable and prudential regula-
tions and unless for the management and disposition of
the stock and business affairs of the company. People
vs. Cummings, 72 N. Y., 433; 61 Barb., 397; 10 Nevada
107.

Cook says "The minority in such incorporated bodies
are under an implied obligation to submit to the will
of the majority." He is right as far as he goes, but
he should add, "in cases only where there is neither
conspiracy or fraud".

At Common Law a stock-holder had no right to cast
The statutes in most of the states, however, have regulated the matter, so that now a stockholder may vote by his attorney or by proxy and, although with the minority, his vote counts. The corporate officers elected by the majority have no right, neither can they make any laws or rules changing the statutory right to vote by proxy, or fix such rules as will impose upon the minority hardships and difficulties.

Members in the minority are entitled to notice of election, except where the time is fixed by the charter. Where no sufficient time is fixed by charter or statute or by-law, each stock-holder is entitled to an express personal notice of every corporate meeting. No usage can operate to excuse a failure to give such a notice, and it has been held that custom or by-laws cannot
change or abrogate the right to a notice of corporate meetings. The King vs. Bird. 13 East, 387.

Right to restrain Ultra Vires Acts.

A single share-holder has ample power to restrain a corporation from diverting the corporate funds from the purposes for which they were originally intended, and ordinarily can prevent any ultra vires act; provided, always, that he is not chargeable with acts or omissions by which his rights can be held waived or forfeited. Thus a share-holder in a railroad corporation may enjoin the carrying out of an ultra vires lease of the road. 41 N. J. Eq. 1, or the performance of an illegal contract, 24 Pa. St. 378. A minority or even a single share-holder may restrain the corporation or the corporate management from diverting the corporate
funds to unauthorized purposes. 43 N. H. 515. Thus a company, chartered to manufacture pig iron, may be enjoined by one of its stock-holders from erecting a corn and flour mill. 52 Ga. 276.

Unless the right to alter or repeal is reserved to the state or some express provision in the original instrument covers the matter, the charter or articles of association cannot, against the will of a single stock-holder, be substantially altered by the Legislature, even with the consent of the majority. 24, N. J. Eq. 455. This is because of the implied agreement between the state and the corporation. Of course it is not a contract in the sense that A contracts with B. On the contrary, in the charter the state does not purport to contract with the corporation nor the corpora-
tion with the state. The terms and provisions of the contract are rather rules of law which will manifest themselves in legal relations between the corporators and between them and other persons contracting in respect to the corporate enterprise. The agreement on the part of the state is that it will not alter or repeal these rules of law. And a share-holder has his remedy by injunction to restrain the acceptance of any radical amendment. 4 Biss. 78; 6 Ohio St. 119.

Still the Legislature may confer on the corporation additional powers tending to facilitate the accomplishment of the original purposes of incorporation. 10 N. J. Eq. 171.

It is the duty of the corporate management to conduct the affairs of the corporation in the interests of
share-holders as such; and the management will not be justified in promoting outside interests of a majority of share-holders in disregard to the interests of never so small a minority. A court will interfere at the suit of a minority when the majority seek to appropriate the assets of the company or to obtain for themselves advantages not shared by the minority. 31, Minn 140; 23 Blatchf. 517; 11 Daly 373.

In the case of Goodin vs. the Cincinnati etc. Canal Co., 18 Ohio St., 169, Justice Welsh, in delivering the opinion of the Court, said: "To undertake, by getting control of the company, and then, under pretense of acting as agents or trustees for all the stockholders, deliberately to trample under foot the rights of the minority is rather a sharp practice and one which a
Court of Equity will never tolerate." A minority of share-holders, on behalf of themselves and other share-holders, may, for conspiracy and fraud or acts ultra vires whereby their interests have been sacrificed, maintain a bill in equity against the corporation, its officers and others who have participated in the wrongful acts. 6 Allen 52.

Ultra Viros Acts in Reference to Sales, Consolidation, etc.

That a charter constitutes a contract between the corporation and its stock-holders is a principle of law that has become firmly imbedded in the jurisprudence of modern times. Upon this principle of law rests the stability, permanence, and honesty of management of corporations, particularly those of railroads, and from it
arises much of the confidence, safety and protection of the stock-holder himself.

It was first promulgated in America in 1820 in Livingston vs. Lynch, 4 Johns. Ch. 373, and was applied to corporations in the Hartford and New Haven R. R. Co. vs. Croswell, 5 Hill 383 (1843). These cases have been followed by a long line of supporting decisions. They were the first to establish clearly that any act or proposed act of the corporation or of the directors of a majority of the stock-holders, which is not within the express or implied powers of the charter of incorporation or association,—in other words, any ultra vires acts, is a breach of contract between the corporation and each of its stock-holders, and that consequently any one or more of the stock-holders may object
there to and compel the corporation to observe the terms of the contract as set forth in the charter.

The case of Abbot vs. the American Hard Rubber Co., 33 Barb. 578 (1861) clearly established the principle in this country that a dissenting stock-holder may prevent the sale by the directors, or by a majority of the stock-holders, of corporate property which is essential to the continuance of the business of the corporation or the payment of corporate debts. And even where a dissolution is the purpose in view, if the corporation is a prosperous one it is extremely doubtful whether such sale can be made. The old Common Law doctrine, that a majority of the stock-holders may at any time effect a voluntary dissolution, is still maintained. But if the purpose of such dissolution is not the bona fide
discontinuance of such business, but is the continuance of that business by a new corporation, then the better and latter rule is that a dissenting stock-holder may prevent the sale even though it is made with a view of dissolving the corporation. This is the law laid down by the well reasoned case of Kean vs. Johnson, 9 N.J. Rq. 401, the court saying: "It is not true that a majority of stock-holders in any corporation, however prosperous their affairs may be, can at their own mere caprice, sell out the whole source of their emoluments, invest their capital in other enterprises and that, however the minority may desire the prosecution of the business, in which they had engaged, they have no injury to complain of at Law or in equity so long as they obtain their portion of the proceeds of the sale. If such were the
law, corporations would soon be few, for seldom would 
capitalists, whatever their comparative wealth, invest 
in enterprises so readily rendered profitless at the 
caprice or in obedience to the interests of any set of 
men or a single man rich enough to control a majority 
of the stock." And even where the majority have a 
statutory power to dissolve the corporation at their 
pleasure, yet they cannot use that power to defraud the 
minority out of the fair valuation of their property. 
Wallace J. saying in the case of Ewin vs. the Oregon 
such circumstances is an abuse of the powers delegated 
to the majority. It is no less wrong because accom-
plished by the agency of legal forms."

Such dissolutions are practically frauds on the law
and on dissenting and minority stock-holders. They seek to do indirectly what cannot legally be done directly. If, however, the corporation is an unprofitable and failing enterprise, then a sale of all the corporate property with a view of dissolution may be made by a majority of the stock-holders. 30 Penn. St. 42. The reason for this is that it would be unjust for one member to hold his fellow members to an investment that is unprofitable and impracticable, and prevent them from embarking in another that is more remunerative. If the sale is made to another corporation, the stock of the latter cannot be forced upon the dissenting stock-holders. They are entitled to their money.

These principles of law are important, particularly when a consolidation of corporations is attempted by a
dissolution of one of them. Corporations are formed for the purpose of transacting their own business and not for the purpose of allowing others to do it for them. Unless the charter expressly confers upon the company the right to consolidate, a minority could prevent such consolidation. Thomas vs. Railroad Co. 101 U. S. 82; Tro etc. R. R. Co. vs. Boston & R. R. Co., 86 N. Y. 117; Kean vs. Johnson, 8 N. J. Eq. 401; Clinch vs. Financial Co. L. R.; 5 Eq. 430.

By far the greater number of cases involving acts which are ultra vires affecting the rights of stockholders are cases growing out of attempted consolidation, absorption, lease or sale of the property of one railroad corporation by or with that of another railroad corporation. The tendency of railroads in these modern
times is towards the consolidation and creation of trunk lines which serve to annihilate smaller concerns. The demands of commerce have caused the consolidation and absorption of smaller corporations by larger, which have given rise to many decisions analyzing the different transaction incident thereto and adjusting the rights of the parties on equitable principles. Is it any wonder that men who have millions of dollars involved in a business enterprise, but who nevertheless have no say as to the manner of its use, should cry out to the courts and Legislatures of the states to help them? But, is the right of the minority stock-holder to be considered supreme when the needs of this growing country call for a consolidation of two vast enterprises in order to facilitate business, or is he to be allowed to clog the
wheels of commerce because he has a few paltry dollars at stake? No; he may object for fraud, conspiracy or trickery, but where the promotion of the interests of all concerned will be attained, he will either be obliged to submit or step down and out.

Right to Dividends.

The ultimate object for which every ordinary business corporation is formed is for the pecuniary profit of its individual members. Any net increase of the capital of an institution of this kind is a gain upon the united investment of its share-holders, and may be distributed amongst them as profits, each share-holder being entitled to his proportionate dividend or share. Of the different kinds of dividends I shall not speak, as the rules of Law applicable to one are applicable to all.
The power of determining whether a corporation has earned a surplus which would warrant the payment of a dividend is vested in a board of directors. In exercising this power the directors cannot act arbitrarily; they must make an investigation of the affairs of corporation and must in good faith apply the principles of good business judgment, coupled with fairness, to the transaction. But the directors cannot be held liable for a mere mistake of judgment in making an erroneous valuation of the company's assets. Stringers Case, 4 Chan. 475.

Profits earned by a corporation may and should be distributed among its share-holders; but it is not a violation of the charter if they are allowed to accumulate and remain invested in the company's business. The
managing agents of a corporation are impliedly vested with a discretionary power with regard to the kind and manner of distributing its profits. Pratt vs. Pratt, 33 Conn. 446; Karnes vs. Rochester etc. R. R. Co. 4 Abb. Pr. (N.S.) 107; Barry vs. Mer. Ex. Co. 1 Sandfs. Chan. 280, 303. They may apply the profits to the payment of a floating, or funded debt or in the development of the company's business; but so long as they do not abuse their discretionary powers or violate the company's charter, the court cannot interfere. State vs. Bank of Louisianna, 6 La. 745; Smith vs. Prattville M'f'g Co., 29 Ala. 503.

But it is also clear that the agents of a corporation and even a majority cannot arbitrarily withhold profits earned by the company or apply them to any use
which is not authorized by the company's charter. If a majority of the share-holders of a corporation, or the directors thereof, wrongfully refuse to declare a dividend, and distribute profits earned by the company, any share-holder feeling aggrieved may obtain relief in Equity. Stevens vs. South Devon Ry Co., 9 Hare 313. Beers vs. Bridgport Spring Co., 42 Conn. 17; Scott vs. Eagle Fire Co., 7 Paige 203; Browne vs. Monmouthshire Ry Co., 13 Beav. 32.

In Faucett vs. Lourie, 1 Drew. & Sm., it was held that a declaration of a dividend gives the share-holders such a legal right to the payment of it that a Court of Chancery will not, at the suit of a single share-holder, interfere by an injunction to restrain the directors from paying it.
Suits against corporations to enforce the payment of dividends cannot be maintained until a demand has been made and payment refused. 52 Barb. 45; State vs. Balt. etc. R. R. Co., 6 Gill. 368. A Court of Chancery will, upon the application of any dissenting member, enjoin an attempt to distribute any part of the capital stock as a dividend. Carpenter vs. N. Y. etc. R. R. Co., 5 Abb. Pr. 277; Salisbury vs. Metropolitan Ry Co. 38 L. J. Chan. 249.

In general the declaration of a dividend rests entirely with the directors. The free exercise of their discretion cannot be interfered with by the contracts of the promoters or the original incorporators as to the disposition of corporate profits. But when money which ought to have been divided among the stock-
holders has been applied by the directors to a purpose not warranted by and not within the scope of the charter, there is such a breach of trust as to give a Court of Equity jurisdiction. And obviously whenever there is a clear abuse of power on the part of the corporation management and a refusal to declare a dividend that ought to be declared, a Court of Equity will at the instance of any shareholder, provided there is no laches, compel the proper authorities to declare and pay the dividend.

There can be no dispute and it is a well known fact, especially among business men, that those who hold a minority of the stock of the corporation are often shamefully abused and their rights disregarded. They seldom have any representation on the board of directors and thus know little of the inside workings of the man-
agement of the corporation affairs. There has been a
tendency by the courts in recent times to alleviate this
suffering on the part of the minority and to give them a
recognition, at least, where it has been demanded.
There are unfortunately few, if any, adjudicated cases
on this point and it is only from the dicta of judges
that we can see this.

The Legislatures of some of the states have also
seen fit to make some enactments in this direction.
There is now a bill before the Legislature of this state
in which it is attempted to provide a method by which a
minority may have a representation on the board of
directors. It provides that for a certain number of
directors to be elected, each stock-holder shall vote for
but a limited number, generally one or two more than half
the whole number to be elected. By this means it will be possible for the minority to obtain representation where before it was impossible. This is a step in the right direction; and while it is not best that the majority should be subject to all the petty whims of the minority, still it is advisable that they have some means of knowing what is being done with their investments, and that they should have a representative present who may object at the proper time to any unrighteous and malicious action on the part of the majority.

John Hay M. Powell