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Rights of Dissenting Shareholders to Appraisal and Payment

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RIGHTS OF DISSENTING SHAREHOLDERS TO APPRAISAL AND PAYMENT*

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The corporation of a century ago was radically different from the corporation of today. A closely knit organization, in which the few shareholders took an active interest, it resembled in many respects the ordinary partnership. But with the general expansion of commercial enterprise, the corporation underwent fundamental changes, and the rules which the common law had developed to regulate a simple form of business organization in a simple society became unsuited for the complex organism the corporation had become.

Thus, unanimous consent of the stockholders was in most jurisdictions necessary for the sale of all the assets of a solvent corporation,[1] to effect a consolidation or merger,[2] to bring about a change in the nature of the business,[3] or in the financial structure.[4] These restrictions on the majority were serious hindrances to the sweeping reorganizations in structure which modern needs had made the order of the day. Add to the trouble and delay of calling stockholders' meetings of companies of numerous and widely spread membership the difficulty of attaining unanimity on any proposition, and the hamper which this rule put on corporate development becomes apparent.

This situation called for statutory aid, which was liberally given, with the result that in most states, and especially in those where

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*This paper is intended as a comparative study of the remedy with a view to suggesting changes in the existing statutes on the subject. For an analysis of the New York statutory provisions, see Weiner, *Payment of Dissenting Stockholders* (1927) 27 COL. L. REV. 547. The rights of non-assenting shareholders in case of amendments of corporate charters is considered at length by Professor E. M. Dodd in *Dissenting Shareholders and Amendments to Corporate Charters* (1927) 75 U. OF PA. L. REV. 584.

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[1]Abbot v. American Hard Rubber Co., 33 Barb. Ch. 578 (N. Y. 1861); Kean v. Johnson, 9 N. J. Eq. 401 (1853); Meyerhoff v. Banker's Securities, 147 Atl. 105 (N. J. Ch. 1929); Theis v. Spokane Gas Co., 34 Wash. 23, 74 Pac. 1004 (1904). But see Treadwell v. Salisbury Mfg. Co., 73 Mass. 393 (1856); Bowditch v. Jackson, 76 N. H. 357, 82 Atl. 1014 (1912); Warren, *Transfers of Corporate Undertakings* (1917) 30 HARV. L. REV. 335; (1929) 14 MINN. L. REV. 58.

[2]Geddes v. Anaconda Mining Co., 254 U. S. 590, 41 Sup. Ct. 209 (1920).

[3]Natusch v. Irving, to be found in Gow, LAW OF PARTNERSHIP (3d ed. 1830), Appendix, Item No. VI.

[4]Kent v. Quicksilver Mining Co., 78 N. Y. 159 (1879); Campbell v. American Zylonite Co., 122 N. Y. 455, 25 N. E. 853 (1890).

incorporation is most frequent because most ardently sought, the widest powers in the majority to amend, merge, sell, and alter the financial structure and the characteristics of outstanding stock were written into the statutes.[5]

But it was also realized that it was necessary to afford some relief to dissenters; that, though a small group should not be able to prevent the majority from doing with the corporation what they thought wise, yet the minority should not be forced to continue in an enterprise radically different from the venture on which they originally embarked, or in an essentially altered status. The result in most jurisdictions, was a compromise conferring on the dissenters the right to receive the cash value of their stock and providing for an appraisal where no agreement could be reached.[6]

The statutes of the various states are unlike in scope. New York has elaborate provisions for dissenters, and confers this right to appraisal and payment in more situations than do most states. The instances are: the sale of the corporation's property;[7] consolida-

[5]As illustrations see N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) §§ 20, 38, 86; DEL. GEN. CORP. LAW (1929) §§ 26, 64a, 59, 39; MD. ANN. CODE (Bagby, 1924) §§ 29, 45, 33, 94. The corporation laws of the different states are conveniently collected in PARKER, CORPORATION MANUAL (30th ed. 1929).

The effect of these statutes on existing charters is a moot question, and is considered in the article by Dodd, *Dissenting Shareholders and Amendments to Corporate Charters* (1927) 75 U. OF PA. L. REV. 584. For what is probably the majority view, see Peters v. U. S. Mortgage Co., 13 Del. Ch. 11, 114 Atl. 598 (1921).

[6]CONN. GEN. STAT. (1918) § 3524; KY. STAT. (Carroll, 1922) § 558; ILL. GEN. CORP. ACT (1919) § 73; MASS. GEN. LAWS (1921) c. 156, § 46; N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) §§ 21, 87, 38(12), 105(9), 14; OHIO GEN. CORP ACT (1929) §§ 8623-72; Ind. Laws 1929, p. 756, 757. The National Banking Act gives dissenting shareholders similar relief in the case of a consolidation of banks. 12 U. S. C. A. § 33 (1927).

[7]N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAWS) § 21. In Matter of Timmis, 200 N. Y. 177, 93 N. E. 522 (1910), "sell and convey its property" was held to include a sale of the calendar department of a general lithographing business, for securities in another corporation and an additional sum in cash. Dissenters were held entitled to payment because the company had parted with an important part of the enterprise, though it furnished a comparatively small fraction of the company's income. But the sale of one of a chain of drug stores was held not to be included in the section. Wattley v. Nat. Drug. Stores Co., 122 Misc. 533, 204 N. Y. Supp. 254 (Sup. Ct. 1924), *aff'd*, 208 App. Div. 836, 204 N. Y. Supp. 956 (1st Dept. 1929).

If the object of the corporation is to buy and sell property, such sale would be in the regular course of business and would not entitle the dissenter to payment. Keating v. Coleman, 214 App. Div. 668, 213 N. Y. Supp. 213 (2d Dept. 1925). Similarly, if leasing its property is included as one of the corporate purposes. Matter of Knaisch, 203 App. Div. 725, 197 N. Y. Supp. 116 (4th Dept. 1922).

tion;[8] alteration in the preferences of outstanding shares;[9] issuance of stock to employees;[10] and sale of assets on voluntary dissolution for securities in another corporation.[11] Some states include the important situation of a fundamental change in the corporate objects brought about by amendment;[12] or where there is an extension of the term of corporate existence.[13] But most states limit the right to cases of merger or consolidation.[14]

In most corporate charters the power "to sell, assign, transfer, convey, lease or sublease real property" is provided for, whatever the nature of the company's business. Such a provision is in the charter of the United Corporation, an investment company. This, however, would not defeat the right of a dissenter to payment upon a sale of the property, except where such sales are the primary object of the enterprise. Matter of Erlanger, 237 N. Y. 159, 142 N. E. 571 (1923).

[8]N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) § 87.

[9]*Ibid.* § 38(12) provides that the right shall exist if the change in the certificate "alters the preferential rights of any outstanding shares." In Dresser v. Donner Steel Co., 247 N. Y. 553, 161 N. E. 179 (1928), the issuance of a new class of stock having superior preferential rights to outstanding preferred stock was held, by a divided court, not to entitle dissenting holders of the latter shares to an appraisal and payment. The reason given was that the preferences in the outstanding shares were not technically altered, though the value of the preferences was considerably changed to the prejudice of the holders.

The same court considered the problem again in *In re* Schaffer Stores Co., 250 N. Y. 242, 165 N. E. 279 (1929). Here there were two classes of preferred stock. The certificate was amended to retire both classes and substitute in their place a single class of preferred stock similar to the old first preferred shares. Dissenting holders of the old second preferred stock were held entitled to an appraisal, the majority of the court finding a destruction of the technical preferences in the retirement of the old and the issuance of the new stock, although the old preferences were preserved. The majority felt bound by the rule laid down in the Dresser case, *supra*, that the alteration of technical preferences was determinative; the dissenting judges were disinclined to grant the right to payment having denied it in the Dresser ease where the dissenters were actually prejudiced.

Other states require in addition to changes in the preferences that the holders be prejudiced thereby. OHIO GEN. CORP. ACT. (1929) § 8623–15.

Louisiana requires that the amendment change "the rights of the holders of any outstanding shares" [LA. BUS. CORP. ACT (1928) § 52], thus presumably including common stockholders when preferred stock is issued. To the same effect is the UNIF. BUS. CORP. ACT, § 42 (1).

[10]N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) § 14. Illinois has a like provision, Ill. Laws 1923, p. 282. See also N. J. Laws 1920, c. 175, § 2 (c); Calif. Laws, 1921, c. 34, § 3. See Fordham, *Some Legal Aspects of Employee Stock-Purchase Plans* (1930) 8 N. C. L. REV. 161, 165.

[11]N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) § 105 (9).

[12]LA. BUS. CORP. ACT (1928) § 52; MASS. GEN. LAWS (1921) c. 156, § 46; OHIO GEN. CORP. ACT (1929) § 8623–15.

[13]LA. BUS. CORP. ACT (1928) § 52.

[14]These changes can be brought about in different ways in the various states. In some a bare majority suffices; in others a greater number is necessary, and

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There are some cases which seem to be authority for the proposition that, even in the absence of statute, a dissenting stockholder has the right to receive payment for his shares when the majority effects fundamental changes.[15] It is difficult to see on what principles other than some general notion of fairness such a result is predicated. These courts seem to have extended this right to the minority as the price the majority must pay for the valuable privileges which the statutes have conferred upon them, as a form of equitable relief against the new powers of the majority.

That there continue to be limitations on the powers of the majority under existing statutes is clear. What they may do with the corporation and the stockholder's interest therein continues to be confined by constitutional and equitable principles. Their power to change the charter by amendment or to accept amendments offered by the state is circumscribed. Where there was no reservation of the power to "alter and amend" in the legislative grant,[16] the power at best extends to non-fundamental changes.[17] It is considerably

for some changes even the assent of "non-voting" stock must be reckoned in making up the requisite number.

Similar provisions for dissenting shareholders are provided for by the ITALIAN COMMERCIAL CODE. Article 165 provides that minority stockholders opposing a resolution which extends the duration of the corporation, or authorizes a fusion or reclassification or increase in the capital stock, or changes the objects of the enterprise, are entitled to retire by having their shares redeemed on the basis of their value as shown by the balance sheet last accepted. KUHN, STUDY OF THE LAW OF CORPORATIONS (1912) 137. Moreover, for most important changes a three-quarter quorum, with an affirmative vote of the majority of all the outstanding stock, is required. Instances are a dissolution prior to termination; merger; extension of duration; decrease of capital stock; reclassification or increase of capital stock; changes in objects and amendments of articles. ITAL. COM. CODE. art 158; KUHN, *loc. cit. supra.*

[15]Lauman v. Lebanon Valley R. R., 30 Pa. 42 (1858); Barnett v. Philadelphia Market Co., 218 Pa. 649, 67 Atl. 912 (1907); International & G.N.R.R. v. Bremaud, 53 Tex. 96 (1880). See also, Koehler v. St. Mary's Brewing Co., 228 Pa. 648, 77 Atl. 1016 (1910); Treat v. Hubbard-Elliot Copper Co., 4 Alaska 497 (1912).

[16]Banel v. Alton & Sang. R. R., 13 Ill. 504 (1851) (change in the location of a railroad); Pacific R. R. v. Renshaw, 18 Mo. 210 (1853).

[17]In the absence of the reserved power "to alter, amend or repeal", the state can not by statute passed after the creation of the corporation authorize a majority to accept an amendment altering or extending the nature of the enterprise: Zabriskie v. Hackensack & N. Y. R. R., 18 N. J. Eq. 178, 90 Am. Dec. 510 (1867); Dow v. Northern R. R., 67 N. H. 1, 36 Atl. 510 (1887); or permitting a consolidation with another corporation: Clearwater v. Meredith, 1 Wall. 25 (U. S. 1863); or increasing the liability of stockholders to creditors of the corporation: Ireland v. Palestine, B.N.P., etc. Co., 19 Ohio St. 369 (1869).

less curtailed when the state made such a reservation at the time of incorporation and later conferred new powers on the majority.[18]

[18]Looker v. Maynard, 179 U. S. 46, 21 Sup. Ct. 21 (1900) (permitting cumulative voting); Wright v. Minn. Life Ins. Co., 193 U. S. 657, 24 Sup. Ct. 49 (1903) (changing kind of insurance written); Randle v. Winona Coal Co., 206 Ala. 254, 89 So. 790 (1921); Morris v. Am. Pub. Util. Co., 14 Del. Ch. 136, 122 Atl. 696 (1923); Davis v. Louisville Gas & Elec. Co., 142 Atl. 654 (Del. Ch. 1928); Durfee v. Old Colony & F. R. R., 5 Allen 230 (Mass. 1862) (permitting the extension of a railway); Somerville v. St. Louis M. & M. Co., 46 Mont. 268, 127 Pac. 464 (1912) (changing non-assessable stock to assessable); Salt Lake Automobile Co. v. Keith-Obrien Co., 45 Utah 218, 143 Pac. 1015 (1914) (authorizing issue of preferred stock taking precedence over prior issued preferred stock).

The following cases set forth limitations on the power of amendment: Ry. v. Allerton, 18 Wall. 233 (U. S. 1873); Shields v. Ohio, 95 U. S. 319, 24 L. Ed. 357 (1887); Superior Water, Light & Power Co. v. City of Superior, 263 U. S. 125, 44 Sup. Ct. 82 (1923); Zabriskie v. Hackensack & N. Y. R. R., *supra* note 17; Pronick v. Spirits Distributing Co., 58 N. J. Eq. 97, 42 Atl. 586 (1899) (reducing the dividend rate on outstanding preferred stock); Lord v. Equitable Life Assur. Soc., 194 N. Y. 212, 87 N. E. 443 (1909) (stripping stock of voting rights); Garey v. St. Joe Mining Co., 32 Utah 497, 91 Pac. 369 (1907) (making non-assessable stock subject to calls).

There is a real conflict as to the effect of the reservation in the state of the power to amend. Whether this means more than the power to alter the contract between the state and the corporation is the moot point. Though it is held that a subsequent statute enabling the amendment has the same effect as though that power in the majority were originally written into the charter, the controversy begins anew as to the limitations on such power, the argument being that property rights which have arisen out of the contract between the shareholders *inter sese* and which have "vested" cannot be destroyed either by the state or by the majority under legislative authorization. At opposite poles on this question, stand Davis v. Louisville Gas & Elec. Co., *supra*, and Lonsdale Securities Corp. v. Int'l Mercantile Marine Co., *infra* note 19.

The suggestion is made that, if there is a provision for paying dissenters in the proposed corporate plans or if they are given the right to demand payment, the action under the amendment becomes less harsh and should lead the court to permit the majority move "as a sort of eminent domain." (1928) 14 CORNELL LAW QUARTERLY 85. The fallacy of this argument seems to be the need to resort to the concept of eminent domain in situations where no public enterprise or purpose is necessarily involved and where the rule is therefore inapplicable.

There remains the more fundamental question whether the reservation of the power to alter and amend by the state should be limited to the relation between the state and the corporation, and should not be extended to the incidents of the contractual agreement among the shareholders. The writer does not intend to discuss this problem, which is largely bound up with conflicting theories of the nature of the modern corporation. Which result we reach will to a great extent depend on whether we continue to regard the "essence of corporation" as being a grant from the state, the historical Anglo-American view, or whether we embrace the Continental notion that the corporation is a contractual institution under the supervision of the state. See Dodd, *op. cit. supra*

And even where the charter originally provided for the right in the majority to amend or change at will, equitable considerations of fairness and the constitutional protection of contract rights still hover in the background as guardians of the interests of minority shareholders.[19]

But these limitations will presumably be imposed to enjoin unauthorized or unfair actions, not to extend to dissatisfied members the right to cash in their shares. If it is unjust for the minority to find itself in a new enterprise or in a radically different position in the old one, it is likewise unjust to force the dissenter to accept the option of being bought out when no such provision was in his contract with the other shareholders.[20] The effect would be to validate pushing him out if a cash sop be offered. Though this may be done by a public corporation exercising the privilege of eminent domain,[21] no such privilege extends in favor of ordinary business corporations where no public use is involved.[22] And further, even if extending to him the right to payment will legitimate the corporate change by satisfying due process, nevertheless the writer fails to see how the dissenter may insist on this kind of relief as a price for not contesting the change when the majority have made no such provision for him.[23]

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note 5; BERLE, STUDIES IN CORPORATION FINANCE (1928) 23, *et seq.;* Putnam, *State Interference, under the Reservation Clause, with Contracts Between the Stockholders of Corporations* (1929) 7 N. Y. U. L. Q. REV. 487.

[19]For the extent of the power in the majority to amend when expressly provided for in the original charter, see: Peters v. U. S. Mtge. Co., 13 Del. Ch. 11, 114 Atl. 598 (1921); General Investment Co. v. American Hide & Leather Co., 98 N. J. Eq. 326, 129 Atl. 244 (1925); see also Davis v. Louisville Gas & Elec. Co., *supra* note 18. Yoakam v. Providence Biltmore Hotel Co., 34 F. (2d) 533 (D. R. I. 1929), noted in (1930) 15 CORNELL LAW QUARTERLY 279.

For the limitations on this power, see: Lonsdale Securities Co. v. Int'l Mercantile Marine Co., 101 N. J. Eq. 554, 139 Atl. 50 (1927); Kent v. Quicksilver Mining Co., 78 N. Y. 159 (1879); BERLE, *op. cit. supra* note 18, at 47.

[20]In Natusch v. Irving, *supra* note 3, an injunction was granted by Lord Eldon restraining a change in the nature of the business, notwithstanding an offer by the company to pay the dissenting member his original contribution to the enterprise, plus interest. See also Ashton v. Burbank, 2 Dill. 435 (U. S. C. C. D. Minn. 1873).

[21]Black v. Delaware & R. R. Canal Co., 24 N. J. Eq. 455 (1873); Spencer v. Seaboard Air Line Co., 137 N. C. 107, 49 S. E. 96 (1904).

[22]Morris v. Eylton, 125 Ala. 263, 28 So. 513 (1899); see Jackson Co. v. Gardner Ins. Co., 220 Fed. 113 (C. C. A. 1st, 1912).

[23]Even where the corporation was a public service company, a statute authorizing consolidation under the "alteration and repeal" clause was upheld against dissenting stockholders, though it made no provision for payment to them. Hale v. Cheshire R. R., 161 Mass. 442, 37 N. E. 307 (1894).

Where the amendment or change is unauthorized by the charter or the statutes, no provision for paying dissenters should validate it. And where the charter or statute permits the majority to override the objections of dissenting members, the power should not entail, in the absence of statutory provision therefor,[24] the necessity of buying up the shares of those who disapproved. And the majority of the courts seem to have so held.[25]

This view is strengthened by the fact that most courts regard this right as an additional one of the stockholder.[26] Thus, if the proceedings are irregular or unauthorized, they may be set aside.[27] Likewise, if the consolidation is fraudulent.[28] Moreover, the directors and majority must propose a merger or consolidation which is fair and equitable, and "the stockholder cannot be required to exercise his option of surrendering his stock for compensation until he has had an opportunity of joining in the consolidation under terms and conditions which, as to him, are legal and equitable."[29]

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[24]By a recent amendment to the Maryland Code, Laws 1927, c. 581, § 36½, the right of dissenters to payment is expressly denied when the charter originally gives the majority the power to sell, lease, or exchange all the corporate property. Its effect is to limit the right to payment given by § 36 to cases where the charter was later amended to confer the right to sell on the majority.

[25]Nugent v. Board of Supervisors, 19 Wall. 241 (U. S. 1873); Jones v. Missouri-Edison Elec. Co., 135 Fed. 153 (C. C. E. D. Mo. 1905), s. c., 144 Fed. 765, 776 (C. C. A. 8th, 1906); Mayfield v. Alton Ry. Gas & Elec. Co., 198 Ill. 528, 65 N. E. 100 (1902); Traer v. Lucas, 124 Iowa 107, 99 N. W. 290 (1904); Germer v. Triple State, 60 W. Va. 143, 54 S. E. 509 (1906); Port Edward, etc. Ry. v. Arpin, 80 Wis. 214, 49 N. W. 828 (1891); FLETCHER, CYCLOPÆDIA OF CORPORATIONS (1918) § 4798.

[26]Jones v. Missouri-Edison Elec. Co., *supra* note 25, Cole v. Wells, 224 Mass. 504, 113 N. E. 189 (1916); Bingham v. Savings Investment, etc. Co., 107 N. J. Eq. 413, 138 Atl. 659 (1927); Kelly v. Mariposa Land & Mining Co., 4 Hun. 632 (N. Y. 1st Dept. 1875); Langon v. Franklyn, 29 Abb. N. C. 102, 20 N. Y. Supp 404 (City Ct. 1892); Colby v. Equitable Trust Co., 124 App. Div. 262; 108 N. Y. Supp. 978 (1st Dept. 1908), *aff'd*, 192 N. Y. 535 (1908); Lazenby v. Int'l Cotton Mills Co., 174 App. Div. 906, 160 N. Y. Supp. 1 (1st Dept. 1916); Winifree v. Riverside Cotton Mills, 113 Va. 717, 75 S. E. 309 (1912); Jones v. Rhea, 130 Va. 345, 107 S. E. 814 (1921); Treat v. Hubbard-Elliot Copper Co., *supra* note 15; *cf.* Wilson v. Waltham Watch Co., 293 Fed. 811 (D. Mass. 1923).

[27]Jones v. Rhea, *supra* note 26; Treat v. Hubbard-Elliot Copper Co., *supra* note 15.

[28]Jones v. Missouri-Edison Elec. Co., *supra* note 25; Tanner v. Lindell Ry., 180 Mo. 1, 79 S. W. 155 (1903).

[29]Colgate v. U. S. Leather Co., 73 N. J. Eq. 72, 98, 67 Atl. 657, 668 (1907). But a stockholder who avails himself of the statute for an appraisal upon the sale of the corporate assets can not attack the sale itself as fraudulent. Wall v. Parrot Co., 244 U. S. 407, 37 Sup. Ct. 609 (1917).

The right to payment is regarded as an alternative one with the right of going along on the new venture or preventing it if improper. Payment is not regarded as validating unauthorized action; nor as rendering constitutional acts which, in its absence, would be held to violate due process. If payment were held to be the exclusive right of a dissenter, it seems clear that, except in the cases where the right of eminent domain exists, the provision would be unconstitutional as confiscatory. There is more in a share of stock than the right to its cash value when the owner opposes majority plans.

II

The statutes are for the most part crudely drawn and have left in their wake a host of problems. Even the elemental question as to who are included in the class entitled to payment is not clearly answered. Most of the statutes are based on the first English provision in the Companies Act of 1862,[30] which conferred the right to payment on stockholders who "did not vote in favor" of the change, "expressed their dissent", and demanded payment. The phrase "did not vote in favor", or its equivalent "not voting in favor", appear in the majority of the statutes in this country. Some few explicitly require that the stockholder must have "voted against such action"[31] to earn the right to be paid. In the latter states the stockholder is afforded little relief, for the same statutes permit disfranchising his stock. By the simple expedient of stripping his shares of voting power, the stockholder is deprived of the right to payment though he strongly objects to the majority plans. If the majority action be not tainted with fraud or irregularity, the dissenter must continue as a "partner" however unacceptable the new enterprise may be.

In the other group of states, the statutes are ambiguous—"not voting in favor" does not clearly define the class. One possible interpretation is that the right applies only to those shareholders who have the privilege of voting on the proposal and have either voted against it or at least refrained from voting for it. But the right to vote must be there. Else it might be argued why mention "voting" if it were intended to include members who have no voting rights.[32]

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[30] 25 & 26 VICT. c. 89, § 162 (1862).

[31] Indiana, Maine, Massachusetts, and Pennsylvania. See Abbot v. Waltham Watch Co., 260 Mass. 81, 156 N. E. 897 (1927).

[32] In 1862 when the remedy was first afforded, non-voting shares were probably unknown in England, and hence the problem never arose there nor was the statute indefinite or troublesome on that score.

Another, and it seems to the writer a more plausible, interpretation of "not voting in favor" would include all shareholders except those who cast votes in favor of the change, regardless of voting power. This view would seem to follow from those cases which insist that these statutes be liberally construed in favor of dissenters[33] and from the realization that the other interpretation considerably emasculates the remedy by excluding the large class of non-voting stock. The rationale of the provision being that a member should not be forced to continue in an altered enterprise not acceptable to him, his right to retire and be compensated should exist whether or not his status was such that he could vote against the change. In fact it would seem that his case for payment would be the strongest because he has no voice in the consideration of the proposed plans and is powerless to prevent their consummation.

At any rate, the statutes are not clear in defining the class to which they apply—a most essential part of every law. The difficulty can be obviated by giving the right to payment to "all shareholders except those who voted in favor of" the proposal and who dissent and demand payment.[34]

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[33]N. J. & H. H. Ry. & Ferry Co. v. American Elec. Works, 82 N. J. L. 391, 81 Atl. 989 (1929). In Matter of Drosnes, 187 App. Div. 425, 175 N. Y. Supp. 628 (1st Dept. 1919) there was a defect in the proceedings to sell all the corporate assets. It was held that a dissenter could waive the defect and demand payment under the statute. *Cf.* Matter of Macdonald, 205 App. Div. 579, 190 N. Y. Supp. 873 (2d Dept. 1923).

[34]The Ohio Act (GEN. CORP. ACT (1929) § 8623–14, as amended by laws of 1929), by conferring the right to vote on any amendment substantially changing the purposes of the corporation on every class of stock irrespective of voting power in other matters, and on all classes of stock proposed to be changed by an increase or reduction in par value of issued shares, or changed from par to no par, or prejudiced or altered in any other way, has solved the problem in another way. In case of reorganization "all dissenting stockholders, whether or not entitled to vote", are entitled to this relief under subsection 72 which provides for payment to dissenting shareholders "who shall not have voted in favor" of the proposals. The 1927 Ohio Act expressly conferred the right in all cases to non-voting dissenters.

In South Carolina in the case of a sale of assets, the right to an appraisal and payment is given to "any stockholder not voting in favor". S. C. Laws 1926, Act No. 599, § 2. In the case of a merger or consolidation, the right to payment is in addition given "if any stockholder . . . not entitled to vote thereon shall . . . object in writing." Laws 1925, Act. No. 169, § 3. The reason for enlarging the class in the latter instance is not apparent, and it may be that the difference in the language was not meant to have a correspondingly different effect.

The new Tennessee corporation act confers the right to payment upon non-voting as well as voting dissenters. Tenn. Laws 1929, p. 261, *et. seq.*

Another question which arises is whether this right to payment can be denied by express provision in the articles of incoporation or in the by-laws. The statutes generally are silent on this point, except as they prohibit the charter from contravening the laws of the state. Thus the Delaware Corporation Law of 1929 permits the certificate of incorporation to "contain any provision which the incorporators may choose to insert for the management of the business and for the conduct of the affairs of the corporation . . . provided such provisions are not contrary to the laws of this state."[35] The certificate may not be amended "to permit the insertion of any matter not in conformity with the provisions" of the Act,[36] but are to "contain only such provisions as it would be lawful and proper to insert in an original certificate of incorporation."[37] Corporations may "make by-laws not inconsistent with the laws of this State,"[38] but every corporation shall be governed by the provisions and be subject to the restrictions and liabilities in this chapter. Section 61 gives the right of appraisal and payment to dissatisfied stockholders after a merger or consolidation. Would the withdrawal of the right in the original charter or in a subsequent amendment be "inconsistent with the laws of the state"? The acts give no answer.[39] But in the case of a charter attempting to require a lesser vote for the sale of assets to a foreign corporation than that provided for in the statute, it was held that the provision was contrary to law, and the rejection of the certificate of incorporation by the Secretary of State was upheld by the New York Court of Appeals.[40]

In England there are cases holding that the remedy is mandatory and any attempt to contract it away by provision either in the original memorandum of association or in the articles is entirely ineffective.[41] And in those jurisdictions where the right is regarded as existing in equity regardless of statutory provision,[42] presumably,

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[35]DEL. GEN. CORP. LAW (1929) § 5 (8). [36]*Ibid.* § 25.

[37]*Ibid.* § 26. [38]*Ibid.* § 2 (6).

[39]The Ohio Legislature in 1929 amended the 1927 General Corporation Act, expressly to permit the charter to take away the right to payment. The Act now confers the remedy, "unless the articles otherwise provide . . ." Section 8623–72. See also § 8623–15 to the same effect.

[40]People *ex rel.* Barney v. Whalen, 189 N. Y. 560, 82 N. E. 1131 (1907).

[41]Payne v. The Cork Co., [1900] 1 Ch. 308; Bisgood v. Henderson's Transvaal Estates, Ltd., [1908] 1 Ch. 743; *cf.* Cotton v. Imperial, etc. Investment Co., [1892] 3 Ch. 454. And unless provision is made to satisfy payment to a dissentient member, an injunction will be granted restraining the liquidator from parting with any of the assets. *Re* Hester and Co., 44 L. J. Ch. (N. S.) 757 (1875).

[42]Barnett v. Phila. Market Co., 218 Pa. 649, 67 Atl. 912 (1907).

nothing in the charter or in the statutes, for that matter, can take it away from the dissenter.[43]

If a charter can by express provision exclude the right to payment, this right can be negated not only by a provision at its inception, but by a subsequent amendment as well. And a corporation to evade the necessity of paying dissenters when an important change is contemplated could amend its charter so that payment would be precluded and then proceed with the merger or consolidation without the perhaps disquieting requirement of paying cash to dissenters.[44]

But again arguing the reasons behind these statutory provisions, it would seem that the provisions for payment are mandatory and cannot be taken away in the charter. It would be an idle gesture to confer a right which can be rendered nugatory by the same group against whose actions it was designed to protect the minority. Here again there is need for removing the ambiguity in the statutes.

III

Still other ambiguities abound. The statutes of many states which restrict the purchase by a company of its own shares of stock out of surplus[45] or otherwise restrict the reduction of capital stock,

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[43]Aside from the question of statutory interpretation, the problem will to a certain extent be bound up with the general question of how far the contract between the shareholders, as evidenced by the charter, will be untrammeled by equitable limitations. BERLE, MATERIALS IN THE LAW OF CORPORATION FINANCE (1929) 28. Is this right to payment so essential that to contract it away would be so anti-social as to have the law impose an equitable restriction on the right so to contract, as it does, for example in the case of the equity of redemption in a mortgage? Probably not, for in a good number of states no such right to payment exists at all.

[44]A possible hindrance to this device would be the fact that in some states such an amendment of itself gives the right to payment, *e.g.* Louisiana. In most states, however, it does not. In these latter, there might be some relief in equity to set aside such a move. See Dodd, *op. cit. supra* note 5.

[45]DEL. GEN. CORP. LAW (1929) § 28; N. Y. CONS. LAWS, c. 40 (PENAL LAW) § 664(5). The N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) § 38(5) prohibits the reduction of capital stock when it will "reduce the actual value of its assets to an amount less than the total amount of its debts and liabilities plus the amount, as reduced, of its capital or issued capital stock."

In the absence of statutory authorization, the jurisdictions are in conflict as to the power of a corporation to purchase its own shares. In England and in some of our states no such power is implied. Trevor v. Whitworth, 12 App. Cas. 409 (1887); Chicago R. R. v. Marsailles, 84 Ill. 643 (1877); German Sav. Bk. v. Wulfekuhler, 19 Kan. 60 (1877); COOK, CORPORATIONS (8th ed. 1923) §§ 309–312. In such jurisdictions, the problem discussed below will have added complications.

suggest the possibility of a limitation on the right to payment. It is generally provided that, when the corporation is to dissolve or the capital stock is to be reduced formally, the debts must first be paid or at least sufficient assets must be left for such debts before the stockholders can share in the assets.[46] But suppose the corporation votes to change the preferences in outstanding shares, or to sell the property, and some of the members object. The same states provide that they may demand payment. Does this mean that they can demand cash whether or not there is sufficient surplus, or only if there is sufficient surplus?

There are the ordinary canons of statutory interpretation to look to for guidance. The provisions for payment being specific, they may be regarded as exceptions to the general prohibition of purchasing shares out of capital. But this is no absolute rule of law and would not be conclusive even if we could label the one specific and the other general. The order in time of enactment will not be very helpful because of the usual reenactment of both provisions in the same codifications.

The provisions against a corporation's purchasing its own shares out of capital are inserted for the protection of two groups—the creditors and the remaining shareholders. The latter are safeguarded by keeping the original contributions to the enterprise unimpaired for its further development, and by preserving the proportionate voting strength of the members; the former by keeping intact a fund to look to for the payment of debts. Though it may be that the provisions for paying dissenters were meant to qualify the protection given to the other shareholders by the general prohibition against reduction of capital stock informally, yet it is less probable that it was intended to permit the rights of creditors to be jeopardized. The application of the familiar "trust fund" doctrine would result in the continuing liability of the "paid-out shareholders" to creditors in the event that such payment rendered the corporation insolvent.[47] In cases of agreements by the corporation to pay the dissenters, the courts would probably limit their validity to situations where, after payment of the agreed price, the company continues to be solvent.[48] If the transaction were tainted with fraud or attempted to defeat the rights of creditors, an injunction

[46] DEL. GEN. CORP. LAW (1929) §§ 28, 19.

[47] *In re* O'Gara & McGuire, 259 Fed. 935 (D. N. J. 1919); Crandall v. Lincoln, 52 Conn. 73, 52 Am. Rep. 560 (1884); Commercial Nat. Bk. v. Burch, 141 Ill. 519, 31 N. E. 420 (1892).

[48] *In re* Fechheimer Fishel Co., 212 Fed. 357 (C. C. A. 2d, 1914); Atlanta Ass'n v. Smith, 141 Wis. 377, 123 N. W. 106 (1910).

would issue or the sale would be set aside.[49] In a state like New York[50] where the purchase of shares out of capital is made a penal offense, the directors might raise the objection in opposing the motion for the appointment of appraisers. Hence it would seem that the creditor's right to protection is paramount to the dissenter's right to payment.

A variation of the problem is the extent of this limitation on the right to payment. Must the capital remain unimpaired, or is it enough that after payment to dissenters sufficient assets remain to meet existing corporate debts? The 1929 Ohio Corporation Act,[51]

[49]*In re* S. P. Smith Lumber Co., 132 Fed. 618 (N. D. Tex. 1904); Columbian Bank's Est., 147 Pa. 422, 23 Atl. 625 (1892); Trevor v. Whitworth, *supra* note 45.

[50]N. Y. CONS. LAWS, c. 40 (PENAL LAW) § 664(5). Although the New York courts have found an implied power in a corporation to purchase its own stock, they have recognized that the penal law limits that power. The effect of the limitation on agreements to purchase its own shares has been considered in Richards v. Wiener Co., 207 N. Y. 59, 100 N. E. 592 (1912) and again in Topken, Loring & Schwartz Inc. v. Schwartz, 249 N. Y. 206, 163 N. E. 735 (1928). The latter case seemed to settle the rule here, but adverse criticism has been levelled against it: (1929) 29 COL. L. REV. 356, (1929) 42 HARV. L. REV. 829; and the latest New York decision in Cross v. Beguelin, 226 App. Div. 349, 235 N. Y. Supp. 336 (1st Dept. 1929) seems to leave the matter in uncertainty once more. See (1929) 15 CORNELL LAW QUARTERLY 108. For a good discussion of the general problem, see Glenn, *Treasury Stock* (1929) 15 VA. L. REV. 625.

[51]Section 8623-416. Maryland has a similar provision. MD. ANN. CODE (Bagby, 1924) art. 23, § 50. South Carolina's limitation is even more sweeping. S. C. Laws 1926, Act No. 599, § 5, after making provision for paying dissenters in the event of consolidation, states: "the liability of corporations . . . or of stockholders or officers thereof, or the rights and remedies of the creditors thereof or of persons doing or transacting business therewith, shall not in any way be impaired or diminished by the consolidation of two or more such corporations under the provisions hereof."

Since the purchase of a single share of dissentient stock, by decreasing the creditor's security, increases the probability of non-payment, it pro tanto "impairs" his "rights and remedies" against the corporation. If this is the meaning of the statute, it would nullify the remedy entirely. And since it probably is not, the literal meaning of the statute cannot be resorted to, and the usefulness of the provision is questionable. It does seem to impose on paid-out shareholders a continuing liability to creditors in the event of ensuing insolvency.

Section 2 of the same act, which assesses the costs of appraisal against the corporation, but provides that neither that sum nor the "amount of valuation fixed" shall be paid out of the corporation assets "until all existing debts of the corporation have been paid. . ." further restricts the dissenter's remedy, and would seem to render section 5 entirely unnecessary; for, if payment is postponed until all existing debts are paid, it is hard to see how creditors can be injured, unless section 5 was meant to continue the paid-out stockholder's liability to future creditors, which is unlikely. The absence of any statutory provision in South Carolina regarding the power of a corporation to purchase its own shares generally, completes the confusion.

which is one of the few statutes expressly recognizing and providing for the conflicting rights of creditors and dissenters, provides that: "A corporation may purchase shares of any class issued by it . . . from shareholders who by reason of dissent are entitled to be paid the fair cash value of their shares," but not when the result of such purchase would be to make it reasonably probable that the corporation would be "unable to satisfy its obligations and liabilities". This seems to be the proper solution of the problem and would probably be reached in most jurisdictions even in the absence of such express statutory provision. The creditors should be protected to the extent of preventing the payment of dissenters when such payment would render the corporation insolvent. It is doubtful whether creditors should receive the protection which the New York law seems to give them and the remaining stockholders against any reduction of capital in apparent limitation on the right of dissenters to payment. Strangely enough these problems seem never to have been raised by the cases,[52] but they are real enough to demand clarification in the statutes.

Further, assuming some limitation on the power of a corporation to purchase its own stock in order to pay dissenters, what is the effect? Does it mean that the majority may go ahead with the change—be it a consolidation or an alteration in the preferences of outstanding shares—but that the dissenters cannot be paid? Or does it follow that, since the dissenters cannot be paid because it would impair the corporation's solvency or capital fund, the consolidation or change in preferential rights cannot be consummated? Either choice involves some elements of unfairness and lessens the utility of the remedy as a compromise between majority and minority. But if we assume that creditor's rights are paramount the dilemma is real and we must make our choice.

It may be argued that the limitation should be upon the majority's right to bring about the necessity for payment. This would necessitate that, as a condition to the change they seek to make, the majority be required to keep the value of the corporate assets at least equal to the amount of the debts. To do this it might be necessary for the majority to make a further contribution to the capital of the

[52]It may be that as a practical matter corporations will make provisions in advance for creditors and dissenters to insure the consummation of their plans, or failing, abandon them, so that situations where the rights of the majority, dissentients, and creditors conflict may not frequently arise in the courts. But the problem will be a weighty one in the corporate deliberations over the proposed changes which may bring about such conflicts, and the rights of the parties in court if litigation should arise will influence the action agreed upon.

company. This would be the price of the change, for originally unanimity was required. The need was abolished only when provision for paying dissenters was made.[53] If such payment can not be given, unanimity is again necessary.

It is more likely, however, that the courts will adopt the other alternative, and if the limitation be found to exist, it will cut down the dissenter's right to payment, not the majority's power to act.[54] The tendency of the legislature being to confer greater freedom of action on corporate managements, such statutory construction would not be amiss. For such a view it might be urged that in many cases where a corporation is in bad straits a merger or reorganization is necessary for recovery, and to prevent its consummation because dissenters can not be taken care of would be to confer a potent weapon for blackmail on unscrupulous objectors to beneficial corporate changes. On the other hand, it may be argued that, by encouraging sufficient dissension and thereby creating a group large enough to prevent payment by the corporation, the majority could relieve itself of the need of paying any—an equally undesirable corporate practice.

Whichever rule the policy of any particular state may lead to, the need exists for a rule to remove the present uncertainty.

There are other limitations on the dissenter's right to be paid which merit brief mention. In England and in some of our states it is expressly provided by statute that the stockholder loses his right to payment if the majority disaffirms the project.[55] In New York this result has been reached, unaided by anything in the statute.[56] A corporation voting for a change may later find itself faced with the prospect of paying for the shares of a large group of dissatis-

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[53]If our conclusion that the right to payment is mandatory where there is a statutory provision therefor and cannot be denied by the charter is valid, this argument gains force.

[54]THE UNIF. BUS. CORP. LAW, § 42 (3) provides: "A shareholder shall not be entitled to payment for his shares . . . unless the value of the corporate assets which would remain after such payment would be at least equal to the aggregate amount of its debts and liabilities exclusive of capital stock." This resolves the question against the stockholder, and would probably deny the right to all dissenters even though there might be sufficient assets to pay some. The 1929 Tennessee Corporation Act has a like provision, § 38.

[55]Companies Act (1929) § 234 (3); MD. ANN. CODE (Bagby, 1924) art. 23, § 36; OHIO GEN. CORP. ACT (1929) § 8623–72.

[56]Matter of Millard, 221 App. Div. 113, 222 N. Y. Supp. 633 (1st Dept. 1927), *aff'd*, 246 N. Y. 546, 159 N. E. 645 (1927); Matter of O'Hara, 133 Misc. 184, 231 N. Y. Supp. 60 (Sup. Ct. 1928).

fied members. It should have the privilege of abandoning the venture.[57]

The statutory requirements of notice must be followed and the dissent must be real.[58] Acceptance of any of the gains of the change will prevent the dissenter from cashing in his shares.[59] Laches will also bar him.[60]

In Louisiana,[61] when the majority voting for the change is sufficiently large (80% of the voting power), the dissenter is stripped of his right to payment, probably on the theory that such small minorities are objecting to harass the company or else that there is wisdom in large majorities.

As has before been indicated,[62] the dissenter's rights are greater than that of being paid—the latter being but an additional right. Unauthorized and fraudulent changes may be enjoined. If the sale is to the majority itself so as to be in breach of the fiduciary relation, the minority can recover the value of the property in the hands of the new company.[63] But it is probable that payment of the dissenters will be held to be merely a condition subsequent to making the change valid,[64] that the failure to provide for them will render the transaction only voidable. This will probably be true even though the statutes generally provide only that the appraised value shall be recoverable "as directed by the court",[65] or else "as other debts are by law collectible";[66] for, the relief being in equity, the courts

[57]In Ohio, once the dissenter has demanded payment, he cannot withdraw and go along in the changed enterprise without the consent of the board of directors. OHIO GEN. CORP. ACT (1929) § 8623-72.

[58]*In re* Demerara Rubber Co. Ltd., [1913] 1 Ch. 331. The court held that the notice of dissent must state not only that the shareholders dissent but also that the liquidator must either abandon the project or else purchase the dissenter's shares. But see *In re* London Bread Co., 62 L. T. (N. S.) 224 (1890) to the effect that the dissent may be informal. See also Wall v. Parrot Co., *supra* note 29.

[59]Wormser v. Metropolitan Street Ry., 184 N. Y. 83, 76 N. E. 1036 (1906); but see Treadwell v. United Verde Copper Co., 134 App. Div. 394, 119 N. Y. Supp. 112 (1st Dept. 1909).

[60]Drake v. N. Y. Suburban Water Co., 26 App. Div. 499, 50 N. Y. Supp. 826 (2d Dept. 1898); *cf.* Finch v. Warrior Cement Co., 141 Atl. 54 (Del. Ch. 1928).

[61]LA. BUS. CORP. ACT (1928) § 52. The new ENGLISH COMPANIES ACT (1929) § 155 has a like provision.

[62]*Supra* note 26.

[63]Ervin v. Oregon Ry. and Nav. Co., 27 Fed. 625 (C. C. D. N. Y. 1886).

[64]The English statute expressly so provides. *In re* Hester Co., 44 L. J. Ch. (N. S.) 757 (1875). See also Horner & Co. v. Lawrence, 86 Misc. 95, 98, 149 N. Y. Supp. 82, 84 (Sup. Ct. 1914).

[65]New York.

[66]Delaware. The ENGLISH COMPANIES ACT (1929) § 234 (4) provides that, if the company elects to purchase the members' interest rather than abstain from the

may and generally will provide means of assuring the payment.[67] Though the statutes treat the obligation to pay the dissenters as that of the corporation of which they are members, yet if the corporation has parted with its assets, the sum is collectible against the other company;[68] and in some cases the stockholders may be given a lien on the transferred assets.[69]

IV

Probably the most important problem which arises is that of valuing the stockholders' shares. The statutes make scant provision regarding the value to be fixed, and the cases shed little light on methods of valuation. It is not the purpose of this paper to go into the fundamental and troublesome questions of valuation which today are engaging the attention of courts, commissions, and legislatures alike. But to reach any conclusions as to the effectiveness of the remedy we are considering, it is necessary to see how the legislatures and courts have treated the question.

The wording of the statutes is not uniform. Some states refer merely to the "value" of the shares; others, the "fair cash value"; still others, the "fair value"; some, the "market value" or "full market value". Except possibly where the market value is set as the guide, the wording of the statutes will probably have little effect on the determination of the price.[70] The courts will seek the "intrinsic value"—the proportionate share of the assets of the com-

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dissolution, "the purchase money must be paid before the company is dissolved." Schemes of reconstruction which fail to make provision for paying dissenters will not be approved by the court. *In re* De La Rue & Co., 81 L. J. Ch. (N. S.) 59 (1911); *In re* General Motor Cab Co., [1913] 2 Ch. 377.

[67]In some states the company must post a bond to insure the payment, *e.g.* Maine. In Tennessee the corporation may elect to post a bond or else permit the award to become a lien against its assets. See *infra* note 96.

[68]CONN. GEN. STAT. (1918) § 3524; FLA. GEN. LAWS (1927) § 6564; Atlanta, B. & A. R. R. v. Atlantic Coast Line R. R., 138 Ga. 353, 75 S. E. 468 (1912).

[69]MD. ANN. CODE (Bagby, 1924) art. 23, § 36; ME. REV. STAT. (1916) c. 51, § 64. Some courts are unsympathetic to the idea of giving a lien on the transferred assets to the dissentients. *In re* Interborough Consolidated Co., 277 Fed. 455 (S. D. N. Y. 1921); Kremer v. Public Drug Co., 41 S. D. 365; 170 N. W. 571 (1919).

[70]In Matter of Dupignac, 123 Misc. 21, 204 N. Y. Supp. 273 (Surr. Ct. 1924), "clear market value", "fair market value", and "cash value" were said to be synonymous. That case, however, involved the question of the taxation of closely held stock. *Cf.* Donald v. American Smelting & Refining Co., 62 N. J. Eq. 729, 48 Atl. 771 (1901).

pany including good will.[71] Many of the elements which go to make up market value will not be considered. Such extrinsic factors as artificial manipulation and speculation which go into making up market value will not be weighted.[72] But *quaere* whether the expectation of distribution of profits or the "contract position" of different classes of stock as to earnings or liquidation, which so largely determine the price on the market, should not be included even in arriving at intrinsic value.[73]

Where the market value is prescribed, some interesting problems arise. Do the statutes mean to give effect to all the extrinsic factors which may at any time give the stock a value entirely removed from any basic considerations? Probably not, and hence the attempts to exclude such artificial factors by calling for the "fair" or "full" market value. But the test for the "full market value" was laid down by a recent New Jersey case[74] as the method a broker hired to sell the stock would use, by considering what previous sales between willing buyers and sellers brought—and not by its "intrinsic" value. This method was likewise prescribed by the same court for appraisal where the statute called for "fair market value".[75]

The Ohio code expressly provides that, if the "full market value... is abnormally enhanced or depressed by unfair combinations or by

[71]Good will is recognized as a legitimate item of value in which the dissenter may share. Matter of Seaich, 170 App. Div. 686, 156 N. Y. Supp. 579 (1st Dept. 1915). The value of the good will is arrived at by multiplying the average annual profits by a number which is not fixed, but is a question of fact determined by the circumstances of the case. Van Au v. Magenheimer, 126 App. Div. 257, 110 N. Y. Supp. 629 (2d Dept. 1908). The interest on the capital and surplus employed in the business must be deducted from the net profits. And the annual profits used as the multiplicand must be average. Thus, in Matter of Erlanger, 237 N. Y. 159, 142 N. E. 571 (1923), the appraisers refused to estimate good will at a certain three years' net earnings because those were peak years, but took the average for five years and found no profits and no good will at all. For an economic analysis of the bases of good will, see COMMONS, LEGAL FOUNDATIONS OF CAPITALISM (1924) 182, *et seq.*

[72]Tierney v. United Pochahantas Coal Co., 89 W. Va. 402, 109 S. E. 339 (1921).

[73]In Matter of Clark, 131 Misc. 151, 226 N. Y. Supp. 141 (Sup. Ct. 1927) it is suggested that the right consists only in "an aliquot part of the assets". The "contract position" of the shares will not be considered in the valuation. In the main case on dissolution the dissenting preferred (as to dividends only) shareholders were permitted to include in estimating their share of the assets, surplus made up of sums which might have been declared as dividends in prior years on common stock. *Cf.* Continental Ins. Co. v. United States, 259 U. S. 156, 177, 42 Sup. Ct. 540, 547 (1921); North American Mining Co. v. Clarke, 40 Pa. 432 (1861).

[74]*In re* Morris Canal & Banking Co., 6 N. J. Adv. 987 (1928).

[75]Prall v. U. S. Leather Co., 6 N. J. Misc. 967, 143 Atl. 382 (1928).

an illegal monopoly or by any other wrongful act, other evidence than the market sales at that time may be resorted to for the purpose of showing the fair value of the stock",[76] thus coming closer to the criterion of intrinsic value.

Some statutes[77] specifically exclude as an element in value any depreciation or appreciation in consequence of the consolidation or merger, realizing that the change may produce a radical revision of the share's value, "market" or "intrinsic".

Where the merger or what not has brought the prices up, the dissenter, if the stock has a ready market, will dispose of them without resorting to his statutory remedy. It is only when the market price goes down that the dissenter is likely to seek payment from the corporation, and then only if he feels that the intrinsic value will prove sufficiently greater than what the shares can bring on the market to warrant the trouble of starting the necessary proceedings.

The remedy will largely be resorted to in the cases of companies whose shares have no definite market, and where such is the case, "market value" is to a great extent meaningless; for it was probably not the intention of the legislature to have the value determined by what a forced sale would bring,[78] or in the absence of sufficiently numerous buyers and sellers and sales to make a "market".[79] In such cases therefore, intrinsic value is again likely to be the criterion used.

Whatever the test preseribed in the statute, the problem of valuing the shares will continue to be the hard one the question of judicial

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[76]2 OHIO GEN. CODE (Page, 1926) § 9034. Illinois, however, provides that the fair value shall be paid, but states that "the value of such shares at such date shall be their market value in case the stock of such corporation is listed upon any exchange." Ill. Laws 1923, p. 282. Thus, all those factors which go to make up stock exchange prices are included in determining the "fair value" of shares. For a criticism of the market as a criterion of value, see Friday, *An Extension of Value Theory* (1922) 36 Q. J. OF ECON. 197.

[77]R. I. GEN. LAWS (1923) c. 248, § 56; 2 N. J. COMP. STAT. (1910) §§ 108, 108a. MD. ANN. CODE (Bagby, 1924) art. 23, § 36. The New Jersey cases, *supra* notes 74, 75, say that in arriving at the "full market value" previous sales are to be considered. The statutes call for the exclusion of fluctuations in value brought about by the merger or consolidation. Prices of actively traded stock are frequently affected by premature rumors of negotiations for mergers, and the effect of such mergers are discounted in the market price long in advance of the consummation of the change. The task of the appraisers in arriving at the market value—evidenced presumably by public sales—which is free from the effects of the merger or consolidation will not be a light one.

[78]Jackson Co. v. Gardner Investment Co., 220 Fed. 113 (C. C. A. 1st, 1912); Matter of Dupignac, *supra* note 70.

[79]See Int'l, etc. R. R. v. Bremond, 53 Tex. 96, 120 (1880).

valuation always is.[80] Calling for "fair value" and then leaving the exigencies of each case in the hands of the appraisers under supervision of the court is likely to work better than any legislative attempt to prescribe a general rule at once restrictive and yet too vague to be anything but troublesome.[81]

During the period from the time of dissent until the final order, the status of the shareholder is ambiguous. Since the statutes of many states provide for the valuation as of the date of dissent, his rights as a stockholder would be in abeyance from that time, since he would not be affected by any change in value during that period. However, he does not lose his status as a stockholder for all purposes until he is paid and surrenders his stock. In Florida and South Carolina, however, he does.[82]

The allocation of costs in these proceedings is likely to be one of the most potent factors in determining the efficacy of the remedy. Appraisal of any considerable property will be a costly proceeding, as a glance at some of the records of the litigated cases will show. In New York and a few other states the costs are taxed against the corporation.[83] In Florida they are equally divided between the shareholder and the corporation unless the corporation shall have offered to pay the dissenter a lesser sum than the amount awarded, in which case the entire costs are levied against the corporation.[84] Louisiana penalizes with costs that party whose contention as to the value of the share was overruled by the award.[85] Ohio leaves the matter to the discretion of the court;[86] England to the judgment of the arbi-

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[80]Bonbright, *The Problem of Judicial Valuation* (1927) 27 COL. L. REV. 493.

[81]Most of the statutes are silent about interest. Ohio leaves the date from which interest shall be computed in the discretion of the court when it renders judgment. Illinois allows interest from the date the change was consummated. In New York, though there is no statutory provision, the Court of Appeals has held that the dissenter is entitled to interest from the date of the court order, not from the time of the appraisers' report. Matter of Erlanger, *supra* note 71, distinguishing Matter of Seaich, *supra* note 71, which seemed to have awarded interest from the date of dissent, and Matter of Task v. Peekskill Plow Works, 6 Hun 236 (N. Y. 1st Dept. 1875), which computed interest from the time of the report by the appraisers. The court in the Erlanger case held that the award of the appraisers was not a final order until confirmed or modified by the court and interest should run only from that time. In England interest runs only from the date when the amount awarded is demanded and not from the date of dissent. *In re* U. S. Direct Cable Co., 48 L. J. Ch. (N. S.) 665 (1879).

[82]FLA. GEN. LAWS (1927) § 6564; S. C. Laws 1926, Act No. 599.

[83]Indiana, Rhode Island, and South Carolina.

[84]FLA. GEN. LAWS (1927) § 6564.

[85]LA. BUS. CORP. ACT (1928) §§ 52–54.

[86]OHIO GEN. CORP. ACT (1929) § 8623–72.

trators.[87] What the costs shall include is not clear. Presumably the remuneration of the appraisers and the incidentals of the appraisal are included. In some states reasonable attorney's fees are expressly covered.[88] But what other items may be added? Do the costs include the expense of the dissenter's accountants, or of preliminary appraisers to advise him whether the corporation is making him a fair offer before he appeals for arbitration? Does it include the expense of his expert witnesses before the appraisers?[89] Whether or not such items can be charged in the costs will be important in determining whether arbitration should be resorted to for comparatively small differences between the prices asked and offered.

The arbitrary assessment of costs against either side is inadvisable as it gives the other side the upper hand in negotiations. Likewise, making the costs depend on whether the final amount awarded is greater or less than the sum offered by the corporation or asked by dissenter is unfair, as it might make this large item depend on a slight variation and would not take into account any honest difference of opinion. Leaving the matter of costs entirely in the discretion of the court seems the best solution, since it would probably be administered to tax the unreasonable party in the transaction or be divided when the diagreement was honest. This arrangement would encourage both parties to attempt an extrajudicial settlement. The unreasonable party would not be likely to look with favor on the prospect of resorting to appraisal proceedings, and the other party would have little to fear if such proceedings became necessary to fix a fair price.

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[87]8 & 9 VICT. c. 16 (1845), known as the Companies Clauses Consolidation Act.

[88]South Carolina, Minnesota, and Florida.

[89]N. Y. C. P. A. § 1518 provides what the bill of costs of an *arbitration* may include. Such items are legal fees of witnesses, referees, and other officers; fees for publication, for printing papers, and "such other reasonable and necessary expenses as are taxable according to the course and practice of the court or by expression of law." Although the English statute makes the appraisal proceedings subject to all the rules regarding arbitration, the New York statute gives no indication whether the same is true here, and the above section may not be applicable.

N. Y. C. P. A. § 1545 fixes referees' fees at $10 per day, but this is generally altered by stipulation.

In Int'l Fastener Co. v. Francis Mfg. Co., 204 App. Div. 526, 198 N. Y. Supp. 455 (4th Dept. 1923), it was held that the charge for the services of an expert accountant, chosen by the referee for the plaintiff in an arbitration to examine the defendant's books, could not be included in the bill of costs.

CONCLUSIONS

A comparative study of the various statutes and cases leaves one with the definite notion that changes are advisable in order to make the remedy complete.[90] Of course it is first necessary to decide whether the right is one which ought to be granted. But assuming the wisdom of the provision as a just and workable compromise between the conflicting aims of the majority and minority, the need is for a remedy which will be effective. Any such study is incomplete without full statistics of the frequency with which corporations undergo such changes as will require paying dissenters, how often dissenters exercise this right, and how frequently they must resort to the statutory appraisal to obtain a fair price. Such statistics are unfortunately unavailable. But we do know that mergers, consolidations, and reorganizations are of frequent occurrence of late, and that the situations in which this remedy was meant to apply will be numerous.

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[90]The provisions of the Uniform Business Corporation Law are set forth here to illustrate a suggested model statute on the subject:

> SECTION 42. *Rights of a Shareholder Not Assenting to Certain Corporate Action.*
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> 1. If a corporation has authorized the sale, lease or exchange of all its assets . . . at a time when it is able to meet its liabilities then matured, or has . . . authorized an amendment which changes the corporate purposes, extends the duration of the corporation or changes the rights of the holders of any outstanding shares, a shareholder who did not vote in favor of such corporate action may, within 20 days after the date upon which such action was authorized, object thereto in writing and demand payment for his shares.
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> 2. If, after such a demand by a shareholder, the corporation and the shareholder cannot agree upon the value of the shares at the time such corporate action was authorized, such value shall be ascertained by three disinterested persons, one of whom shall be named by the shareholder, another by the corporation and the third by the two thus chosen. The finding of the appraisers shall be final, and if their award is not paid by the corporation within 30 days after it is made, it may be recovered in an action by the shareholder against the corporation. Upon payment by the corporation to the shareholder of the agreed or awarded price of his shares, the shareholder shall forthwith transfer and assign the shares held by him at, and in accordance with, the request of the corporation.
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> 3. A shareholder shall not be entitled to payment for his shares under the provisions of this Section unless the value of the corporate assets which would remain after such payment would be at least equal to the aggregate amount of the debts and liabilities exclusive of capital stock.

Section 48 provides that the right shall attach in case of a merger or consolidation, and "the liability . . . to such dissenting shareholder for the value of his shares so agreed upon or awarded shall also be a liability of the surviving or new corporation, as the case may be."

The silence of the statute on the question of costs, and the finality of the appraisers' findings intimate that costs will be in the discretion of the appraisers or, at any rate, in the discretion of the court.

It will be observed from the remainder of the text that the writer believes certain changes and additions advisable in the foregoing suggested statute.

First among the problems will be that of deciding in which situations the dissenter shall be given the right to be paid. Most states are agreed that the right should exist in cases of merger or consolidation, and for the same reasons, in the case of a transfer of all the assets.[91] Any fundamental alteration in the nature of the enterprise by an amendment of the charter would likewise seem an appropriate occasion for relieving dissatisfied members of the necessity of continuing in the venture. Changing the rights of outstanding stock and thus altering the status of the shareholder to his prejudice should give to anyone who is hurt thereby the privilege of withdrawing.[92] And since the reduction of the capital stock alters the position of the remaining shareholders in the enterprise, a dissenter should enjoy the right to payment.

As has been indicated before, the right should not be dependent on the power to vote, but should extend to all those who dissent from the proposed changes; else the remedy will be considerably emasculated and will be unavailing to those who most need it—disfranchised shareholders.

The powers of the minority in the usual corporation of today are sufficiently meagre to make them deserving of these provisions as of right, and they should be a mandatory part of every charter. Especially in those articles of incorporation where the draftsmen seek to give the most sweeping powers to the managing groups and presumably would attempt to negate these rights by express provision, should the right exist, as the dissenters will have little say in the consummation of any changes. It is true that to that extent we would be curtailing the freedom to contract, but where sufficient social benefit results therefrom, the thought should not be a bugaboo. And we have assumed the wisdom of the remedy.

The question of reconciling the conflicting interests of the creditors and the majority and minority stockholders will prove troublesome. There should be little doubt that the creditor's rights ought not to be jeopardized; but it is probably enough to provide that after pay-

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[91]These statutory remedies, it seems, have not altered the common law rule that a majority can dispose of the assets of a company which is either insolvent or has ceased to do business. In such cases moreover dissenters have no right to be paid. Weingreen v. Michelbacher, 163 App. Div. 950, 149 N. Y. Supp. 110 (1st Dept. 1914); Matter of MacDonald, 205 App. Div. 579, 199 N. Y. Supp. 873 (2d Dept. 1923).

[92]Missouri grants the right to payment in the sole instance of an amendment which authorizes the issuance of non par shares in exchange for existing shares with par value (Mo. Laws 1923, p. 362, § 2) apparently without regard to whether the shareholders are prejudiced thereby.

ing the dissenters the remaining assets be at least equal to the aggregate amount of its debts and liabilities exclusive of capital stock, or to adopt the more general Ohio provision against resulting probability that the corporation will be unable to satisfy its debts.[93] The New York limitation against any impairment of capital seems too drastic. Whether this limitation shall be upon the majority's right to proceed with the change or upon the dissenter's right to be paid is a question which will largely depend on the location of one's sympathies generally in cases where the interests of majority and minority shareholders collide. It is the belief of the writer (though he suspects it will not be the opinion of most legislators or lawyers) that the limitation should be upon the power of the corporate managers to make the change. The majority should be permitted to bring about a situation which normally calls for payment to dissenters only when they can make such payment without hurting creditors.

The question of costs of the appraisal is likely to be one of the most important elements in the effectiveness of the remedy. As has been pointed out, arbitrarily to tax such costs against the corporation might encourage objecting stockholders to use the remedy for blackmailing the corporation with unreasonable demands. To levy them against the stockholders would have a similar opposite effect. To make the allocation always dependent on whether the appraiser's figure was more or less than that offered by the corporation would be arbitrary, and might result in the assessment of a large sum against it for a slight variation in a case where their offer was fair and made in good faith. Leaving the power to affix and assess the costs of the proceedings, including reasonable attorney's and accountant's fees, in the discretion of the court is better than any fixed rule.[94]

Ample provision should exist in each state to assure that the dissenters will be paid the sum awarded. The transaction should not

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[93]N. Y. CONS. LAWS, c. 40 (PENAL LAW) § 664 apparently restricts the remedy to cases where dissenters can be paid out of surplus without any impairment of capital at all. But N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) § 38(5) seems to permit the reduction of capital stock to the point where its assets equal its debts and liabilities "plus the amount, as reduced, of its capital or issued capital stock". This section should prevail over the more rigid restriction of the penal law. What the New York courts will do when these conflicting provisions are squarely before them is largely conjectural, but it is submitted that the penal provision is unnecessarily restrictive.

It has been held that a corporation can pay salaries to officers out of capital. Hunter v. Conrad, 132 Misc. 579, 230 N. Y. Supp. 202 (Sup. Ct. 1928).

[94]This has been the English practice ever since the first statute was passed in 1862. The Ohio Code has a similar provision: OHIO GEN. CORP. ACT (1929) §8623-17.

be held up pending the appraisal but some security might be required as is the case in Maine.[95] The exact nature of this administrative detail should depend on the particular practice in the state.[96]

Of course the right should be an additional one to all the other rights of the stockholder. It should not validate unauthorized or fraudulent transactions, nor prevent the shareholder, though he has objected to the proposed change, from electing to abide by it and continue in the enterprise as then altered.

Amplified and made definite, it is believed that the remedy is a workable compromise of the internal conflicts in the modern dynamic corporation. Although the dissenter will have a difficult time deciding whether the sum offered by the corporation for his shares is a fair one,[97] and may yield in many cases rather than resort to arbitration and the possibility of subsequent court proceedings, yet if he feels that the offer is sufficiently inadequate and that his expenses may be paid by the corporation if he proves his case, the remedy is as effective as are most legal remedies. The trouble and the question of costs will loom on both sides as a deterrent to resorting to the statutory proceedings and will smooth over the gap caused by minor variations in the sums asked and offered. The corporation will not be anxious to have its accounts made public by the proceedings, nor risk the possibility that the dissenter will seek for some flaw to enjoin the consummation of its plans. The existence of the remedy, potent if necessarily resorted to, will probably have for its effect a peaceful settlement of many intra-corporate dissensions.

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[95]ME. REV. STAT. (1916) c. 51, § 63.

[96]The new Tennessee Corporation Act gives the corporation which is selling its property and has dissenters to care for, the option of having a decree entered against it for the appraised value which will be a lien on the property, or of posting a bond for double the probable value of the shares. Tenn. Laws 1929, § 38, p. 261, *et seq.*

[97]It has been held in England that a dissentient member has no right to examine the books of a company, in liquidation for the purpose of reconstruction, in order that he may test the advisability of accepting the offer made for the shares or go to arbitration. *In re* Glanorganshire Banking Co., 28 Ch. D. 620 (1884). However, in view of the general position in this country that stockholders have access to the corporate records, at least for any honest purpose, the English case will find little support here. Varney v. Baker, 194 Mass. 239, 80 N. E. 524 (1906); Henry v. Babcock-Wilcox Co., 196 N. Y. 302, 89 N. E. 942 (1909). Moreover, it is probable that in addition to the right to payment the dissenter has the right to an accounting to see whether the proposed change is a fair one and to determine which one of his alternative remedies he should resort to. Logan v. N. Y. Sugar Refining Co., 176 App. Div. 660, 163 N. Y. Supp. 214 (2d Dept. 1917).