

1893

Rights of the Minority Stockholders

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T H E S I S.

RIGHTS OF THE MINORITY STOCKHOLDERS.

By

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CORNELL UNIVERSITY.

1893.

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RIGHTS OF THE MINORITY STOCKHOLDERS.

INTRODUCTION.

The growth of corporations has been marvelous during the past few decades, yet it is indisputable that the requirements of trade and the variously increasing number of new enterprises have demanded such growth in this mode of conducting many of the business affairs of the present century. The creation of this "legal entity" with its peculiar safeguards has been the means by which great capitalists first dared to venture the investment of their funds in many enterprises. The limited liability to which the stockholders of a corporation is subject has made timid men bold enough to enter enterprises which if the partnership alone existed would never have been dreamed of. To this element of the corporation is due the existence, at the present day, of our extensive system of railroads, banking institutions, and other great enterprises. The partnership liability was too great, and the success of these enterprises too uncertain for them to grow or receive favor without the safety of the institution known as the "creature of the law".

While the invention of the corporation has proved of great benefit in aiding and giving an incentive to business

enterprises of all descriptions, yet the manner in which it is necessarily conducted affords many opportunities for the commission of frauds. In the early days of corporations it became firmly established that the majority has exclusive control over the affairs of the corporation. This was deemed a necessary consequence of the corporation's existence.

For some time after the creation of the first corporations the injured minority stockholders had few if any remedies against the managing body, however flagrant their acts might be. Later, however, the court of equity came to the rescue of the body of stockholders who because of the inferiority of their number, were overpowered by the acts of those constituting the majority, and recognized their rights to a limited extent. Even then, however, the conditions must be of a peculiar and alarming nature in order that judicial cognizance would be taken of an alleged injury to the minority.

While to the present day the management of the affairs of the corporation is largely within the discretionary power of the majority, yet there has been a gradual and continual enlargement of the powers of the courts to remedy wrongs which are committed by the governing body, or result from the omission on its part to perform some duty.

In the following pages the object will be to consider some of the more important circumstances in which the courts have come to take cognizance of injuries to the minority stockholders.

No attempt will be made to more than incidently refer to wrongs of which the courts have taken jurisdiction from ancient times, and which arise out of the ordinary business associations more naturally than out of corporate relations.

I GENERAL RIGHTS AND REMEDIES OF THE MINORITY.

The broad proposition is often laid down by the courts that a court of equity has power to remedy every wrong which may arise, whether or not there has been a rule formulated to apply to the particular case in hand. Plainly those maintaining this doctrine ^{overlook} many long established customs of equity. Thus a very general exception to this proposition is found in the attitude which courts of equity assume towards the acts of the majority stockholders of a corporation. For example, it is well established that when property is turned over to the corporation by subscribers in payment of their stock, other subscribers cannot complain so long as the directors have not been guilty of bad faith in placing a valuation upon the property so received, even though they may actually have exercised very bad judgment. It matters not if the property be worth less than one half the estimated value, and the financial condition of the corporation by reason of such transactions is well-nigh ruined. Further, it is conceded on all hands that as regards the inner transactions of the corporation, in the absence of actual fraud, the directors and majority stockholders have absolute control over the management of the corporation, even though the minority stockholders are

in such peculiar circumstances that the acts of the controlling body work great damage to their interests.

It is said in justification of this well established^{doctrine} and in many cases perhaps justly, that those entering the corporation do so upon an implied condition that they will submit to the rule of the majority.

Further exceptions will appear upon the consideration of the various matters relating to the subject now being investigated..

The courts often hold that the controlling body of a corporation must perform each and every duty which is imposed upon them with the utmost good faith to all interested in the affairs of the corporation.

If this principle were strictly enforceable, the often^{occurring} "freeze out" and the many combinations and "trusts", would be prevented. The difficulty lies in the fact that those carrying on the affairs of the corporation do so in such a manner that their aims are accomplished by skillfully covering up all traces of proof of the transaction and the injured minority stockholders are absolutely unable to satisfactorily explain to the court how they were defrauded. This condition of affairs presents a great stumbling block to the courts, and often is the explanation of the failure

of the minority to sustain actions against the majority.

By most of the authorities the directors of the corporation are regarded as occupying the relation of trustees to the corporation, and the courts often lay down the general proposition that such officers must use the care of an ordinary prudent business man, or the care which a person exercises in conducting his own business affairs(a). Just what amounts to the requisite care or discretion is often a difficult matter, and must be solved by a careful consideration of all the circumstances.

It often occurs that the officers of the corporation own a majority of the stock, and are thus the better able to direct the affairs of the corporation with a view to promote their own interests and injure those of the minority. Plainly this is in violation of their trust relation and the injured stockholders by resorting to a court of equity may obtain relief.

In the case of *Dunphy v Travellers Newspaper Ass.* (146 Mass. 495.) the president of the defendant corporation was the owner or controller of a majority of the stock, and by reason of his power, controlled the election of the

(a) *Hun v Cary*; 82 N.Y. 65.

directors, whom he was able to manage in his own interest. Large sums of the corporation had been invested in outside concerns, and another large portion of the corporate funds was kept on hand without drawing interest, and in addition he had improperly received large amounts as his salary. The courts held that relief should be granted the injured stockholders, and in the course of the opinion declared that "Courts of equity are swift to protect helpless minorities of stockholders from the oppression and fraud of majorities."

The directors are equally responsible for omission or neglect to perform corporate duties, and for acts which they do that work an injury upon the stockholders. Thus where the directors of a bank permit the property, money and effects of the bank to be stolen, wasted and squandered by allowing insolvent persons to overdraw their accounts etc., the directors will be held strictly responsible for the breach of duty(a).

It is generally admitted by the courts that all acts of the officers of the corporation which are performed with bad faith, cannot be ratified by the majority stockholders. On the other hand, it is equally authoritative

(a) Brinkerhoff v Bostwick; 88 N.Y. 52.

that even if the minority have suffered greatly from the manner in which the affairs of the corporation have been conducted, yet if there has been no actual fraud and the acts thus injuring the minority are assented to by the majority of the stockholders, there is no relief allowed the injured members of the corporation. In regard to ultra vires acts, however, there is an exception to this doctrine, and it is held that as to acts which are beyond the powers and privileges granted by the legislature to the corporation there is no power of ratification(a). Under such circumstances a single dissenting stockholder can enjoin the performance of the unauthorized acts. To effect the remedy of such complaining stockholders an injunction preventing this misapplication of the funds of the corporation, is very effectual and is often granted by the courts. Thus where the directors of a coal company abandoned the business for which the company was organized and engaged in speculations in stocks etc., the court held that "The directors of a moneyed or other joint stock corporation, who willfully abuse their trust or misapply the funds of the company, by which a loss is sustained, are personally liable as trustees to make good the loss".(b)

(a) Atwood v Merryweather; L.R. 5 Eq. 464.

(b) Robinson v Smith; 3 Paige 221.

When on the other hand, the ultra vires acts have been performed, or the parties cannot be placed in their original position the courts are very reluctant in setting aside the transactions(a).

In attempting a "freeze out" the officers and majority stockholders frequently do all in their power to depress the value of the stock, in order that, in the course of time, the minority stockholders will be compelled to dispose of their interest in the corporation, thus allowing the majority or those acting in their interest, to get possession of the stock thus disposed of, and thereby effecting the desired purpose.

According to principle the majority ought not to be allowed to accomplish such an object, and the courts^{are} tolerably clear in upholding this doctrine, yet there are many difficulties surrounding the granting of relief to those imposed upon. For instance, the directors and majority stockholders may hold, with apparent good faith, that instead of a declaration of the surplus assets being made, such profits should be kept on hand by the corporation, for the purpose of meeting an emergency, which they claim, may confront the company. Because of no dividends being distrib-

(a) Dodge v Woolsey; 18 How.(U.S.) 331.

uted among the stockholders, the stock will necessarily fall in value, and if such continues to be the case, the minority will be obliged to dispose of their stock. Under such circumstances the majority accomplish their object and the courts are confronted with the barrier of apparent good faith on the part of the majority, and as a result, the minority often fail in accomplishing the impeachment of the conduct of the controlling body. In the same manner the majority often defeat the rights of the minority by urging a retention of the surplus assets of the corporation, to gobble up , at the first appropriate opportunity, some competing industry. If this latter plan is followed out skillfully it is very difficult for the minority to obtain relief.

A case illustrating the principle that it is contrary to equitable principles for the majority to conduct the affairs of the corporation with the view to depress the value of the stock and compel the smaller stockholders to sell it, is found in *Barr v N.Y.L.E. & W. R.Co.* (96N.Y. 444.) There the Erie Railway leased the Suspension Bridge and Erie Junction Railway agreeing to pay 30% of the gross earnings of the leased road, this sum not to be less than \$105,000 per annum. \$70,000 of this sum was to be paid as

interest on the bonds of the ^{company,} lessor, and the remainder to be distributed among the stockholders of the lessor road as dividends. The lessee road did not pay the portion of rent which was to be distributed as dividends, and obtained control of a majority of its stock. The Erie Railway was sold to the defendant, the N.Y.L.E.&W. R.Co., and the officers of this latter road became officers of the leased road. These officers conducted the affairs of the leased road in such a manner as to render its stock almost worthless, with the intent to compel the minority to sell their stock. The court granted the minority an accounting and the payment of all rents in arrear.

II (I) INSPECTION OF THE BOOKS OF THE CORPORATION.

In many of the states it is provided by statute that the subscription books of the company shall be accessible to all stockholders a certain period before a meeting at which officers are to be elected or business of importance is to be transacted.

Putting the books of the corporation beyond the reach of the minority stockholders is commonly resorted to in effecting some injury or wrong, and it therefore becomes important to examine the result of such conduct on the part of the majority.

In those states where there are statutory requirements allowing any stockholder to inspect the corporate books, there is no controversy among the courts in enforcing the statute upon the subject, and the matter is usually effected by granting the injured members of the corporation a writ of mandamus compelling the officers to allow the inspection of the corporate books. There is a tendency, however, among the courts to construe the statutes rather strictly. Thus in New York, where it is provided by statute (a) that a stockholder has the absolute right to inspect the books within thirty days prior to the election of directors, it

(a) Laws 1882 Chap. 409 sec. 199.

has been held that it is within the discretion of the court to compel the company to allow an examination of the books at other than the specified times.(a)

In New Jersey the statute provides that the chancellor may, in his discretion, order the books of the corporation to be brought into court and there inspected at any time.(b)

(2) VOTING.

It is generally conceded that the majority have no right to exclude the votes of the minority, and the latter may, by the aid of equity, have the question of good faith on the part of the majority in their voting closely scrutinized.(c) This latter doctrine has also lately been laid down by an English court.(d)

On the other hand, there seems to be no power in the minority to prevent the majority stockholders from placing their voting power in the hands of a single person, who is to vote according to instructions. Such person, however, must not be incapacitated to vote.(e) No complaint can be made against the votes of one or more of the stockholders

(a) Peo. v Eadie; 30 N.E. 1147.

(b) Revision p. 186 Sec. 50.

(c) Gamble v Queens Co. Water Co. 25 N.E. 201.

(d) Trans. Co.; L.R. App. Cases 589.

(e) State v Ohio M.R.Co.; 6 Ohio Cir. Ct. R. 415.

where the matter before the meeting is the confirmation or rescission of an agreement by which the stockholders in question transfer their own property to the corporation. If however, the persons so interested control a majority of the stock and there is fraud on their part in the sale of such property, their right to vote will be questioned by the courts.

(3) NOTICE OF MEETINGS.

Where the by-laws or articles of incorporation of a corporation ^{Provide} for the giving of notice to the stockholders a certain period of time before an election or special meeting is to take place, the majority cannot pass a measure in their behalf, and to the detriment of the minority stockholders' interest, without having notified all those who would thus be injured, of the intended action, in order that the latter may have opportunity to be heard. The majority can never, under such circumstances, have their acts sustained, even though they be not detrimental to those representing the minority and who were thus excluded from the meetings. (a)

Where there is no regulation in the charter or by-laws,

(a) Wiggins v Freewill Baptist Church; 49 Mass. 301.

and the statute is silent upon the matter, each stockholder must be notified of the intended meeting, or acts then and there transacted, will not be valid and binding upon the minority. Nor will any established usage of not giving notice validate the transaction, when this matter has been neglected.(a)

The majority by the violation of this general doctrine often attempt to ignore the rights of the minority, and if the former have among their number the officers and directors of the corporation, it is very difficult for the injured members of the corporation to obtain a proper adjustment of their rights. In spite of this fact, the courts have firmly established the principle that such actions on the part of the majority is contrary to principles of justice, and whenever it is possible to arrive at the true state of affairs, the wrong will be remedied.

(4) DIVIDENDS.

The declaration of a dividend, as a rule, rests in the fair and honest discretion of the directors of the corporation(b); but where the surplus earnings are needlessly

(a) Wiggins v Freewill Baptist Church; 49 Mass. 301.

(b) Robinson v Smith; 3 Paige ~~222~~.

and improperly withheld, a court of equity will compel the directors to distribute such surplus among the stockholders (a).

While the courts often refuse to compel the directors to distribute the surplus assets, yet in nearly all the instances in which this relief has been denied there has been present the exercise of honest discretion on the part of the officers. For example, it has been held that where the surplus on hand was not equal to more than one half the debts of the corporation, a distribution would not be compelled by the court.(b)

On the whole, the general tendency seems to be to give the officers of the corporation considerable freedom in this matter, and while the courts maintain the doctrine here laid down, yet it is requisite that there be a clear case of fraud or very bad judgment before they will grant the complaining stockholders remedy.

In *Beveridge v N.Y.El.R.R.Co.* (112 N.Y. 1) the court laid down the proposition that the directors are to be guided by their own discretion in the declaration of a dividend and the matter will not be controlled by the courts.

(a) *Smith v Prattville &c Co.*; 29 Ala. 503.

(b) *Karnes v Rochester & Genesee R.R.Co.*; 4Abb.(N.S.) 107.

The judge in delivering the opinion in this case cited in substantiation of the above doctrine *Williams v W.U.T.Co.*; 93 N.Y. 162. In 93 N.Y. it was held that the declaration of a dividend rests in the fair and honest discretion of the directors, which plainly does not warrant the radical stand taken in the latter case.

It is plain that where the majority stockholders ratify the refusal of the directors to declare a dividend, and there has been actual fraud in the action of such directors, the minority can, by resorting to equity, compel the directors to distribute the surplus funds of the corporation, where it is clear that the circumstances warrant such a decree. Where no fraud is present, but there is bad judgment exercised by the directors in withholding a dividend, it would seem that the ratification by the majority will render the question final, and the minority must abide by the decision thus reached.

(5) ISSUES OF WATERED STOCK.

Watered stock may be issued in various ways; but the more usual methods resorted to are, (1) where an amount in cash less than the par value of the stock is received and it is issued as fully paid up and, (2) where it is issued

for overvalued property turned over to the corporation.

The right of a corporation to issue stock as fully paid up when in reality such is not the case, has by most courts, been deemed dangerous to honesty and general prosperity and on this account not to be allowed. While some courts admit that there are some benefits resulting from the issue of watered stock, under certain circumstances, yet the dangers of allowing such a privilege are so great that they do not hesitate to deny this right to a corporation.

It matters not whether the majority stockholders ratify the issue of stock for less than its par value, for a single dissenting stockholder may, by bringing an action in equity, restrain the issue. (a) If, however, a stockholder ratifies or in any way assists in the issue of watered stock, it would seem that he waives all rights relating to such issues. (b)

A dissenting stockholder can have shares fraudulently issued below par, cancelled after they have been transferred to another party for value with notice of the transaction; for the rule under such circumstances is, that the transferee takes subject to the original equities and will

(a) Gamble v Queens Co. Water Co.; 25 N.E. 201.

(b) Knowlton v Spring Co.; 57 N.Y. 518.

not be protected. Where, however, a transferee does not have such notice, he will not be affected by the fraudulent issue.(a)

In some of the states there are constitutional provisions against issuing stock below par. In New York, however, the matter is now regulated by Sec. 42 of the Stock Corporation Law, where it is declared that "No stock shall be issued for less than its par value". While this provision in the New York statutes prevents the issue of stock for less than its par value in money, yet watered stock is still possible. Thus it is provided in the same section of the late corporation law that property may be accepted in payment of stock for the use and lawful purposes of the corporation. This value is to be estimated by the officers of the corporation, and even if there has been a marked overvaluation, yet if there has been no fraud or bad faith in the matter, the courts will not disturb the transaction. Further, bonds of the corporation may be issued at their fair market value and then exchanged for stock at par, making an easy method of watering the stock. These are by no means the only ways in which stock may be issued below par in New York.

(a) Foreman v Bigelow; 4 Cliff. 508.

In most of the states it is provided by statute that certain property may be accepted in payment of stock, under varying circumstances. It has been noticed that New York has a statute allowing such transactions.

It is generally held that in the absence of bad faith on the part of the directors, in overestimating the value of the property received in payment of stock, no one can attack the transaction.(a) When, however, there is actual fraud in the valuation of the property, a dissenting stockholder may have the stock cancelled and the property returned, and should the stockholder bringing the action, so desire the authorities seem to indicate that the persons to whom the stock was issued may be compelled to pay the difference between the par value of the stock and the amount actually paid, the stock being thus made valid and binding upon all parties.(b) However, in *Van Cott v Van Brunt*; 82 N.Y. 535, the rule was laid down that the purchaser of such shares will only be obliged to pay the difference between the market value of the stock and the actual amount paid. This is certainly a wrong decision and contrary to the weight of authority. As to whether this doctrine is

 (a) *Coit v N.C. Gold Amal. Co.*; 7 Sup. Ct. Rep.(U.S.) 231.
 (b) *Elyton Land Co. v B.W.El.Co.*; 9 So. Rep. 129.

in accordance with the view of the present Court of Appeals is a doubtful matter, and until a direct decision is made, the question will remain a mooted one.

Where the promoters of a corporation just after its incorporation and before others have subscribed to stock, issue stock as fully paid up when such is not the case, the subsequent subscribers may compel the promoters to pay up their subscriptions or the amount still due thereon.

(a) On the other hand, if the subsequent stockholders treat the subscription as paid up, or do any other acts that would lead to the conclusion that they have decided to ratify the previous agreement between the promoters and the corporation, which took place when the stock was taken, then no action can be maintained by the subsequent stockholders. (b)

In the previous discussion of stock issued below par the general attitude of the courts has been set forth, but in the U.S. Supreme Court in a late decision, a different view of watered stock has been taken. In *Hanley v Stutz*; 139 U.S. 417, a corporation whose stock was selling below par and being desirous of increasing its business by making

(a) *Bailey v Gas Coal & Coke Co.*; 69 Pa. St. 334.

(b) *Id.*

necessary improvements, issued stock at its par value, at the same time adding as a bonus to the purchaser, bonds of the corporation. The court held that "An active corporation, finding its original capital impaired by loss or misfortune, may , for the purpose of recuperating itself, and of producing new conditions for the successful prosecution of its business, issue new stock and put it upon the market and sell it for the best price that can be obtained".

The reasoning upon which the court proceeded was that great injustice would result in a case like the one under consideration if the capital stock could not thus be increased, where the value of the stock had fallen below par. In this case, however, it was expressly declared that the doctrine thus established, ought not to be applied to cases where the transaction was carried on merely for the purpose of watering the stock, and not to improve the condition of the corporation.

While there are many apparently good reasons for favoring the doctrine laid down by the U.S. courts, when restricted in the manner there applied, yet if the right of a corporation to issue watered stock is recognized at all, it will become extremely difficult, if not impossible,

to keep the reins drawn tightly, and there will be a great liability of the issue of watered stock under circumstances which work great damage to business interests and general honesty. It is better to entirely prohibit the issue of stock below par, than to allow it under any circumstances.

The directors of a corporation have no right to give away certificates of stock to contractors building the road of the company in order that they may become majority stockholders, and thus exert a controlling influence in the election of officers and the management of the road.(a)

In such a case a dissenting stockholder may have the stock thus disposed of, declared void. Further, in order that ratification may estop such complaining stockholder, he must have acted with a full knowledge of the facts.(b)

According to the weight of authority the corporation has no right to give away stock under any circumstances, for this is a power which is beyond the authority of a corporation.(c) Those taking certificates of stock enter into an implied agreement that a debt is thereby created between the corporation and the stockholder for the par value of the stock, and all stockholders become members of the

(a) R.R.Co. v Kelly; 77 Ill. 426.

(b) Id.

(c) Hanley v Stuts; 139 U.S. 417.

corporation upon this condition. This being the case, the minority can obtain a complete remedy against the directors and majority stockholders, whenever an attempt is made to evade the principle that stock cannot be given away.

There is no sound reason for making a distinction between stock issued gratis and that issued as fully paid up when only a portion of its par value has been paid. In the former case there is certainly watered stock , and to the greatest degree. Because of this, there should be no difference in the view taken of the two cases by the courts, and the rights of the minority should be identical under both circumstances.

While most of the authorities take this view, yet in New York, as indicated in the case of Christensen v Eno; 106 N.Y. 97, a distinction is made as to the liability of the person receiving stock gratis and that which is issued for an amount less than par. In the latter case he may be compelled to pay at least the difference between the amount actually paid for the stock and its market value, while under the former circumstances he is under no liability because of having received the stock as a present, for the whole or a part of its value.

(6) CONSOLIDATION, AMENDMENTS TO CHARTER, AND DISSOLUTION.

It is well established that in the absence of a provision in the charter or a general law existing at the time of the creation of the corporation providing that extensions or alterations looking towards a consolidation may be made, upon the fulfillment of certain conditions, no majority however great can enter into an agreement to alter or enlarge the business of the company, by consolidation with other enterprises or in any manner whatever. The reasoning being that each person when entering the corporation, assumes the liabilities of a stockholder upon the implied agreement that the business shall continue to be that for which the corporation was created.

For the state to pass a measure in any manner affecting the scope or nature of the business for which the corporation was organized when no such right was given it before the creation of the corporation, would clearly be invalid, since it impairs the obligation of contracts between the stockholders and the state, as well as between the corporation and the state. This doctrine was firmly established in the Dartmouth College case, and has become thoroughly settled throughout the country.

No matter if the majority are in favor of the consol-

idation or alteration of the nature of the business, the minority cannot be compelled to enter a different business than was carried on by the corporation when they entered it. An exception to this general doctrine is recognized where public policy or necessity demands a consolidation. In such a case, however, the Legislature must provide that the dissenting stockholders shall be paid a fair and just amount for their stock in the old corporation.

In a New Jersey case it was held that where the Legislature empowered a railroad corporation of that state to purchase a certain other railroad, with the condition that "None of the rights &c of the stockholders of the purchased road shall be injuriously affected", if a single stockholder of the purchased road object to the transaction, it will be set aside.(a) The court proceeded on the theory that this sale was a bargain which all must assent to, on account of the condition upon which the stockholders became members of the corporation.

This doctrine is carried so far, that it has been held where the articles of association of an express company provided that an amendment to them might be made by a concurrent vote of two thirds of the executive committee and a majority of the trustees, a consolidation could not be effected in this manner against the consent of a dissent-

ing stockholder.(a)

Where the Legislature has provided that subsequent charters of corporations may be altered or amended so that consolidations may be affected^{at} the will of the majority or a certain proportion of the stockholders, it is generally held that a dissenting stockholder cannot impeach the transaction, in the absence of fraud, his only remedy being, if he absolutely refuse to enter the new corporation or the altered one, to have the value of his stock appraised, and the amount as thus estimated, paid him.

Where the changes proposed are immaterial, the minority will not be recognized by the courts when attempting to have the modification declared invalid.

In Utah the statute provides that any corporation may consolidate with any other upon two thirds vote of all the stock at a special meeting. In Ill. corporations engaged in the same general business and carrying on business in the same locality, may consolidate under like circumstances. In Maine a majority may sanction a consolidation, but the minority by going into court may have their stock appraised and the amount paid to them. By Pa. Corporation Law sec. 38 it is made lawful for any corporation to sell and dispose

(a) Blatchford v Ross; 54 Bar. 42.

of all its corporate property. It is provided in Maryland that consolidation of two corporations may take place if a majority of the stockholders of each corporation so agree. The statutes of Tenn. declare that street railway, gas and electric plant, and water companies, are forbidden to consolidate with any similar corporation within the same city or town, without the consent of the municipal government. By a three fourths vote of the stock, all and any corporations may consolidate in the state of Nevada. In California it appears possible for general corporations to consolidate(a).

By Laws 1892, Chap. 691, it is provided in New York that when two thirds of the stockholders, shall agree, a consolidation of business corporations may take place, but the stock of the dissenting stockholders must be paid for. Railroads in New York having intersecting lines, may consolidate with the consent of two thirds of the stockholders. When two lines run parallel to each other, however, consolidations are forbidden.(Laws 1890, Chap. 565.)

By one railroad leasing another line for a long period of years, a virtual consolidation of the two lines is effected, but this is not allowed, the courts holding that in the

(a) Stimson American Statute Law Vol. II Sections 8380, 8381.

absence of a provision in the articles of incorporation, no such right will be allowed unless all the stockholders consent to the agreement, or there is a general ^{law} to that effect upon the statute books which was in existence at the time of the creation of the corporation.(a) It has been held, however, that where the charter of a railroad company contains the provision that it may be leased upon the assent of three fourths of the stockholders of the corporation, such lease will be binding upon this condition being complied with, even though the result of the transaction be that the preferred stockholders, only receive profits.(b)

As to amendments to the charter of a corporation in general, it may be said that in order that they *may* be valid against the opposition of a single dissenting stockholder, there must either be a reservation of such power by the Legislature in the charter of the corporation, or there must have existed at the creation of the corporation a general law giving this power to the Legislature, to which all corporations are subject. If this were not the case, the U.S. constitutional provision that "No state

(a) Abbott v Johnson & Horse R.Co.; 80 N.Y. 27.

(b) Town of Middletown v Bos. & N.Y. Air Line R.Co., 52 Conn.351.

shall pass any law impairing the obligation of contracts" would be clearly disregarded. The stockholders became members of the corporation under an implied agreement that the nature and scope of the corporate business should remain the same, unless all deem it advisable to effect this change under the authority of an amendment to the corporation's charter.

If the amendment be slight or immaterial, it will not be set aside, being deemed to injure no one seriously.

In Maine and New Jersey it is held that although there be a general law providing that the charter of a corporation shall be subject to alteration, suspension and repeal in the discretion of the Legislature, and also a provision in the charter of the corporation to the same effect, yet the amendment will be of no effect unless all the stockholders accept it .(a) The reasoning applied in the New Jersey case is, that it was plainly the intention of the Legislature not to give power to one part of the corporation as against the other, which was not before allowed.

A thorough and careful study of the case in question, shows that the court deemed the rule there laid down only applicable in extreme cases.

 (a) Oldtown & Lincoln R. Co. v Veasie; 39 Me. 571.
 Zabriskie v R.R. Co.; 18 N.J. Eq. 178.

A contrary view is taken in a majority of the states.

In New York and Mass. it is held that the Legislature has the power to alter or extend the enterprises of the corporation without the consent of the stockholders.(a) The courts of Missouri and Illinois take the stand that the majority stockholders with the legislative enactment, may make a change providing it be not a radical one.(b)

The majority stockholders cannot effect a dissolution of the corporation against the will of the minority when it is in a fairly prosperous condition. In New York it has even been held that in the event of insolvency of a manufacturing corporation, it remains in the discretion of the court to sanction a dissolution.(c) In *Kean v Johnson*; 9 N.J. Eq. 401, the court in discussing this matter made use of the following lucid and expressive language: "A majority of stockholders in a prosperous corporation, cannot at their own mere caprice, sell out the whole source of their emoluments and invest their capital in other enterprises, where the minority desire the prosecution of the business in which they had engaged. The contract is,

(a) *Buffalo & N.Y. City R.Co. v. Dudley*, 14 N.Y. 336.

(b) *R.R.Co. v Hughes*, 22 Mo. 291.

(c) *Denike v Lime Co.*, 80 N.Y. 599.

that their joint funds shall, under the care of the specified persons, generally called directors, be employed, and that for specified purposes".

It is plain that the directors of the corporation alone, cannot dissolve it, for what the majority stockholders cannot do, is certainly beyond the power of these officers.(a)

In some of the cases there is an inclination towards the view that the majority in interest of the stockholders may dissolve the corporation by a voluntary surrender of its franchises, even though a minority of the stockholders are opposed to the dissolution. A careful reading of these cases, however, will disclose the fact that most of them arose under circumstances in which it would have been ruinous to continue the corporate business, or at any rate, to the interest of all the stockholders to have the corporation dissolved. It is generally conceded by most of the authorities that where it will be disastrous to continue the business of the corporation, the majority may dissolve it even though the minority strenuously oppose such action, and hence the cases just referred to, can hardly be said to be exceptions to the general rule.

(a) Jones v Bank of Leadville, 17 Pac. 272.

III. MANNER IN WHICH THE MINORITY MAY BRING ACTIONS.

Where there has been fraud in the management of a corporation, the party primarily injured is the corporation, the stockholders being considered distinct from the corporation, and only indirectly affected. This principle has become firmly fixed in the decisions of the courts, and it is clearly settled that when a corporation has been injured in any manner whatever, the proper party to sue, is the corporation itself. When, however, the circumstances are such, that relief can only be obtained by the institution of a suit by a stockholder, he will be granted a hearing by the courts.

In discussing this subject, Pomeroy says: "Although the corporation holds all the title, legal or equitable to the corporate property, and is the immediate cestui que trust under the directors with respect to such property and is theoretically, the only proper party to sue for wrongful dealings with that property, yet courts of equity recognize the truth that the stockholders are ultimately the only beneficiaries, that their rights are really though indirectly protected by remedies given to the corporation, and that the final object of suits by the corporation is

to maintain the interests of the stockholders.-----

Hence whenever a cause of action exists primarily in behalf of the corporation against directors, officers and others, for wrongful dealings with corporate property, or wrongful exercise of corporate franchises,----- and the corporation either actually or virtually refuses to institute or prosecute such a suit, then, in order to prevent a failure of justice, an action may be brought and maintained by a stockholder or stockholders".(a)

Where the facts in the complaint show that the defendants charged with the wrong doing, or some of them, constitute a majority of the directors or managing body at the time of commencing the suit, so that a refusal to bring suit by them can reasonably be inferred, the minority stockholders in bringing the action need not aver that an attempt has been made to have the managing body/institute the suit.(b) In the case of *Atwool v Merryweather*, L.R.5 Eq. 464, a suit by a stockholder was sustained, although no demand or request to sue had been made to the managing body, and no leave to sue had been obtained, because the principal defendant, a director, by means of the very fraud complained of, had control of a majority of the votes

(a) *Pomeroy Equity Jurisprudence*, Vol. III, pp 9,10.
(b) *Brewer v Bos. Theater Co.*, 104 Mass. 378.

in the managing body.

In those cases where those complained against have not complete control over the affairs of the corporation, so that it is possible that the corporation itself might, upon being appealed to, bring the action, the complaint must allege that the officers of the corporation have been appealed to, but without success. In general, the court must be satisfied that the complaining party or parties could not find redress through the officers of the corporation, or by any action among the stockholders.(a)

It is invariably held that in actions by the minority stockholders the corporation must be a party to the suit, usually being made defendant. The proper course is to join as plaintiffs the minority stockholders, or to bring the suit in the name of one of the dissenting stockholders, in behalf of himself and all of the other stockholders who may choose to come in; and all others acting in behalf of the corporation whom it is alleged have taken part in committing the wrongs, the majority stockholders, and the corporation itself, are to be made defendants.

It is to be noticed that the corporation is the party primarily to be benefited by the result of the suit brought by the minority, and the latter are benefited only indi-

(a) Brewer v Theater Co. 104 Mas. 378.

rectly, it being the corporation alone that was directly affected by the wrongful acts.

In all cases the stockholders must not have been guilty of laches in urging the remaining stockholders to take action or allowing such a period of time to elapse that the courts may reasonably suppose that the dissenting stockholders have acquiesced in the acts complained of, for under such circumstances relief will always be denied by the courts.

IV.

CONCLUSION.

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Perhaps the greatest objection to carrying business enterprises by means of the corporation, is the fact that the majority rule is so liable to work injury upon the small stockholders who go to make up the minority. This condition of affairs is constantly being deplored, and sometimes the magnitude of the frauds committed upon the minority so completely overshadow all the good elements of the corporation, that this mode of transacting business is bitterly condemned, both by the courts and the Legislature; and it is forgotten how much the corporation has done to encourage capitalists to engage in what previously were considered hazardous enterprises in the highest degree.

While it is unfortunate that the majority are able to work so much injury upon the minority, oftentimes with no probability of the latter obtaining relief, yet this state of affairs is unavoidable, being a necessary adherent of corporations, as they are now regarded. It is inconsistent with the very existence of a corporation that the rule should be reversed and the minority control the affairs of the corporation, for this would lead to far greater wrongs than exist at the present time.

The position which the minority should occupy in a corporation, is that of a regulating body, which is willing to heartily aid the majority when in the honest opinion of the latter such action is for the true welfare of the corporation, but at those times when it is evident that the majority are acting for their own interest and not for the benefit of the corporation, after striving to the utmost to effect a remedy within the corporation, this injured body should resort to the courts for relief.

When the minority have conducted themselves in this manner it is seldom that the courts turn them away without remedy.

It is encouraging to note the attitude which courts of equity, especially, are taking towards new grievances inflicted by the majority upon the minority, and it is safe

to say that in a comparatively short period of time, equity will be able and willing to grant the minority a remedy for all real injuries which they have suffered at the hands of the majority. Perhaps the legislatures will be able to aid the courts somewhat in bringing about this desired state of affairs, yet for the most part, the matter may be left with the courts, who are sure to learn wherein they have failed in the past, and profit by the discovery.

C. R. Kruidler.